

## 3. Literature Review

### 3.1 Defining Key Terms

Due to the often extensive media focus on outsourcing implementations, this term has been widely spread in the last few years. In Germany, like in many other developed countries, international outsourcing activities constantly provoke large debates, whether on TV, newspaper or other media. In this context, it has to be mentioned that the term “outsourcing” has received a particularly negative connotation. This negative perception can be clearly attributed to the often negative impact this activity has on the outsourcer’s respective personnel. Accordingly, international outsourcing can also lead to job losses and so-called job exports, terms that outsourcing is increasingly associated with (Amiti & Wei, Fear of Service Outsourcing: Is It Justified?, 2004).

The problem of international outsourcing in terms of terminology is that this activity basically combines two very prominent business practices, namely offshoring and outsourcing. But as experts tend to use both terms interchangeably, great confusion exists concerning the exact meaning of each of these phenomena. What amplifies this confusion is the fact that many of the countries affected by this phenomenon do not consider English as their native language. Consequently, non-native speakers without major English skills have certain difficulty to derive its meaning. Even though, similar definitions might also be available in other languages – for instance, the Spanish word for outsourcing is *terciarización* - the respective English terms are becoming the most common around the world. Therefore, a precise definition of both terms, offshoring and outsourcing, is indispensable.

Afterwards, other important terms such as offshore-outsourcing and nearshoring will be explained, too. This will complement the basic knowledge the reader must dispose of in order to guarantee an easy understanding of the continuing progress of this thesis.

### 3.1.1 Offshoring

Although offshoring might be a rather recent phenomenon which substantially increased along with globalization, a lot of different definitions can already be found. Unfortunately, many of the available definitions tend to be highly sophisticated or sometimes just too specific. In order to assure that key terms are well understood, definitions of different authors will be presented.

A precise and understandable definition is provided by Rushton and Walker (2007, p.4): Offshoring is the relocation of the provision of services from one country to another to benefit from cost savings.(...) Organizations can undertake offshoring without outsourcing and vice versa, be they manufacturers or service providers". Another definition of offshoring can be found in OECD's glossary of statistical terms. According to this organization, offshoring describes a "business's (or a government's) decision to replace domestically supplied service functions with imported services produced offshore" (OECD, 2004, ¶1). The shortest definition of offshoring is most probably provided by the internet platform investorwords.com. According to this web glossary, offshoring is simply defined as "shifting a business function from one country to another" (Investorwords.com, 2010, ¶1).

As it can be observed in the presented definitions, offshoring can refer to the process of simply moving business functions to another country as well as to the phenomenon of moving business activities to a company's subsidiary in a foreign country. The latter case can also be described as captive offshoring, an equivalent to Foreign Direct Investment (FDI).

### 3.1.2 Outsourcing

As "the use of the term outsourcing has not been standardized" (Amiti & Wei, Fear of Service Outsourcing: Is It Justified?, 2004, p. 4), a wide range of different definitions can be found.

The magazine Entrepreneur, for instance, describes the phenomenon of outsourcing as “the practice of having certain job functions done outside a company instead of having an in-house department or employee, handle them” (Entrepreneur, 2010, ¶1). A legal definition is provided by the American web site uslegal.com. Here, outsourcing is referred to as “the movement of a function inside a company to an entity outside it” (uslegal.com, 2010, ¶3). According to Rushton and Walker (2007, p.4), “outsourcing can be defined as the strategic use of external specialized service providers to execute and manage activities or functions that are normally seen as non-core to the business”.

Although the presented definitions of both, offshoring and outsourcing, have been clear and easy to understand, it is recommendable to also include a taxonomy of outsourcing as it emphasizes and illustrates the exact difference that exists between these terms.

**Table 3.1: Taxonomy of international outsourcing**

Location of activity	Hierarchy-based (internalized)	Market-based (externalized)
Home country	In-house (at home)	Outsourced to third-party provider
Foreign country	Within MNE subsidiary of firm (captive offshoring) <ul style="list-style-type: none"> <li>▪ Equivalent to FDI</li> </ul>	Outsourced to third-party provider (local firm or subsidiary of other MNE), that is, OO

Source: (Bartels, Frank; Lederer, Suman;, 2009)

As it can be seen in table 3.1, the phenomenon of international outsourcing is referred to as offshore outsourcing (OO). Obviously, these terms are synonyms which, according to the provided taxonomy, describe the activity of giving away part of a company’s business to an external provider, who is located in a country different to the buyer’s one. In this paper both terms, international outsourcing and offshore outsourcing will be used interchangeably. They will also be simply referred to as outsourcing. In accordance with current business literature, offshoring will equally describe the international outsourcing phenomenon. However, this will only be done if the context is clear enough and allows such a procedure. In order to avoid confusion, foot notes will often be employed to clarify which type of offshoring (offshore outsourcing or captive offshoring) is actually meant.

Derived from the provided definitions, an outsourcer is a company that gives away business activities to a third-party provider in a foreign country. However, the term outsourcer can also be used in reference to a country.

### **3.1.3 Business Process Outsourcing**

Business process outsourcing, in short BPO, can be considered as a subset of the previously described outsourcing phenomenon. It “is typically categorized into back office outsourcing - which includes internal business functions such as human resources or finance and accounting, and front office outsourcing - which includes customer-related services such as contact center services” (Customer Management IQ, 2011, ¶1). In general, BPO includes the transfer of critical, but not core business functions to an external vendor (Sourcingmag.com, 2011). In the upcoming research as well as in the subsequent discussion and conclusion, outsourcing will mainly refer to this specific type of externalization. If this is not the case, it will be explicitly mentioned.

### **3.1.4 Knowledge Process Outsourcing**

Just as BPO, knowledge process outsourcing or simply KPO is another subset of externalization. But in contrast to business process outsourcing, KPO does not refer to the externalization of common business processes, but rather to a company’s core activities. Consequently, it can be defined as a “high value added form of BPO” (BPO Tiger, 2007, ¶1). The handling of such core activities usually require greater skill, knowledge, education and expertise. Examples of KPO are outsourcing activities in the area of product design or research & development (Sourcingmag.com, 2011). In this paper, BPO and KPO will always refer to an international type of externalization.

### **3.1.5 Insourcing**

Insourcing describes “the use of in-house personnel or an internal department to meet an organization's need for specific services” (QFINANCE, 2009, ¶1). From this point of view, it can be considered as the opposite of the previously described outsourcing phenomenon. Nevertheless, the term can also refer to a whole country, depending on the context. For instance, insourcing countries, also referred to as insourcers, describe nations that are recipients or destinations of international outsourcing activities. A brief example will clarify this specific meaning of the term: A German car maker decides to contract a third-party, an American company, to handle its financial processes. From the German point of view, this would be (international) outsourcing, but from the American perspective it is insourcing (What is?com - The leading IT encyclopedia and learning center, 2008). At the same time, Germany is considered as the outsourcing country or simply as the outsourcer. Accordingly, United States would be the insourcing country or the insourcer.

### **3.1.6 Nearshoring/Farshoring**

Nearshoring describes a phenomenon similar to offshore outsourcing with the only difference “that the outsourcing partner in nearshore outsourcing is located geographically closer than the outsourcing partner in offshore outsourcing” (Outsource2india, 2009, ¶1). Farshoring describes the opposite activity of nearshoring, meaning the removal of business processes to geographically more distant countries.

## **3.2 Identification of the Biggest Absolute Outsourcers**

Table 3.2 presents a ranking of the biggest service outsourcing countries in the world. The left side of the table refers to business services in general; the right side to computer and information services only.

The volume of executed outsourcing activities is represented in U.S. Dollars. In other words, the figures do not reflect the number of different service outsourcing activities carried out by the respective countries. Moreover, it should be taken into consideration that the data, presented in the table below, was retrieved in 2002, the latest year for which internationally comparable information was available.

**Table 3.2: Biggest absolute outsourcers<sup>1</sup>**

Million US Dollars

Rank	Country	Business Services	Rank	Country	Computer & Information Services
1	United States	40,929	1	Germany	6,124
2	Germany	39,113	2	United Kingdom	2,602
3	Japan	24,714	3	Japan	2,148
4	Netherlands	21,038	4	Netherlands	1,586
5	Italy	20,370	5	Spain	1,572
6	France	19,111	6	United States	1,547
9	United Kingdom	16,184	9	France	1,150
11	India	11,817	10	China, P.R.	1,133
18	China, P.R.	7,957	14	Russia	592
20	Russia	4,583			

Source: (Amiti & Wei, Fear of Service Outsourcing: Is It Justified?, 2004)

Nevertheless, the table contains some valuable information as it gives the reader a good overview of where to localize the most important outsourcing centers.

“The term business services comprises services such as accounting, management, consulting, call centers, and other back-office operations; computing and information [left side of the table] comprise hardware consultancy, software implementation, and data processing” (Amiti & Wei, International Monetary Fund, 2004, p. 37). In this context, outsourcing is referred to as international outsourcing or offshore outsourcing.

<sup>1</sup> The ranking of computer and information services does not include any information about India. This is due to the fact that this country has no separate information on such services in its balance of payments.

As it can be easily identified from Table 3.2, United States are the top outsourcers in the business services category. Germany is the second biggest absolute outsourcer, followed by Japan, Netherlands, Italy and France. It should be highlighted that Germany, even though being a much smaller economy than the United States, is almost on a par with the North American country in terms of outsourcing value. This fact inevitably raises the question of the biggest relative outsourcers. However, this question will be answered in the following abstract. Moreover, there is a considerable gap in terms of value between the first two countries and the rest of the nations. Equally important is the fact that there is neither an emerging economy nor a single developing country among the ten biggest absolute outsourcers of business services. A similar situation can be found in the area of computer & information services. Again, outsourcing appears to be a phenomenon principally observed in industrialized countries. Nevertheless, this time there is at least one emerging economy among the ten biggest absolute outsourcers: China.

A closer look on the upper ranks of the right side of the table reveals that Germany is leading the ranking of IT-service outsourcing by far. It outsources more than twice as much of such services as the number two in the list, the United Kingdom. The United States, being the biggest absolute outsourcer of business services, only ranks 6<sup>th</sup> in the area of computer and information services.

If the two categories are compared, it can be noted that outsourcing of business services is quantitatively much more significant than outsourcing of computer and information services. Concentrating on the more important business services category, the United States together with Japan and Europe can be clearly identified as the mayor outsourcing centers in the world. Nevertheless, if we sum up the portions of all European countries, Europe would be the biggest outsourcing center by far.

### 3.3 Identification of the Biggest Relative Outsourcers

As it can be seen in Table 3.3, Germany is almost on eye level with United States, concerning their respective (absolute) outsourcing values. However, measured by GDP, Germany is a much smaller economy. This leads to consider whether countries should not better be ranked on the basis of outsourcing value relative to their own GDP. The result would be a ranking of the biggest relative outsourcing countries, information that indicates the importance of outsourcing for the respective economies. In their extensive IMF working paper on service outsourcing (2004), the two renowned economists, Amiti and Wei, provide this valuable information.

**Table 3.3: Biggest relative outsourcers<sup>2</sup>**

A. Ratio to Local GDP (%)					
Rank	Country	Business Services	Rank	Country	Computer & Information Services
1	Angola	35.01	1	Cyprus	2.06
2	Congo, Republic of	22.33	2	Luxembourg	1.25
3	Mozambique	17.41	3	Moldova	0.71
4	Ireland	15.44	4	Belgium	0.57
5	Vanuatu	14.22	5	Guyana	0.48
44	India	2.40	13	Germany	0.31
57	Germany	1.96	29	Russia	0.17
74	France	1.33	30	United Kingdom	0.17
75	Russia	1.33	43	China, P.R.:	0.09
85	United Kingdom	1.03	48	France	0.08
99	China, P.R.	0.63	57	Japan	0.05
103	Japan	0.62	73	United States	0.01
117	United States	0.39			

Source: (Amity & Wei, Fear of Service Outsourcing: Is It Justified?, 2004)

As can be observed in Table 3.3, none of the expected industrialized countries are leading the ranking of the biggest relative outsourcers, neither in the business services nor in the computer and information services category. In fact, politically

<sup>2</sup> As in Table 3.2, the ranking of computer and information services does not include any information about India. This is due to the fact that this country has no separate information on such services in its balance of payments.

and economically rather insignificant countries such as Angola, Congo and Mozambique are at the top of these lists. The importance of outsourcing to these economies must be tremendous. In the case of Angola, the economy is barely self-sufficient anymore and would most probably end up in a precarious situation if service imports suddenly stopped.

Although three African countries lead the ranking of the biggest relative business service outsourcers, it is of no use to this paper to start focusing on these economies. This is due to the fact that service imports of these countries might solely have regional but no mayor global implications. Ireland's service imports of 15% of its GDP's value are remarkable, but of no great importance for the international outsourcing scenery, either. Again, this is due to the reduced size of Ireland's economy which, though being an industrialized country, is only ranked 57<sup>th</sup> in the list of the biggest GDP nations.

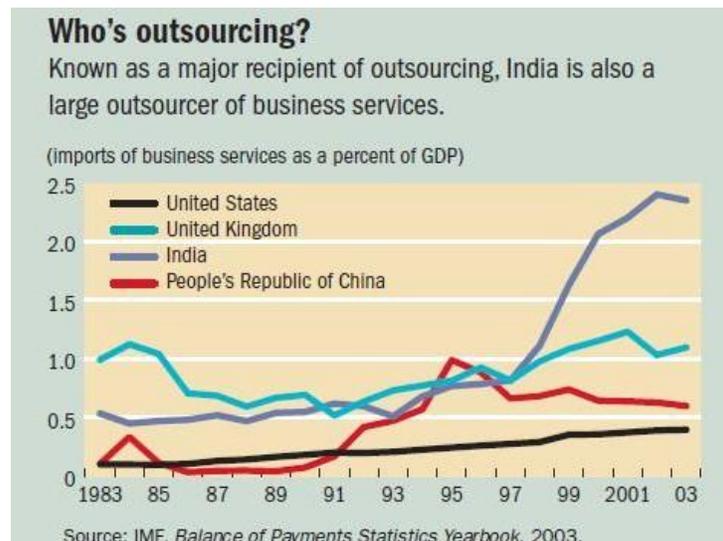
The ranking of the biggest relative outsourcers reveals that Germany is much more inclined to outsource services to another country than it is the United States. The same applies to countries such as France, Russia, United Kingdom, China and Japan, all of them being much smaller absolute outsourcers than the United States.

A special attention deserves India. This has basically two reasons. First, India is the fourth biggest economy in the world (CIA, 2011) and as relative outsourcer it is leaving far behind the rest of the mayor economies. Whereas Indian Business Service imports make up to 2.4% of the local GDP, the correspondent proportion of the United States amounts to only 0.39%, thereby having much less impact and importance for the North American economy. Second, as graph 3.1 shows, Indian imports of business services as a percentage of GDP have dramatically increased from 97 to 2003. In 2002 Indian service imports are almost five times as high as in 1983. Kamishen S. Rayan, Associate Professor of Public Policy at George Mason School of Public Policy in Arlington, Virginia, knows to explain this considerable increase of Indian service outsourcing activities: "A number of Indian outsourcing operations are focusing on mid and higher margin activities in India and have

moved some lower end activities to China and some Southeast Asia countries such as Philippines (due to the costs)” (Rajan & Srivastava, Harvard Computer Society, 2007, p. 39f). Interestingly, Indian growth in the area of service outsourcing might soon also have positive effects for Latin America as this region seems to become an attractive destination for Indian companies. It is known that especially Indian “IT companies are rapidly strengthening their presence in Latin America” (Value Notes -Sourcing Practice, 2007, ¶3). This is basically due to the great time zone advantage and the skilled labor on site (Value Notes -Sourcing Practice, 2007). Referring to this, it is highly probable that Indian companies will not only offshore business processes, but also outsource to Latin America, once the region is sufficiently developed as a service insourcing destination.

However, if Indian GDP continues to grow at high rates (since 2004 never below 6% (Index Mundi, 2010)) and the percentage of service imports in proportion to GDP keeps stable or even continues to grow, India will soon be one of the biggest and most important service outsourcers in the world.

**Graph 3.1: Biggest service outsourcers**



Source: (Amiti & Wei, International Monetary Fund, 2004)

In this chapter, the major service outsourcers in the world have been identified. Those are the United States, Japan and Europe, with Germany as the most significant and sizeable contributor. Due to the depicted potential and importance of the Indian market for the Latin American region, it is recommendable to include also the Asian country in the upcoming research.

In the following chapter, the causes which lead to international service outsourcing in these countries will be pointed out.

### **3.4 Recognition of Mayor Causes for International Outsourcing Activities**

#### **3.4.1 Savings in Labor Costs**

Apparently, the most important factor which leads to international outsourcing is the opportunity to considerably save labor costs. Especially, in the two biggest outsourcing centers, United States and Europe, this aspect plays a decisive role in order to increase the profit margin and productivity (Ghimire, 2006). The criterion of reduced labor costs becomes even more important, as the workforce of major outsourcing destinations is continually improving.

According to a joint study<sup>3</sup>, elaborated by the Weissman Center for International Business at Baruch College and The Paaras Group, “companies cited cost savings (94%) as the main goal of offshoring in 2003” (Outsourcing Institute, 2004, ¶9).

#### **3.4.2 Access to Skill Sets and World-Wide Capabilities**

Moreover, the joint study found out that the second most important factor for offshoring is the attempt to access skilled resources (63%) (Outsourcing Institute, 2004). Especially in the US, “the growing shortage of skilled workers (...) has

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<sup>3</sup> “The joint study was based on surveys and interviews with 38 global companies, mostly based in North America” (Outsourcing Institute, 2004)

prompted companies to look elsewhere for these skill sets. Outsourcing enables firms to access a worldwide pool of workers equipped with a range of skills” (India Reports, 2010, ¶10). Nevertheless, this trend is by no means limited only to the US. Quite the contrary, this is a phenomenon that is observable in basically all industrialized countries, implying the major outsourcing centers of Europe and Japan (Lewin, Massini, & Peeters, Offshoring Research Network, 2008).

### **3.4.3 Access to Vendor Expertise and Improved Delivery Quality**

Another major expectation associated with outsourcing is the access to vendor expertise and improved delivery quality. According to a 2009 UNIDO<sup>4</sup> working paper these are the just-in-time dimensions of lean servicing and should be considered as the elements of innovation at lower costs.

### **3.4.4 Increased Focus on Core Business**

Although the increased focus on the company’s core business does not solely refer to international outsourcing, it is still essential to mention it in this context as corporations may also think in rather global levels when recurring to business concentration. Anyway, the various types of outsourcing offered today allow a company to give away non-core activities (e.g. customer contact) and to focus on higher-value added processes (e.g. product development).

### **3.4.5 Improved Balance Sheet**

An argument for international outsourcing from a rather accountant’s point of view is certainly the one of the improvement of the balance sheet. Hence, the burden of the head count and facilities are transferred from the customer to the vendor. For the service buyer, fixed costs are then turned into variable costs (Rosenthal, Beth

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<sup>4</sup> The abbreviation UNIDO stands for United Nations Industrial Development Organization

Ellyn;, 2001). This is definitely an often cited goal when referring to such business operations. Nevertheless, this aim does not provide any useful information for outsourcing providers on how to position properly in order to attract the desired foreign investment.

#### **3.4.6 Moving Closer to the Target Market**

Moving closer to a large and lucrative market is another advantage for which companies decide to move part of their business to a foreign country. In particular, Indian companies increasingly tend to move closer to their clients in the United States (Value Notes -Sourcing Practice, 2007). It is important to mention that saving labor costs might not always be the major reason for outsourcing activities, especially not for the above mentioned Indian companies. It should be noted that, labor costs abroad are likely to be even higher than in the domestic market. However, the closeness to promising markets sometimes plays a predominant role in the decision-making of outsourcing issues. This aspect will be picked up in the following chapters.

#### **3.4.7 Rapid Cycle Times**

Another aspect, offshoring and outsourcing companies usually like to see, is a “substantial reduction in the time it takes to implement new project initiatives. (...) Reduced costs with a rapid implementation time enhance the viability of new projects by providing a much more attractive cost-to-benefit ratio” (Chelikani & Polineni, 2001, p. 9). Of course, the here presented reasons are not the only drivers that could lead to an international outsourcing decision. Table 3.4 complements the list of reasons and gives a good overview on which have been the main drivers for companies to offshore or offshore outsource part of their business. The presented data has been collected by the Duke University Center for International Business Education and Research (CIBER) and is based on extensive surveys of 253 companies that have already realized or were presently

planning to offshore or offshore outsource some of their business activities. The provided statistics come from surveys conducted between 2004 and 2006.

**Table 3.4: Strategic Drivers of Offshore Implementations**

	Product development implementations	Non-product development implementations	Chi-squared test
Labor cost savings	91%	90%	0.088 Pr = 0.766
Access to qualified personnel	81%	71%	5.961 Pr = 0.015
Other cost savings	80%	69%	5.195 Pr = 0.023
Growth strategy	77%	69%	3.600 Pr = 0.058
Part of larger global strategy	75%	59%	8.280 Pr = 0.004
Competitive pressures	72%	59%	8.626 Pr = 0.003
Increasing speed to market	57%	41%	12.209 Pr = 0.000
Improving service levels	50%	52%	0.176 Pr = 0.675
Business process redesign	48%	51%	0.411 Pr = 0.521
Adopting an industry practice	41%	42%	0.050 Pr = 0.823
Differentiation strategy	36%	26%	3.738 Pr = 0.053
Access to new markets	32%	15%	21.127 Pr = 0.000
Enhancing system redundancy	28%	27%	0.073 Pr = 0.787

Source: (Lewin, Massini, & Peeters, Offshoring Research Network, 2008)

As expected, the labor cost arbitrage remains the most significant driver for offshoring, even in 2006. In this regard, no differences can be observed compared to the previously mentioned joint study of the Weissmann Center and the Paaras Group. Even for the second most important factor, the access to qualified personnel, congruency seems to exist between both research projects. Nevertheless, this observation only remains true as long as details are omitted. A look at the percentages of the presented research studies reveals that the factor of access to skilled resources has substantially gained in importance over the last three years. Accordingly, in 2003 this aspect was mentioned by only 63% of the surveyed companies as a main driver for realizing offshore activities. By comparison, in 2006 this figure has already risen up to 81% in the case of product development offshoring and to 71% in the case of non-product development implementations. The reason for this phenomenon is the increasing shortage of qualified labor force in the industrialized countries. This leads to the fact that even companies' high-end and core activities, such as product development, are increasingly offshored (Lewin, Massini, & Peeters, Offshoring Research Network, 2008). At the same time as access to qualified personnel becomes more

significant, the traditional labor cost arbitrage seems to diminish in importance. This fact as well as the distinction of services being outsourced will be studied later on.

### 3.5 Identification of the Biggest Absolute Insourcers

In order to obtain a holistic understanding of the international outsourcing processes, it is crucial not only to analyze the outsourcing scenery, but also to overview the flip-side of the coin, the respective insourcing countries. According to media reports and political debates in Europe and United States, one could easily get the impression that recipients of outsourcing processes are merely to be found among developing countries, emerging economies etc. (Amiti & Wei, Fear of Service Outsourcing: Is It Justified?, 2004). These debates often tend to be linked to the western fear of job losses and job exports from developed to developing countries.

**Table 3.5: Biggest absolute insourcers<sup>5</sup>**

Million US Dollars

Rank	Country	Business Services	Rank	Country	Computer & Information Services
1	United States	58,794	1	Ireland	10,426
2	United Kingdom	36,740	2	United Kingdom	5,675
3	Germany	27,907	3	United States	5,431
4	France	20,864	4	Germany	5,185
5	Netherlands	20,074	5	Spain	2,487
6	India	18,630	10	France	1,191
8	Japan	17,401	11	Japan	1,140
14	China, P.R.	10,419	12	China, P.R.	638
29	Russia	2,012	25	Russia	137

Source: (Amiti & Wei, Fear of Service Outsourcing: Is It Justified?, 2004)

<sup>5</sup> As in Table 3.2, the ranking of computer and information services does not include any information about India. This is due to the fact that this country has no separate information on such services in its balance of payments.

As rumors and feelings on this topic are abundant, but scientific foundation rather scarce, it is essential to this paper to throw an unemotional glance at the statistical information. This will help to differentiate between hype and hard facts. For many protectionists, critics of outsourcing and other interested people in this area, Table 3.5 might reveal some particularly surprising information. According to this data and contrary to the probably most common expectation, developing countries are not leading the list of the biggest absolute insourcers. Among the first eight countries, only India can be identified as a less developed country. South-East Asian countries such as Malaysia which are generally thought to be big recipients of outsourcing activities do not even appear in the ranking. The biggest absolute insourcers by far in the business service category are the United States. Ireland is leading the correspondent ranking of computer and information services. Nevertheless, the informational value of the data provided by Amiti and Wei (2004) is somehow limited. This is principally due to the following reasons:

The presented data is transparent, based on the Balance of Payments and carefully separated from other types of outsourcing and service trades. Consequently, it appears to be the perfect reference for the purpose of this chapter. Nonetheless, the data is retrieved in 2002. Meanwhile, many changes, especially in the ranking of the biggest insourcers might have occurred. Moreover, the IMF statistics do not reflect Indian service trade in the IT-sector, a branch which is globally associated with Indian insourcing. Therefore, readers must be particularly careful with any kind of interpretation, based on these two economists' data. In order to impart current validity to the IMF-statistics, the given information must somehow be confirmed by more recent references.

A relevant and more recent source is the winter 2007 edition of the Harvard Asia Pacific Review. In their article on international service outsourcing, the two authors, Rajan and Srivastava, make reference to the diverse statistics presented by Amiti and Wei in order to depict the actual global outsourcing scenery. However, in the article's abstract of the biggest insourcers, the authors comment something which is noticeably differing from the data gathered by Amiti and Wei. They state that now

“India is clearly the leading destination for outsourcing of BPO and IT services” (Rajan & Srivastava, Harvard Computer Society, 2007, p. 39). In addition to this, they also remark that “apart from India, China and Russia, countries like Ireland, Hungary, Israel, South Africa, Philippines and Poland are also emerging as important players”<sup>6</sup> (Rajan & Srivastava, Harvard Asia Pacific Review, 2007, p. 39).

In general, it can be stated that the rankings, edited by Amiti and Wei (2004), haven’t lost their validity as they are constantly mentioned, even in more recent business journals. Still, the ranking of the biggest insourcers needs to be updated taking into account India’s considerable rise in this area. Moreover, the new emerging insourcing players should be kept in mind for the further course of this dissertation.

### **3.6 Identification of the Biggest Relative Insourcers**

In order to get an idea of the importance of insourcing for the recipient’s economy, it is crucial to include a ratio, representing the relation between absolute insourcing value and the country’s respective GDP. The result is a ranking of the biggest relative insourcers. By including such information, the same methodology as in the abstract of the biggest outsourcers is kept. This provides the necessary coherence and let the reader know the counterpart of the most intensive outsourcers.

Similar to the ranking of the biggest relative outsourcers, it can be equally observed that rather small economies are at the top of the lists. Accordingly, Vanuatu, Singapore and Hong Kong are leading the ranking in the area of business services, Ireland, Cyprus and Luxembourg the one of computer and information services

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<sup>6</sup> Unfortunately, the Harvard Review editors do not indicate how and when exactly this data has been retrieved.

**Table 3.6: Biggest relative insourcers<sup>7</sup>**

**A. Ratio to Local GDP (%)**

Rank	Economy	Business Services	Rank	Economy	Computer & Information Services
1	Vanuatu	17.13	1	Ireland	8.54
2	Singapore	14.98	2	Cyprus	2.19
3	Hong Kong SAR	11.53	3	Luxembourg	1.09
4	Papua New Guinea	10.55	4	Costa Rica	0.91
5	Luxembourg	9.78	5	Belgium	0.76
21	India	3.79	17	United Kingdom	0.36
33	United Kingdom	2.35	24	Germany	0.26
50	France	1.45	42	France	0.08
54	Germany	1.40	49	United States	0.05
79	China, P.R.	0.82	51	China, P.R.	0.05
88	Russia	0.58	54	Russia	0.04
90	United States	0.56	59	Japan	0.03
95	Japan	0.44			

Source: (Amiti & Wei, Fear of Service Outsourcing: Is It Justified?, 2004)

Indeed, in relative figures small economies show a much more intensive trade of services than economies such as United States, Germany or France. Although this might be an interesting detection, it is not really surprising. Smaller countries often need to attract foreign investment in order to stimulate their economies in the long run. Consequently, they tend to specialize in a specific area. Such specialization can be noted, for example, in Ireland in the IT sector. But also Costa Rica's figures indicate that computer and information services play no subordinate role in this country. On the contrary, it demonstrates certain specialization, too. Unfortunately, there is no more recent information available on India's respective performance.

### 3.7 Biggest Deficit and Surplus Countries

Although the biggest outsourcers and insourcers have already been identified, the question of whether or not industrialized nations move more business processes

<sup>7</sup> As in Table 3.2, the ranking of computer and information services does not include any information about India. This is due to the fact that this country has no separate information on such services in its balance of payments.

outside the country than they actually receive remains unanswered. Either clarity exists on whether European media hypes on outsourcing are justified or not. In order to answer this often emotional and politically explosive question, a table showing the countries' deficit or surplus must be consulted.

**Table 3.7: Biggest deficit and surplus countries<sup>8</sup>**

Rank	Economy	Business Services	Rank	Economy	Computer & Information Services	Rank	Economy	Total
<b>Surplus countries</b>			<b>Surplus countries</b>			<b>Surplus countries</b>		
1	United Kingdom	20555.96	1	Ireland	9882.71	1	United Kingdom	23628.68
2	United States	17864.30	2	United States	3884.00	2	United States	21748.30
3	Hong Kong SAR	15424.54	3	United Kingdom	3072.72	3	Hong Kong SAR	15663.41
4	India	6813.44	4	Canada	1077.12	4	India	6813.44
5	Singapore	3826.12	5	Spain	914.65	5	Singapore	3826.12
6	China, P.R.	2462.05	15	France	41.39	9	China, P.R.	1967.20
10	France	1752.32				10	France	1793.70
<b>Deficit countries</b>			<b>Deficit countries</b>			<b>Deficit countries</b>		
135	Russia	-2570.90	95	Russia	-454.30	137	Russia	-3025.20
139	Korea	-4450.90	96	China, P.R.	-494.85	139	Italy	-4001.71
140	Japan	-7313.51	97	Italy	-674.85	140	Korea	-4555.30
141	Indonesia	-7985.71	98	Germany	-939.29	141	Indonesia	-7985.71
142	Germany	-11205.43	99	Japan	-1007.74	142	Japan	-8321.25
143	Ireland	-13882.01	100	Brazil	-1118.10	143	Germany	-12144.72

Source: (Amiti & Wei, Fear of Service Outsourcing: Is It Justified?, 2004)

The figures<sup>9</sup> of Table 3.7<sup>10</sup> demonstrate that especially United Kingdom and United States are considerably profiting from global service trade. Both nations show a remarkable surplus in the business and in the computer and information services category. Hence, they are also the leading surplus countries in the category that combines the previously named areas. It has to be mentioned that there is a notable gap between these two nations and the countries ranked 3<sup>rd</sup> and 4<sup>th</sup> in the list, Hong Kong and India, respectively. In all surplus countries, but particularly in United States and United Kingdom, protectionist laws aiming to restrict free movement of services would be much more harmful than helpful to their respective

<sup>8</sup> As in Table 3.2, the ranking of computer and information services does not include any information about India. This is due to the fact that this country has no separate information on such services in its balance of payments.

<sup>9</sup> Numbers in million US Dollars

<sup>10</sup> Positive numbers in this table represent net insourcing of services (surplus), and negative numbers represent net outsourcing (deficit).

economies. Bills as the one passed by US Senate in March 2004, looking for restrictions on international outsourcing for federal contracts are consequently counterproductive (Amiti & Wei, Fear of Service Outsourcing: Is It Justified?, 2004).

Contrary to the two Anglo-Saxon countries, Germany's fear of outsourcing appears to be well-founded. Indeed, it is the one with the highest deficit regarding the all-embracing service outsourcing category. Especially in Germany's IT-excluding business sector, international outsourcing is considerable (see Table 3.7, left side). Ireland can be considered as a particularly interesting case as it shows an extraordinary surplus in the area of computer and information outsourcing, but probably the biggest deficit in the business outsourcing sector.

As seen in the abstract of the biggest outsourcers, United States and Germany are the largest users of this business option. If EU-members are put together and considered as a single nation, it would represent the biggest absolute outsourcer by far. Japan is another main actor in the outsourcing scenery. Although still not as significant as the previously mentioned economies, India deserves special attention. This is due to the country's rapid growth of international outsourcing, especially to Latin America.

Moreover, data made clear that despite the apparent leading position of India, service outsourcing is by no means just a one-way route from developed countries to less developed economies. On the contrary, it is a classical two-way street with industrialized countries being also among the biggest absolute insourcers. Interestingly, China is only ranked 18<sup>th</sup> among the biggest insourcers although news media might often convey a very different picture of the situation.

Now, it is also possible to answer to the question whether or not western anxiety over international service outsourcing is justified. The answer is neither yes nor no. It depends. Whereas United States and United Kingdom greatly benefit from international service trade, Germany records a tremendous deficit in this part of its current account. If Germany's particular outsourcing situation is somehow

correlated with negative effects on the labor market is not subject to this academic paper and consequently will not be treated.

### **3.8 Development of International Labor Division**

At this moment of the paper, the reader already knows about the big players in the service outsourcing landscape. All this provided knowledge is based on Balance of Payments records, gathered and meticulously separated by the International Monetary Fund (IMF). In terms of accurateness and specificity, the given information cannot be beaten. In other words, the IMF analyzes quantitatively in the most exact manner what is generally understood by international service outsourcing. However, for the purpose of timeliness, the provided data has been supported and amended by some more recent reports.

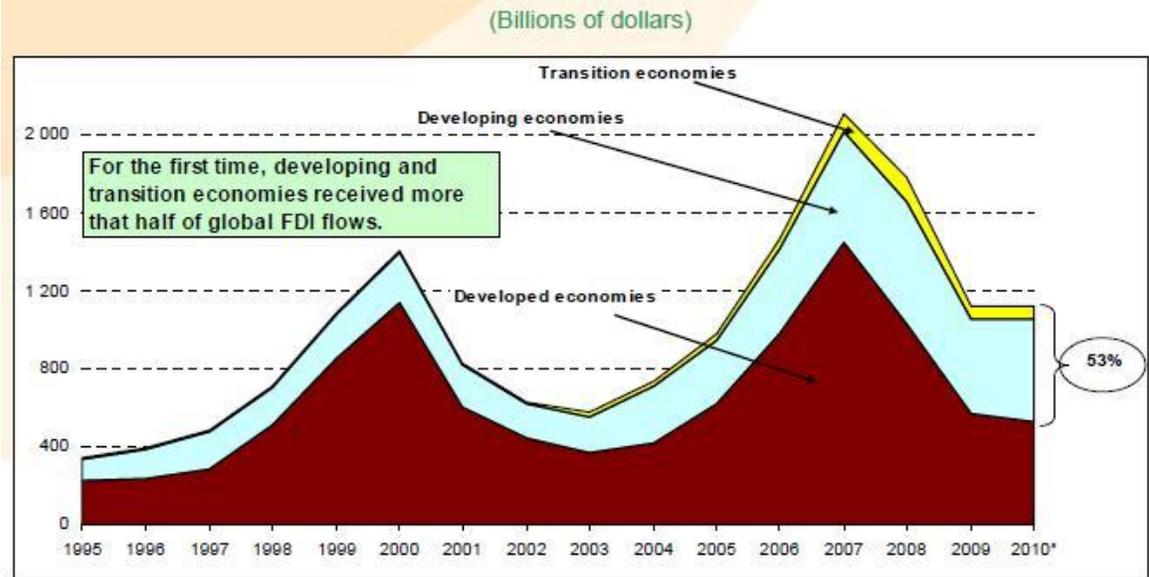
Nevertheless, the supplied records are somehow static. They neither illustrate the dynamics or the development of outsourcing in the past; nor do they give any information or hints on current trends and future perspectives. In order to give the reader an idea of the dynamics in the world of international labor division, presenting figures of the development of FDI inflows proves to be a good choice. Referring to this, some reliable data is provided by the United Nations Conference on Trade and Development (UNCTAD). However, it should be highlighted that the presented information describes the phenomenon of captive offshoring and not the one of international outsourcing. Moreover, FDI does not solely refer to services, but also to the still more significant manufacturing industry.

Nevertheless, it is legitimate to deduce from it a similar performance for the area of international service outsourcing. This is basically due to the following facts:

First, international outsourcing is a business option which is principally considered for the same reasons as captive offshoring (See chapter 3.4). Second, offshore outsourcing processes as well as foreign direct investments equally need to take

into account market specific parameters such as financial attractiveness, general business environment or people skills and availability on-site.

**Graph 3.2: FDI inflows, global and by group of economies, 1995-2010**



Source: (UNCTAD, 2011)

In Graph 3.2, the reader can observe the development of international labor division in a period of time of approximately 15 years. The graph reveals that, all in all, FDI inflows have strongly increased. In 2010, these inflows are estimated to have reached the value of 1,112 billion dollars (UNCTAD, 2011). This would represent a growth of almost 300% compared to 1995. Moreover, it can be easily observed that ups and downs in overall FDI inflows are correlated to global economic activity. In other words, in times of economic downturn, FDI inflows experience a fierce fall, whereas in times of recovery, captive offshoring activities tend to undergo an almost exponential increase. This can be particularly well stated in 2002 and 2008.

However, FDI flows tend to anticipate these economic cycles. Accordingly, a slight decrease in the global GDP real growth rate from 5.3% in 2007 to 5.2% in 2008 (Indexmundi, 2008)<sup>11</sup>, leads to a severe fall of FDI inflows in this period. Thus, the

<sup>11</sup> For reasons of comparison and visualization, the respective table and graph of Indexmundi are attached to the appendices.

strong decline in FDI inflows anticipates the following brutal global economic and financial meltdown of 2009. Likewise, the boost in FDI inflows in 2004 and 2005 anticipates the global economic prosperity following in 2006, 2007 and 2008. Furthermore, the above chart shows that after every global economic crisis, FDI inflows seem to reach a higher peak. So, after global economic downturn in 2002 and 2003, FDI flows raise to a new top level of over 2,000 billion dollars. In contrast to this, the previous peak of approximately 1,400 billion dollars, attained in 2000, appears to be rather small.

Interestingly, all hitherto existing ups and downs in FDI inflows have principally been induced by the group of developed economies. Until 2010, they have constantly been claiming the lion's share of global FDI inflows and it seems that especially in times of economic prosperity these countries are clearly dominating the scenery of captive offshoring. Once again, for many supporters of protectionist ideas this is surely a fact that they might have not expected. Nevertheless, the increasing importance of developing and transition economies as a destination of captive offshoring is something that has to be highlighted. In 2010, for the first time, this group of economies claims more than 50% of the total share of global FDI inflows, thereby outpacing the previously mentioned group of developed countries.<sup>12</sup> Although the percent distribution might change in favor of the developed countries as soon as global economy gets boosted, the current situation and previous development of developing countries is remarkable.

Whereas developed countries experience a further contraction in 2010, the recovery among developing countries has already started. Especially Latin America, South, East and South-East Asia experience a strong growth in FDI inflows in 2010. On the contrary, Europe stands out as the subregion where flows fall most sharply. This is partly due to uncertainties about sovereign debts in some member countries of the European Union (UNCTAD, 2011). According to the UNCTAD Global Investment Trends Monitor, the significant increase in FDI flows

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<sup>12</sup> The UNCTAD table "FDI inflows and cross-border M&As, by region and major economy, 2009-2010" is attached to the appendices.

to Latin America is principally caused by a surge in cross-border M&A<sup>13</sup>. Unfortunately, “the targets of these deals were mainly in the oil and gas, metal mining and food and beverages industries” (UNCTAD, 2011, p. 5). Services seem to have played a minor role.

In Asia, China is the biggest recipient in 2010, receiving more than 100 billion dollars in FDI inflows. However, India is breaking the general upward trend in the region, experiencing severe declines as captive offshore destination. The fact that India, apparently the largest recipient of international service outsourcing, is falling far behind China in terms of FDI inflows is not surprising. It rather confirms the previously mentioned statement that India is increasingly specializing as a global service provider, particularly in the area of high-end activities. On the contrary, FDI does still basically refer to the manufacturing industry.

For 2011, the UNCTAD foresees an improving overall FDI situation. According to the UN-organ,

the improved macroeconomic conditions in 2010 strengthened TNCs' corporate profits and boosted stock market valuations. These favorable conditions coupled with rising business confidence in 2011 will help translate TNCs' record levels of cash holdings (in the order of four to five trillion dollars among developed country firms alone) into new investments. TNCs will also face increasing pressure to make strategic investments to cement their business plans for the post-crisis period. (...) The current overall favourable policy climate for foreign investors further supports the positive prospects for FDI flows in 2011 (UNCTAD, 2011, p. 7).

According to the IMF's latest projections, global economic growth will reach 4.2 percent in 2011. Concerning this economic recovery, it is most likely that also

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<sup>13</sup> M&A stands for Mergers and Acquisitions.

service offshore outsourcing activities will benefit from the accompanied increase of international labor division. In order to successfully compete on a global level, TNCs will see themselves obliged not only to offshore production and other manufacturing-oriented business processes, but also the often more essential service parts. Accordingly, the renowned management consulting firm A.T. Kearney affirms that now “the global services industry’s full potential is ready to be tapped” (Peterson, Erik; Gott, Johan; King, Samantha;, 2011, p. 1). Thus, countries are well-advised to have their homework done in order to attract a significant part of the upcoming global FDI and service outsourcing flows.

In the following chapter, world rankings will show which countries are best prepared and consequently most likely to receive a lion’s share of the forthcoming outsourcing activities.

### **3.9 Identification of the Most Attractive Outsourcing Destinations**

In this chapter, the most attractive service insourcers<sup>14</sup> will be identified by means of rankings. In order to obtain a rather objective picture of the current outsourcing situation, different rankings will be consulted, analyzed and briefly compared. The quality of the given information will be guaranteed by solely recurring to rankings of leading consulting firms and other reliable and specialized institutes in the area of outsourcing. The following rankings will not only make clear the relative position of a country in the global insourcing competition, but also depict its respective strengths and weaknesses. By focusing on Latin American countries, it will be possible to evaluate the current situation of this region as a candidate for receiving future outsourcing activities. The upcoming analysis will also give hints on where to outsource which type of business. In other words, the rankings will also provide information about which countries are tipped as hot spots and for which specific service.

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<sup>14</sup> In this context, the term insourcer refers to a country.

In this context, it should be highlighted that the presented rankings also intend to put the reader up-to-date concerning international service outsourcing. Accordingly, the oldest presented information in this chapter dates from no longer than 2007. However, the newest ranking has just been published (January 2011) and consequently contains the latest movements in the global outsourcing landscape. For reasons of visualization and better comparison, these movements will be shown in an explicit table.

After this chapter the reader will not only know the past and most recent developments in the outsourcing market. More than this, she/he will be able to give a well-founded opinion and estimation on how the global outsourcing landscape could possibly look like in the short to medium term.

### **3.9.1 A.T. Kearney Ranking**

The first presented ranking is elaborated by the prestigious consulting firm A.T. Kearney. Published in 2011, it is the latest ranking available on international service outsourcing. In total, the ranking includes 50 countries. These countries have been selected “on the basis of corporate input, current remote services activity and government initiatives to promote the sector. They were evaluated against 39 measurements across three major categories: financial attractiveness, people skills & availability, and business environment“ (Peterson, Erik; Gott, Johan; King, Samantha;, 2011, p. 19).

Logically, all of the three categories are divided into subcategories. For the category of financial attractiveness, the respective subcategories are: compensation costs, infrastructure costs and tax and regulatory costs. The category of people skills and availability is composed of remote services sector experience and quality ratings, labor force availability, education and language and attrition risk. The subcategories for the measurement of the business environment are: country environment, infrastructure, cultural exposure and security of intellectual property.

The metrics used to evaluate location attractiveness is based on outsourcers' experience as well as on diverse industry surveys.<sup>15</sup> As the three principal categories are not equally important to the outsourcer's location decision, they have been weighted differently. As the financial attractiveness includes the highly significant cost advantage, financial factors constitute 40 percent of the total weight. The two remaining categories each represent 30 percent (Peterson, Erik; Gott, Johan; King, Samantha;, 2011).

As Table 3.8 shows, Asian countries are clearly dominating the top ten of the most attractive locations for service outsourcing. Among the first ten countries, seven belong to the Asian continent. In contrast to this, only one country is African and no one European. The region of Latin America is at least represented by two countries, namely Mexico and Chile. Nevertheless, if the reader's attention is extended to the 20 leading countries, regions other than Asia are definitely put in a more positive light. Out of the 20 most attractive outsourcing locations, six would be European (including Russia), two would belong to the region of Africa and the Middle East, four to the region of Latin America<sup>16</sup>, and one to North America. So, no other Asian country would be added, if the reader extended his/her focus to the list of the first 20. Still, all Asian countries which are seriously competing for global service insourcing, find themselves among the best locations in the world. It can be assumed that these countries have been constantly strengthening and improving their respective service sector in order to attain today's high level of competitiveness.

What is remarkable considering the total score of the ranking, are the enormous gaps that exist among the top four countries. India with an amazing score of 7.01 outpaces by far the number two in the list, China. Thus, India is the uncontested number one among the most attractive service outsourcing destinations. This is due to India's excellent results in both, financial scores and the significant people skills and availability score.

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<sup>15</sup> A detailed index of the metrics used for the above ranking is attached to the appendices.

<sup>16</sup> Although Mexico is also a North American country, here it is accounted as part of Latin America.

Table 3.8: A.T. Kearney Ranking of Global Services Location, 2011

Rank	Country	Financial attractiveness	People skills and availability	Business environment	Total score
1	India	3.11	2.76	1.14	7.01
2	China	2.62	2.55	1.31	6.49
3	Malaysia	2.78	1.38	1.83	5.99
4	Egypt	3.10	1.36	1.35	5.81
5	Indonesia	3.24	1.53	1.01	5.78
6	Mexico	2.68	1.60	1.44	5.72
7	Thailand	3.05	1.38	1.29	5.72
8	Vietnam	3.27	1.19	1.24	5.69
9	Philippines	3.18	1.31	1.16	5.65
10	Chile	2.44	1.27	1.82	5.52
11	Estonia	2.31	0.95	2.24	5.51
12	Brazil	2.02	2.07	1.38	5.48
13	Latvia	2.56	0.93	1.96	5.46
14	Lithuania	2.48	0.93	2.02	5.43
15	United Arab Emirates	2.41	0.94	2.05	5.41
16	United Kingdom	0.91	2.26	2.23	5.41
17	Bulgaria	2.82	0.88	1.67	5.37
18	United States	0.45	2.88	2.01	5.35
19	Costa Rica	2.84	0.94	1.56	5.34
20	Russia	2.48	1.79	1.07	5.34
21	Sri Lanka	3.20	0.95	1.11	5.26
22	Jordan	2.97	0.77	1.49	5.23
23	Tunisia	3.05	0.81	1.37	5.23
24	Poland	2.14	1.27	1.81	5.23
25	Romania	2.54	1.03	1.65	5.21
26	Germany	0.76	2.17	2.27	5.20
27	Ghana	3.21	0.69	1.28	5.18
28	Pakistan	3.23	1.16	0.76	5.15
29	Senegal	3.23	0.78	1.11	5.12
30	Argentina	2.45	1.58	1.09	5.12
31	Hungary	2.05	1.24	1.82	5.11
32	Singapore	1.00	1.66	2.40	5.06
33	Jamaica	2.81	0.86	1.34	5.01
34	Panama	2.77	0.72	1.49	4.98
35	Czech Republic	1.81	1.14	2.03	4.98
36	Mauritius	2.41	0.87	1.70	4.98
37	Morocco	2.83	0.87	1.26	4.96
38	Ukraine	2.86	1.07	1.02	4.95
39	Canada	0.56	2.14	2.25	4.95
40	Slovakia	2.33	0.93	1.65	4.91
41	Uruguay	2.42	0.91	1.42	4.75
42	Spain	0.81	2.06	1.88	4.75
43	Colombia	2.34	1.20	1.18	4.72
44	France	0.38	2.12	2.11	4.61
45	South Africa	2.27	0.93	1.37	4.57
46	Australia	0.51	1.80	2.13	4.44
47	Israel	1.45	1.35	1.64	4.44
48	Turkey	1.87	1.29	1.17	4.33
49	Ireland	0.42	1.74	2.08	4.24
50	Portugal	1.21	1.09	1.85	4.15

Source: (Peterson, Erik; Gott, Johan; King, Samantha;, 2011)

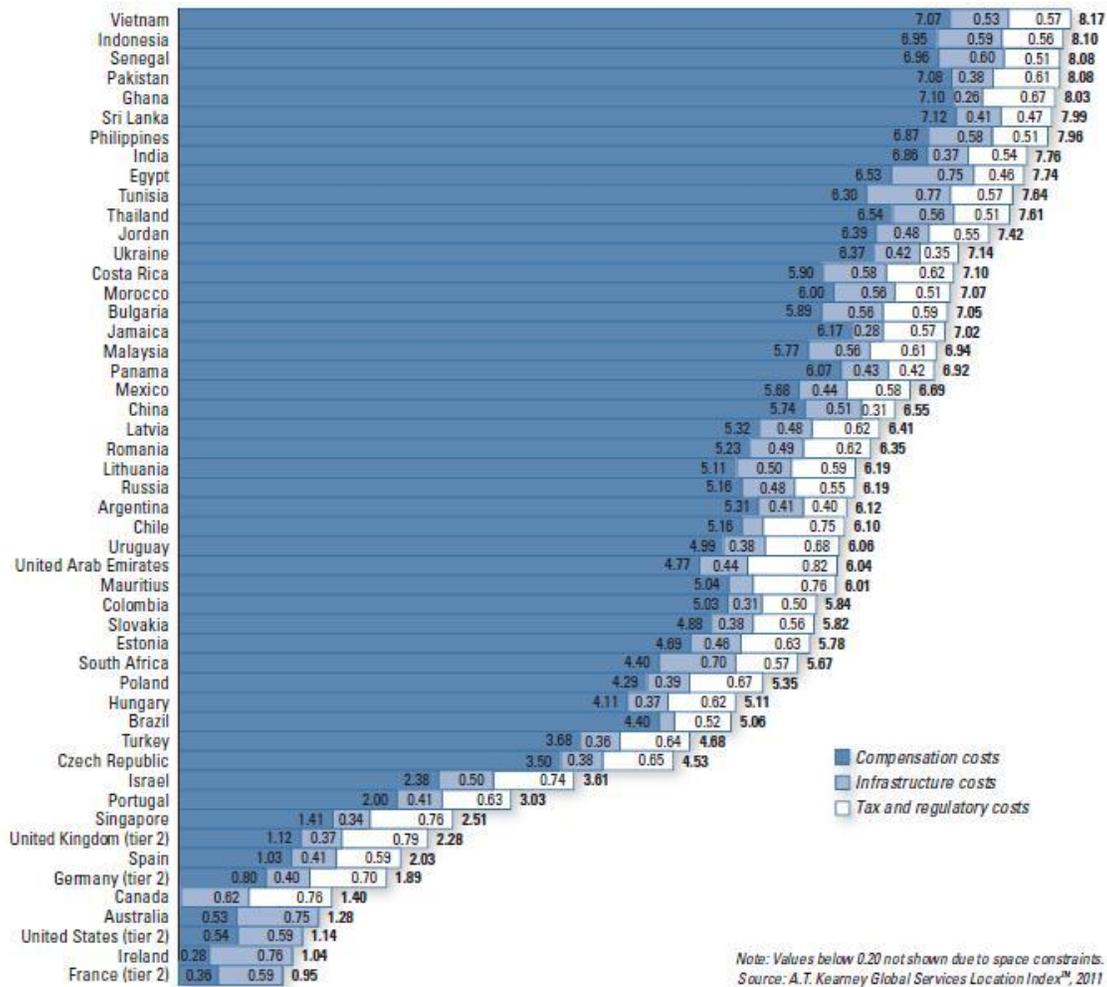
On the other hand, China appears to have equally cemented its number two position in the ranking. Its distance to the number three, Malaysia, is evenly significant. Interestingly, China's major strength seems to lie in the area of people skills and availability and not so much in the financial attractiveness.

Malaysia is in an equally comfortable position concerning its placement, although its cushion to the country ranked 4<sup>th</sup> is not as significant as in the case of China and India. Nevertheless, these three countries seem to have broken away from the rest of the world as attractive service outsourcing destinations. The fact that leads to this assumption is precisely the considerable existing gaps in total score. Later on, A.T Kearney rankings from 2007 and 2009 will show if these countries' leading position has already been lasting for a longer while.

Additionally, it is useful to analyze more deeply the latest ranking with its respective scores of each category. By proceeding in this manner, the reader will get an idea of where Latin America's strengths and weaknesses currently lie. For reasons of comparison, it is also recommendable to take a closer look on Asian countries' performance. In this context, special attention will be paid to India.

Table 3.9 shows the exact results of countries' financial scores. As mentioned before, these are divided into compensation costs, infrastructure costs and tax and regulatory costs. A short look on Table 3.9 suffices to note the enormous difference that exists between countries, performing very well on this dimension and those countries which can be found in the bottom of the table. Table 3.9 reveals that Asian countries together with several nations from the region of Africa and the Middle East are leading in this category. Accordingly, Vietnam is leading the table, followed by Indonesia and Senegal. Among the first ten countries, the reader will also find India, the overall leader in terms insourcing attractiveness. In this context, it should be highlighted that Latin American countries are, at most, mediocre competitors, principally occupying positions in the mid or lower part of the table. Smaller exceptions are the nations of Costa Rica, Panama and Mexico, all of them ranked among the top 20. Focusing on Latin America, especially Brazil is a disappointing case. The South American country obtains the lowest results in the entire Latin American region.

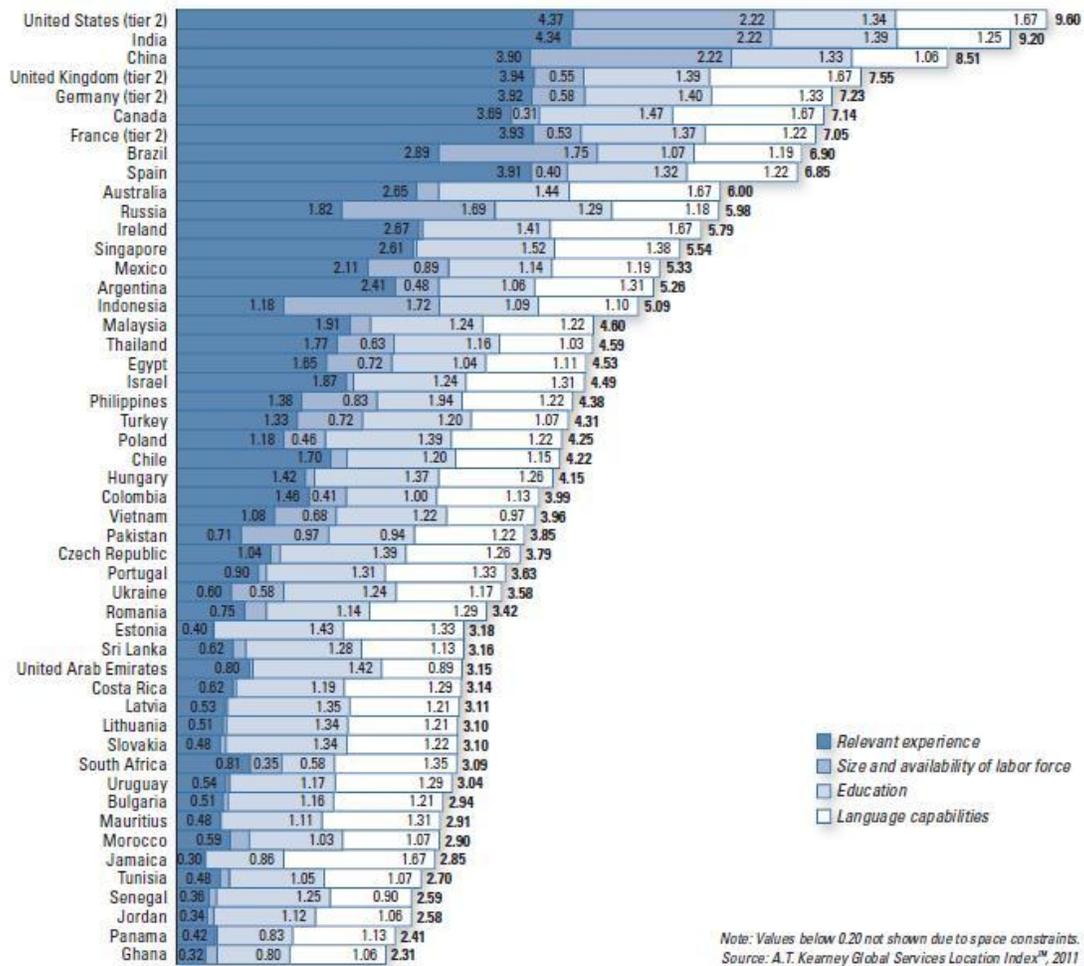
**Table 3.9: A.T. Kearney Ranking of Global Services Location, 2011 - Financial attractiveness score**



Source: (Peterson, Erik; Gott, Johan; King, Samantha;, 2011)

As supposed, the bottom of the table is dominated by developed countries with France, Ireland and United States being the least attractive destinations. Interestingly, differences concerning infrastructure costs are not extraordinarily big between developed and emerging economies. This might be due to the fact that rental costs as well as commercial electricity rates are included in this category, costs that traditionally are much higher in developed countries. In contrast to this, discrepancies in terms of compensation costs seem to be gigantic, thus, causing the poor performance of developed nations and the overall disparity in the financial attractiveness.

**Table 3.10: A.T. Kearney Ranking of Global Services Location, 2011 - People skills & availability score**



Source: (Peterson, Erik; Gott, Johan; King, Samantha, 2011)

Table 3.10, showing the ranking's people skills and availability scores seems to put the previous list upside down. Here, mainly developed countries are leading, and some of the earlier, financially attractive countries of Africa and the Middle East suddenly find themselves at the end of the list. As expected, United States is leading the table. European nations such as United Kingdom, Germany and France are close behind.

Nevertheless, the notion of the table being upside down is not quite correct. The simple reason for it is that destinations that have been previously identified as financially attractive are in no way excluded from the top 20 or even the top 10 of this list. On the contrary, India and China even obtain the 2<sup>nd</sup> and 3<sup>rd</sup> best scores

on this dimension. With such great scores, these countries are even ahead of United Kingdom, Germany, Canada and France. If not top ten, but also top 20 countries are considered, even more financially well-performing nations can be found. Some of these are Indonesia and the Philippines, for example. In the financial attractiveness score, these nations have received the 2<sup>nd</sup> and 7<sup>th</sup> best scores, respectively.

Concerning Latin America, the region's countries are evenly distributed over the list. Whereas Brazil receives an outstanding score, leaving behind economies, such as Spain, Australia and Ireland, Panama almost brings up the rear. Like Brazil, Mexico and Argentina can also be located in the upper part of the table. Contrary to this, Chile and Colombia do not get beyond the mid part of the list and Costa Rica and Uruguay are already at the lower fraction.

If the people scores' components are briefly analyzed, it can be observed that the countries' discrepancies concerning education and language capabilities are not significant. In short, they do not make the great difference in the overall people score. However, the remaining two components, namely relevant experience and size and availability of labor force do indeed make a difference. Particularly bad results in the subcategory of size and availability of labor force, for example, make that all European countries stay behind United States, India and China in the overall people score. It can be assumed that the major causes for these bad results are the substantial demographic changes that are experiencing western civilizations. After all, European countries who definitely dispose of a qualified and well-educated workforce – important criterion to provide high-end services- present alarming fertility rates, partly far below 2.0 children born/woman (Nationmaster, 2008). The same applies to countries such as Australia and Canada.

Bad results in the area of size and availability of workforce are also obtained by rather small countries. This is not a surprising fact as due to their reduced population, only a relatively small workforce will be available.

In the subcategory of relevant experience, especially European countries receive excellent results. As European countries have constantly been also among the biggest insourcers, such outstanding scores are comprehensible and no surprise, either. The same applies to the United States, the biggest insourcer in 2003.<sup>17</sup>

Referring to Latin America, the particularly good performance of Brazil has to be mentioned. The most populated country of the region obtains superior results in both, the experience and the people size and availability score<sup>18</sup>. Consequently, it is the 8<sup>th</sup> best country in the overall people score. Mexico is the only country of the region which can equally present satisfying results on the experience and workforce dimensions. Nevertheless, the respective results for Mexico remain much lower than those of Brazil. On the other hand, Argentina, Chile and Colombia, indeed dispose of the relevant experience for insourcing, but they lack in available labor force. The remaining countries of the region, Costa Rica, Uruguay and Panama seem to lack in both, experience and labor force. Consequently, they can be found in the bottom part of the table.

In table 3.11, the reader can appreciate the exact results of A.T. Kearney's business environment evaluation. At first glance, a high concentration of developed countries can be observed at the top of the list. Further, many developing countries can be found at the bottom of the table. Among those nations, receiving rather bad results, a considerable number of Asian countries can be identified.

Latin America is not pictured in a good shape, either. Only Chile receives a quite favorable score. The South American country is located among the top 20 in terms of overall business environment, doing particularly well on the specific country risk component. However, the vast majority of the Latin American countries occupy no more than mid to lower part positions. Argentina, the region's weakest nation in this score, is even located behind countries like Senegal and Sri Lanka. The main reason for Argentina's bad result is the poor performance in the country risk

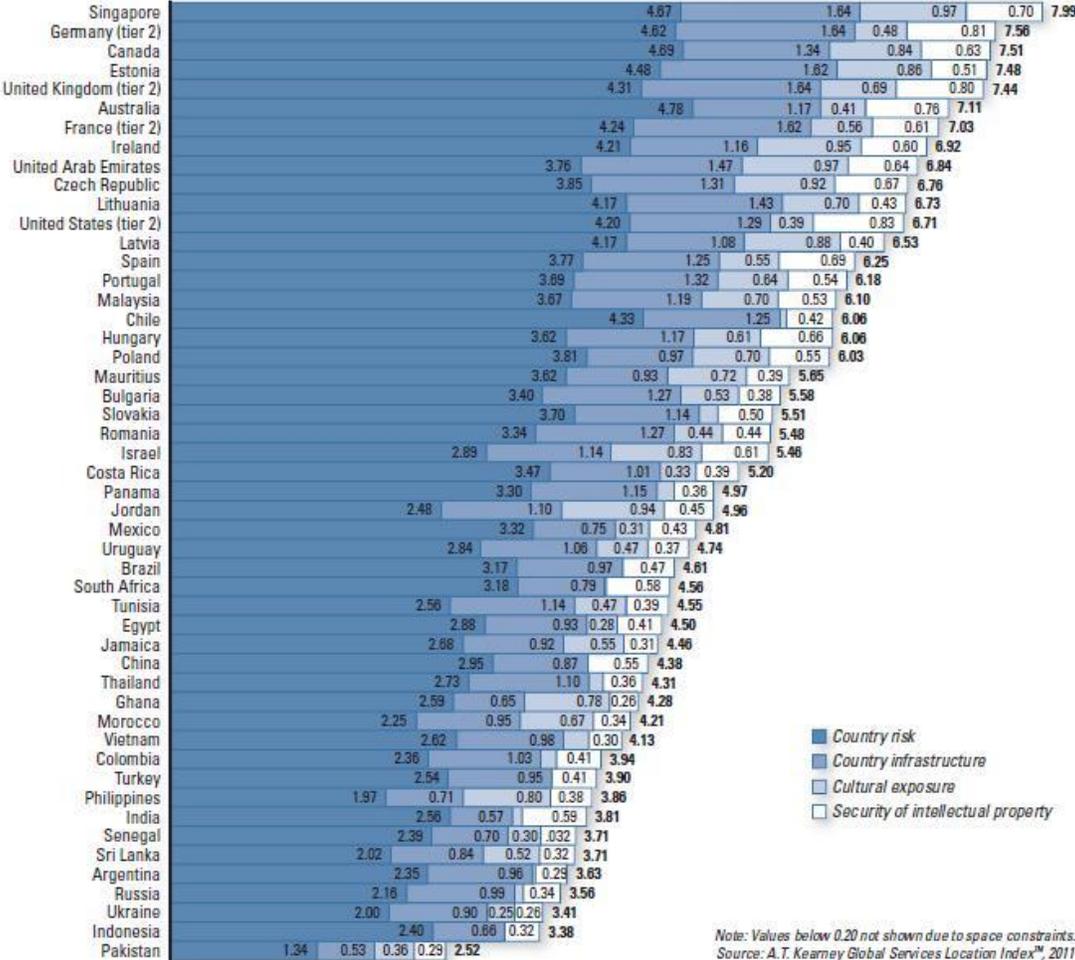
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<sup>17</sup> This comment is making reference to the chapter: Identification of the biggest absolute insourcers

<sup>18</sup> People size & availability score is used as a synonym for size & availability of labor force

component; problem that might be linked to the country's inherent and everlasting currency issues.

**Table 3.11: A.T. Kearney Ranking of Global Services Location, 2011 - Business environment scores**



Source: (Peterson, Erik; Gott, Johan; King, Samantha;, 2011)

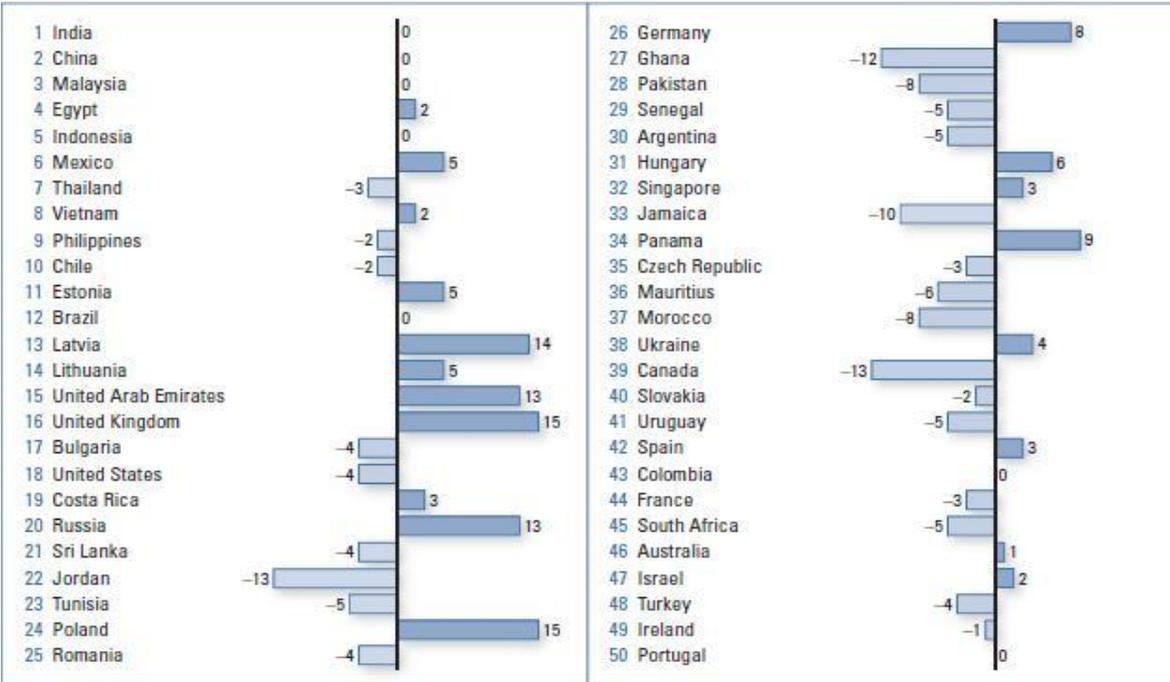
3.9.1.1 Changes in ranking

As A.T. Kearney's recently published 2011 ranking is not the first one of its kind, a comparison over the time can be made. Like this, the enormous dynamics in the market of global outsourcing can be illustrated. Moreover, such a comparison enables the reader to estimate how the region of Latin America has evolved during the last few years. Important about such a temporal comparison is that only

rankings of the same issuer are being used. This is crucial as metrics and measurements might vary from institute to institute. In this case, only rankings of the consulting firm A.T. Kearney are being analyzed.

Table 3.12 shows the changes between the ranking of 2009<sup>19</sup> and 2011<sup>20</sup>. As it can be observed, no changes among the first three countries have occurred. Contrary to this, the financial crisis seem to have considerably shaken up the rest of the ranking, not so much among the top ten countries, but very well among the rest of the top outsourcing destinations. Focusing on the top 20, substantial shifts in the ranking can be observed for Latvia, the United Arab Emirates, the United Kingdom and Russia. In contrast, in the top ten, such a big movement can only be observed for Mexico and this in an even more moderate manner.

**Table 3.12: A.T. Kearney Ranking of Global Services Location: Change in rankings, 2009 to 2011**



Source: (Peterson, Erik; Gott, Johan; King, Samantha, 2011)

Before commenting the causes for these partly extraordinary ups and downs in the lower part of the ranking, it is useful to throw a glance at the A.T. Kearney ranking

<sup>19</sup> A.T. Kearney's 2009 ranking is attached to the appendices.  
<sup>20</sup> Both rankings were elaborated by A.T. Kearney

from 2007<sup>21</sup>. This will help to support the statement that top ten countries have principally remained the same during the last three to four years.

**Table 3.13: A.T. Kearney Ranking of Global Services Location, 2007**

Country	Overall Score	Financial Score	People Score	Environment Score
India	6.9	3.2	2.3	1.4
China	6.6	2.9	2.3	1.4
Malaysia	6.1	2.8	1.3	2
Thailand	6	3.2	1.2	1.6
Brazil	5.9	2.6	1.8	1.5
Indonesia	5.9	3.3	1.5	1.1
Chile	5.8	2.7	1.2	1.9
Philippines	5.8	3.3	1.2	1.3
Bulgaria	5.8	3.2	1	1.6
Mexico	5.7	2.6	1.5	1.6

Source: (BusinessWeek, 2007)

Indeed, seven nations from the top ten have persisted in this group for four consecutive years. In such a dynamic market as it is the world of international labor division, this is indeed an interesting and particularly important fact. Moreover, A.T. Kearney's ranking of 2007 confirms the irremovable position of the top three countries, India, China and Malaysia. Again, India is clearly leading the ranking, doing particularly well on the above mentioned financial and people score. As in 2009 and 2011, China is the number two and Malaysia number three. Once more, the ranking shows the significant overall attractiveness of Asian countries. In 2007, six out of the ten most attractive destinations belong to the Asian continent. All of these countries have in common that they are especially strong on the financial dimension, but underperforming (except of Malaysia) when it comes to the environment score. According to this ranking, the second most attractive insourcing center is Latin America, represented by three countries, namely Brazil, Chile and Mexico. In comparison to the rest of the most attractive outsourcing destinations, Latin America appears to have difficulties to compete on a financial basis. Accordingly, the three listed countries of this region have a rather low score on this dimension. On the two other dimensions, people and environment, the three Latin American countries perform differently one from another. Whereas Brazil seems to

<sup>21</sup> The presented ranking, showing the ten most attractive countries for international service outsourcing, is only an extract of the original one.

have a well-educated workforce, but only mediocre environmental attributes, Chile is showing opposite characteristics, disposing of a good economic/political environment and infrastructure quality, but struggling in terms of education. Mexico positions itself in between Chile and Brazil on the people and environment dimension. So far, no essential differences to the 2011 ranking can be noted. Nevertheless, in 2007, Mexico is the country with the lowest total score in the top ten. This has considerably changed compared to 2011. Now, Mexico is even leading the list of Latin American outsourcing destinations.

Bulgaria, ranked 9<sup>th</sup> in 2007, is the only representative of the Eastern European countries. It receives an outstanding score on the financial dimension, but performs dramatically poor on the educational component. Bulgaria's environment score is about average. In 2009 and 2011, the East European country finally disappears from the top ten. Consequently, no European country is represented in the top ten anymore.

#### 3.9.1.2 Explaining major changes in ranking

As can be appreciated in Table 3.12, several considerable shifts have occurred between the rankings of 2009 and 2011. These changes have been evoked by multiple reasons. In North America a substantial fall in the Index can be observed for Canada. The Nordic country obtained one of the ranking's weakest results in the category of cost competitiveness. The country's compensation costs appear to be the highest among all listed countries. As a result, Canada is becoming a less attractive offshore destination, especially for the United States, still being the biggest customer market for outsourcing services. (Peterson, Erik; Gott, Johan; King, Samantha;, 2011)

In Latin America, Mexico has to be pointed out. The country moved up five spots, positioning itself as the 6<sup>th</sup> most attractive destination for service outsourcing in the world. The country's phenomenal rank in 2011 is due to many reasons. First, an increasing nearshoring sentiment in the United States is noticeable, causing

positive future perspectives. Second, Mexico's average wages have decreased an extraordinary 18% in dollar terms last years, thus, pushing the country's financial attractiveness. Additionally, Mexican management schools are considerably improving in quality. Consequently, the basis for a growing service insourcing sector will be provided in a near future. Finally, "the country boasts one of the highest numbers of Capability Maturity Model Integration (CMMI)<sup>22</sup>" (Peterson, Erik; Gott, Johan; King, Samantha;, 2011, p. 9) certified centers in the world. In contrast to Mexico, Chile surprisingly dropped two spots in the ranking. The country's slight fall is basically caused by two factors. First, the country received a slight downgrade in the infrastructure score due to the February 2010 earthquake. Second, Chile's wages remained quite stable, whereas many other, mainly more affected countries by the financial crisis reduced their wages. Of course, this weakens Chile's relative (financial) position. On the other hand, Costa Rica improved its position in the ranking and moves up three spots at one go. The country's amelioration in the ranking is due to substantial enhancements in general infrastructure, international bandwidth and electricity infrastructure. Argentina falls three spots as a result of inflation and rising demand for increased wages (Peterson, Erik; Gott, Johan; King, Samantha;, 2011).

In Europe, especially the Baltic countries have to be pointed out. Indeed, Latvia, Lithuania and Estonia seem to be among those countries that have best got out of the global economic crisis. Although severely hit by the financial meltdown, these countries refused to devalue their currencies and resorted instead to public reforms that are commonly known as "internal devaluation". In other words, governments cut expenditures and wages by an average of 35%, thereby boosting their overall cost competitiveness. Coupled with strong people skills, these countries have become more attractive for BPO as well as voice and IT outsourcing. The traditionally more significant insourcing country, United Kingdom, has equally experienced a significant rise in the 2011 ranking. Without any doubt,

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<sup>22</sup> CMMI describes a special "process improvement technique for evaluating how efficiently a company is able to deliver technology products to its customers. Capability Maturity Model Integration is often associated with software development, and seeks to integrate the various steps in the development process" (Business Dictionary, 2011, ¶1)

the tremendous ascent of 15 spots has been principally evoked by a steep drop in compensation costs (15% in dollar terms). Moreover, Britain is currently making great efforts to attract more outsourcing projects from its former colony and increasingly important outsourcer, India. Poland is definitely the last year's success story in Eastern Europe. As the United Kingdom, Poland similarly moves up 15 spots thanks to improved investor sentiment. Nevertheless, the Europe's hot spots for nearshoring remain Bulgaria (17<sup>th</sup>), Romania (25<sup>th</sup>) and North Africa and the Middle East (Peterson, Erik; Gott, Johan; King, Samantha;, 2011).

In the Middle East and Africa, major positive changes can be observed for Egypt and the United Arab Emirates (UAE). Egypt has risen to the 4<sup>th</sup> most attractive service outsourcing destination in the world, thereby eclipsing all of the other major European nearshore destinations. Egypt's favorable position is due to the country's large supply of talent as well as to its relatively low rates of economic wages. Moreover, Egypt government has constantly promoted the sector and insisted on improvements on major service standards. Nevertheless, it is unforeseeable if the North African country will be able to maintain its great position after the recent political turmoil. Thanks to more competitive compensation costs, a rise in the quality of its management schools and an improvement in literacy scores, the UAE has lately climbed 15 spots in the ranking and is now the region's second most attractive destination for service outsourcing. In this context, it should be highlighted that the Middle East country has successfully specialized in providing headquarter services for many multinational firms throughout the region (Peterson, Erik; Gott, Johan; King, Samantha;, 2011).

In Asia, no great changes can be noted in 2011. The uncontested top three destinations for international service outsourcing remain India, China and Malaysia. A minor descent can only be observed for Thailand and the Philippines. In Thailand, the descent is slightly bigger and principally due to three reasons. First, the country's almost traditional lack of English proficiency has to be mentioned. It is undoubtedly becoming a major impediment for the attraction of outsourcing services. Secondly, Thailand has still an unstable political situation. This is

increasingly causing uncertainty among foreign investors. Lastly, Thai governmental support in promoting the country's service insourcing industry is quite scarce and definitely insufficient to maintain the country's extraordinarily high rank. The rest of the Asian countries have experienced neither mayor descents, nor greater ascents. They have basically preserved their relatively strong positions in the ranking (Peterson, Erik; Gott, Johan; King, Samantha;, 2011).

### **3.9.2 SourcingLine Ranking**

In order to obtain a rather objective picture of the global insourcing scenery, it is necessary to complement A.T. Kearney's outsourcing ranking with one of another institute or firm, specialist in this respective area. A brief comparison will let the reader know if there is certain degree of congruency between the presented rankings and, consequently, if A.T. Kearney's ranking is somehow representative.

Another ranking of top service outsourcing destinations is provided by SourcingLine, a U.S. service firm, principally dedicated to the matching of outsourcing buyers and providers around the world. The ranking includes 26 outsourcing destinations. Consequently, the ranks solely refer to the participating countries. For example, if India is attributed the second rank in terms of resources and skills, it is the second best performer among the participating countries, not necessarily in the world. Similar to the first ranking, "[outsourcing countries](#) [are evaluated] by cost competitiveness, resources and skills, and business & economic environment. (...) Profiles include statistics on wages, office costs, taxes, university graduates, technological readiness, regulation, corruption, legal protection and much more" (SourcingLine, 2010, ¶3). Moreover, it should be noted that, even though the ranking is quite recent – it was released in 2010- , it might not include most of the factors that have led to the changes, mentioned in the chapter before. As the starting economic recovery and its implications is not taken into account, a comparison with A.T. Kearney's 2009 ranking makes probably more sense.

Table 3.14: SourcingLine Ranking<sup>23</sup> of Global Services Location, 2010

World Rank	Country	Overall Index	Cost Competitiveness		Resources & Skills		Business & Economic Environment	
			Rank	Index	Rank	Index	Rank	Index
1	India	7.0	4	9.1	2	5.2	21	4.1
2	Malaysia	6.1	6	8.9	12	1.7	5	6.8
3	Philippines	5.8	7	8.7	5	2.1	19	4.5
4	Indonesia	5.7	3	9.4	21	1.2	22	4.1
5	Jordan	5.7	5	8.9	23	1.0	10	6.1
6	Thailand	5.6	9	8.6	22	1.1	8	6.4
7	Egypt	5.5	2	9.4	28	0.6	20	4.2
8	Pakistan	5.4	1	9.4	25	0.6	25	3.7
9	China	5.4	14	7.5	4	2.5	15	5.3
10	Bulgaria	5.4	11	8.1	13	1.6	13	5.4
11	Romania	5.3	13	7.6	11	1.7	11	6.0
12	Argentina	5.3	10	8.1	14	1.5	18	4.7
13	Ghana	5.2	8	8.6	24	0.6	17	4.8
14	Mexico	5.1	15	7.3	9	1.9	14	5.3
15	Poland	5.1	17	7.1	7	2.0	12	5.8
16	South Africa	5.1	16	7.2	17	1.4	4	6.8
17	Czech Republic	5.0	20	6.9	8	1.9	9	6.2
18	Vietnam	5.0	12	8.1	19	1.3	24	3.7
19	Hungary	5.0	21	6.7	10	1.9	7	6.6
20	Chile	4.9	19	6.9	20	1.2	6	6.7

Source: (SourcingLine, 2010)

At the top of the SourcingLine ranking, a similar situation as in the A.T. Kearney rankings can be observed. India has not only the leading position in the ranking. More than this, its gap in terms of score to the number two is, once more, gigantic. Moreover, Asian countries are clearly dominating the top ten and prove to be highly competitive in terms of price. Referring to this, again, no major differences in comparison to the previously analyzed rankings can be observed.

Nevertheless, great differences can be noted when it comes to the countries' exact positions. China, for example, is ranked 9<sup>th</sup> in this ranking. In all A.T. Kearney rankings the emerging economy has occupied the 2<sup>nd</sup> rank. Malaysia, the eternal

<sup>23</sup> The presented ranking is only an extract of the original one.

number three in the A.T. Kearney rankings, is ranked 2<sup>nd</sup> according to SourcingLine (2010). Concerning Latin America, the region is not pictured in a particularly good shape. Like in A.T. Kearney's 2009 ranking, only three countries are represented in the top 20. Latin American representatives in the SourcingLine's top 20 are Argentina, Mexico and Chile. Brazil is placed 26<sup>th</sup> which is mainly caused by comparatively weaker scores in the people skills category. Of course, many other changes concerning the exact ranks of the countries can be noted. However, comparing the rankings, rank by rank, is of no great value and consequently omitted in this paper. Contrary to this, it is more important to know whether or not A.T. Kearney's 2009 ranking is basically composed of the same countries as the SourcingLine ranking. Indeed, 15 countries out of A.T. Kearney's top 20 coincide with those of the SourcingLine ranking. Even if the reader's focus is reduced to the rankings' top ten, a high degree of congruency among the rankings can be observed, meaning that out of ten countries, eight are represented in both rankings. Congruency does also exist concerning the strengths and weaknesses of the evaluated countries.

### **3.9.3 Gartner Selection**

Another important study about global offshoring<sup>24</sup> hot spots has been conducted by Gartner, the world's leading information technology research and advisory company. In its comprehensive study, the North American consultancy screens about 72 offshoring destinations. All of the analyzed countries fulfill minimum one of the following two criteria: They already provide a respectable number of services to a non-domestic market, or they have at least started to create an environment that could attract a growing number of foreign services in the near future. It is important to emphasize that contrary to the previous studies, Gartner does not rank the countries, "as each organization will have a different view of which factors are the most important for its needs. For the same reason (...) an overall rating for each country [is not included]" (Excellence Leadership, 2008, p. 2). While omitting

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<sup>24</sup> Offshoring does refer to both, captive offshoring and international outsourcing.

an exact ranking, the Gartner study rather intends to point out which countries currently are among the 30 most suitable for offshore IT and IT-enabled service work. In order to assess the candidates, Gartner recurs to the following criteria<sup>25</sup>:

- Language
- Government Support
- Labor Pool
- Infrastructure
- Educational System
- Cost
- Political and Economic Environment
- Cultural capability
- Global and Legal Maturity
- Data and Intellectual Property Security and Privacy

The following 30 countries<sup>26</sup> have been selected as top offshore locations. They are divided by region:

**Table 3.15: Gartner Selection of the 30 Leading Offshore Locations**

Americas	Asia/Pacific	Europe, the Middle East and Africa (EMEA)
1. Argentina	1. Australia	1. Czech Republic
2. Brazil	2. China	2. Egypt
3. Canada	3. India	3. Hungary
4. Chile	4. Malaysia	4. Ireland
5. Costa Rica	5. New Zealand	5. Israel
6. Mexico	6. Pakistan	6. Morocco
7. Panama	7. Philippines	7. Poland
	8. Singapore	8. Romania
	9. Thailand	9. Russia
	10. Vietnam	10. Slovakia
		11. South Africa
		12. Spain
		13. Ukraine

<sup>25</sup> Detailed information about each criterion is available at: [http://www.excellence-leadership.com/microsites/gartner/2009/gartners\\_30\\_leading\\_location\\_163341.pdf](http://www.excellence-leadership.com/microsites/gartner/2009/gartners_30_leading_location_163341.pdf)

<sup>26</sup> Numbers on the lists do not represent rankings.

Source: (Excellence Leadership, 2008)

According to Gartner's 2008 assessment, more than  $\frac{3}{4}$  of the most suitable countries can be located in regions other than South- and North America. Accordingly, the quite broadly defined region of Europe, the Middle East and Africa (EMEA) is represented by 13 countries; ten countries belong to the region of Asia and Pacific and only 7 to the American continent. A brief look on the respective countries demonstrates that these nations are the same ones as in the previously presented A.T. Kearney rankings. Indeed, all of Gartner's top offshoring destinations are equally represented in the different A.T. Kearney rankings. An extraordinarily high degree of congruency does also exist in comparison to Sourcing Line's top outsourcing locations.

Concerning the Latin American region, only the six highest ranked countries<sup>27</sup> do equally appear in the Gartner selection. In other words, the relatively weaker ranked nations of the region, namely Uruguay and Colombia have not got into the company's final country list.

In general, the presented rankings allow the reader to make a series of particularly important statements:

Concerning the identification of the most attractive insourcing countries, a considerable overlap among the companies' assessment can be stated. This is not quite the case when it comes to the exact rank of the respective countries. This is basically due to two facts: First, the presented rankings have been elaborated in different years and second, every ranking finally defines its own measurements and weights of distribution. Nevertheless, congruency concerning the countries' exact rank seems not be completely excludable.

Thus, India turns out to be number one across all rankings, leaving far behind the rest of the competing countries and regions. The greatest challenger of the undisputed Indian leader appears to be China and Malaysia. But also other Asian

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<sup>27</sup> According to A.T. Kearney's latest ranking

countries are competing for the pole position such as Indonesia, Thailand, Philippines and Vietnam. Consequently, top ten positions are principally occupied by Asian countries. Most of these countries prove to be particularly strong on the financial dimension; India and China also on the people skills score.

However, by no means Latin America's competition is only reduced to this specific region. Especially North Africa, Eastern Europe and the Middle East are increasingly enhancing their potential for becoming major insourcing or nearshoring centers. Egypt is the best example of this, obtaining high overall scores in all presented rankings. Latin America seems to be a case of its own. The region's countries are evenly distributed over the entire ranking, occupying higher, medium and lower ranks. The same is true for the rankings respective categories: financial, skills and environmental. Consequently, no strength or weakness can be identified that would be valid for all nations of the region at the same time.

However, rankings demonstrate that Brazil, Chile and Mexico are just about to become one of the best offshore destinations<sup>28</sup> in the world. The constant ascent of the latter could pave the way to the region's first veritable success story in the area of international service outsourcing. But the rest of the region appears to drag behind. Whereas Costa Rica still remains in the top 20<sup>29</sup> and Argentina at least in the top 30, Panama, Uruguay and Colombia are beginning to fall far behind.

In order to get an idea of how Latin America's insourcing situation could improve, the reader now needs to know which type of services is principally outsourced. Accordingly, it is also important to know which type of services Latin America has traditionally insourced. The upcoming chapter will give a satisfying answer to this question and clear the way to some constructive suggestions for improvement.

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<sup>28</sup> Offshore destination refers to a destination of international service outsourcing

<sup>29</sup> According to A.T. Kearney's 2011 ranking

### 3.10 Types of Services Being Outsourced

Reliable information about the different types of internationally outsourced services<sup>30</sup> is provided by the Duke University Center for International Business Education and Research (CIBER). The institute's statistics are the result of a comprehensive survey on 880 different offshore implementations, either already operating or in the state of preparation at the time of the study. The respective launch dates range from 1990 to 2006.

**Table 3.16: Distribution of offshore implementations across functions and locations**

<b>Functions</b>	<b>% of total (N)</b>	<b>Locations</b>	<b>% of total (N)</b>
<b>IT</b>	<b>26% (227)</b>	India	42% (366)
<b>Product Development</b>	<b>26% (230)</b>	China	11% (98)
Engineering Services	11%	Latin America	8% (74)
R&D	10%	Philippines	8% (71)
Product Design	5%	Western Europe	6% (55)
<b>Administrative</b>	<b>22% (196)</b>	Other Asia	6% (54)
Finance & Accounting	12%	Eastern Europe	6% (51)
Human Resources	5%	Canada	5% (40)
Other back office	4%	Other locations	4% (36)
Legal Services	1%	Mexico	4% (35)
<b>Contact Centers</b>	<b>17% (147)</b>		
<b>Procurement</b>	<b>5% (48)</b>		
<b>Marketing &amp; Sales</b>	<b>4% (32)</b>		

Source: (Lewin, Massini, & Peeters, Offshoring Research Network, 2008)

The results of CIBER's extensive research study might surely surprise one or another attentive reader. Contrary to a widespread supposition, contact centers are not the kind of service that is outsourced the most. According to this study, only 17% of all surveyed offshore implementations refer to the prominent call centers. Although this type of service does still appear to be highly suited for offshoring, it has been outpaced by a wide range of other more sizable services. As expected, one of these services belongs to the area of IT. Indeed, IT services represent a total share of 26% of all offshore implementations. Surprisingly, the percentage of administrative services is almost equally high. These services include the area of finance and accounting, human resources, other back office services and legal services. All together, they already represent 22% of all offshore implementations.

<sup>30</sup> CIBER's research study analyzes both, international service outsourcing and service offshoring. The two different types of international labor division are not separately analyzed. Consequently, offshoring and outsourcing in this abstract will refer to both types of international labor division.

In contrast to this, services of procurement as well as services in the area of marketing and sales seem not to be in the focus of offshore managers. Their accumulative percentage remains below 10%.

The high percentage of administrative services being outsourced might already be quite surprising, although the most astonishing result is still the one concerning product development. According to CIBER's research study (2008), it is especially the type of know-how-intensive services that are currently offshored the most. These services refer to product design, research and development (R&D) as well as to the usually indispensable engineering services. It should be highlighted that these services are typically considered to be the core of many of today's businesses. Many competitive advantages and core competencies are developed in these specific business functions. There is no doubt that the vast majority of innovation as well as part of the corporate identity of major companies are derived from these three areas. Nevertheless, data shows that companies are able to offshore even these technically more advanced activities and that they are doing this to an extraordinarily great extent already. According to Lewin, Massini & Peeters (2008), offshoring of new product development is a rapidly rising trend today. Whereas offshoring used to be limited to simple codified and repetitive tasks, it is now increasingly referred to more complex activities (Lewin & Peeters, *The Top-Line Allure of Off-shoring*, 2006). This change can be principally explained by the emerging shortage of high skilled technical talent in most of the developed economies. A recently published article in the internet-based journal, *Spiegel Online*, documents this problem, pointing to major budding problems concerning university graduates in subjects such as math, IT, natural sciences and technology (Trenkamp, Oliver; Titz, Christof, 2011).

But of course, there are also other important drivers for offshoring product development. According to recent research, another significant reason, for example, turns out to be a firm's need to augment its knowledge base (Lewin, Massini, & Peeters, *Offshoring Research Network*, 2008) The potential knowledge spillovers from the respective host country can be crucial for survival in today's

fierce global and increasingly innovation-based competition (Lewin, Massini, & Peeters, Offshoring Research Network, 2008). Especially in the innovation sector, another significant driver for offshoring is “the pressure to increase speed to market with new or improved products faster than the competition” (Lewin, Massini, & Peeters, Offshoring Research Network, 2008, p. 14). Having available a worldwide flexible pool of qualified personnel that work around the clock using a follow the sun schedule (Lewin, Massini, & Peeters, Offshoring Research Network, 2008), this pressure can be significantly attenuated.

Another main driver for offshoring product development is a company’s need to serve increasingly sophisticated local demands, especially in emerging economies. In other words, as customers in foreign markets become more demanding, local R&D facilities can help a firm to adapt its products better to local needs (Hakanson, 1990).

As chapter 3.4 already dealt with the main drivers for offshore outsourcing of services, the list of reasons for this specific type of offshoring will not be continued. Most of the major drivers are anyway the same ones for all kind of services. However, access to qualified personnel seems to play an extraordinarily important role for this specific offshoring type and consequently should be highlighted in this paper.

An interesting observation according to this aspect is made by CIBER’s research study (2008): “Cost savings are certainly an important driver for many offshore implementations, but when firms need to support their innovation centered strategies in the face of scarce talent, labor cost considerations are less important relative to accessing talent anywhere” (Lewin, Massini, & Peeters, Offshoring Research Network, 2008, p. 24f).

Besides, Pedersen and Orberg Jensen (2007) find out that offshoring of services is an evolutionary process, which usually starts with rather simple and repetitive tasks and which continues with increasingly advanced activities until finally getting to core services such as product development. In this process, also the drivers for

offshoring appear to alter over the time. In other words, whereas a company's first offshore project refers to quite simple tasks and is principally driven by cost factors, subsequent offshore projects of more sophisticated services will most probably be motivated by knowledge seeking objectives (Pedersen & Orberg Jensen, 2007). Similarly, when objectives such as access to qualified personnel or speed to market rise in importance, the probability of offshoring product development increases respectively (Lewin, Massini, & Peeters, Offshoring Research Network, 2008).

In short, access to qualified workers becomes an offshoring factor of growing significance, especially for innovation-centered companies. This fact leads to the new phenomenon of global talent competition. In other words, companies will see themselves increasingly forced to compete for talent on a global scale and the success in this will be crucial for a company to maintain its competitive position in the market.

Concerning the surveyed offshore implementations it is not only interesting to take a look on the different types of services being offshored, but also on the respective destinations for these processes. As it can be observed in Table 3.16, India absorbs more than 40% of all offshore implementations. Once again, the outstanding position of India as the biggest absolute insourcer seems to be confirmed. The number of received offshore implementations – 366 out of 880 – is concordant with the Asian country's paramount overall score in the previously analyzed rankings. Interestingly, the destination with the second highest number of offshore implementations is China. The country has occupied the second rank in all of the presented A.T. Kearney rankings. Latin America receives only 8% of all offshore implementations. Due to its strong performance, Mexico is not included in the group of Latin American countries but is listed separately. The North American country receives almost half as much offshore projects as the entire Latin American region. This confirms the country's leading position in A.T. Kearney's latest ranking.

**Table 3.17: Percentage and (Frequency) of Offshore Implementations by Offshore Destinations**

	<b>Product development implementations</b>	<b>Non-product development implementations</b>	<b>% of product development implementations</b>
<b>Countries</b>			
India	43% (100)	41% (266)	27%
China	19% (43)	8%(55)	44%
Latin America	6% (13)	9% (61)	18%
Philippines	3% (7)	10% (64)	10%
Western Europe	6% (14)	6% (41)	25%
Other Asian regions	8% (18)	6% (36)	33%
Eastern Europe	6% (13)	6% (38)	25%
Canada	3% (7)	5% (33)	18%
Mexico	2% (4)	5% (31)	11%
Other regions	4% (11)	4% (25)	31%
<i>Total</i>	<i>100% (230)</i>	<i>100% (650)</i>	

Source: (Lewin, Massini, & Peeters, Offshoring Research Network, 2008)

In consideration of the fact that product development has become the type of service which is offshored the most, it is useful to know where these offshore projects principally go to. Table 3.17 provides this information. As expected, India dominates also in this specific service segment. Accordingly, it receives 43% of all surveyed product development implementations. Hence, it is little surprising that “new product development is becoming the fastest growing segment in India” (Lewin, Massini, & Peeters, Offshoring Research Network, 2008, p. 3). This is supposed to be caused by the already raised aspect of an increased global race for technology and knowledge workers (Ernst, 2006). The country with the second most product development implementations is China. Though considerably less sizeable than India in terms of offshore implementations, China receives at least 43 out of 260 product development projects. This corresponds to a respectable 19%. Together, both countries absorb almost two thirds of the overall product development implementations. The great “success of Asia in attracting innovation offshoring largely results from major investments in improving and expanding the talent pool available” (Lewin, Massini, & Peeters, Offshoring Research Network, 2008, p. 12). For example, China’s number of first year doctoral students in the highly demanded subjects of science and engineering increased six-fold between 1995 and 2003 (Freeman, 2005). Moreover, “Chinese government has launched programs targeted at retaining university graduates in China as well as attracting

talent from abroad, Chinese or not” (Lewin, Massini, & Peeters, Offshoring Research Network, 2008, p. 12).

Compared to the number of offshore implementations in these two Asian hot spots, Latin America’s share<sup>31</sup> appears to be negligibly small. It merely absorbs 6% of global product development and 9% of non-product development implementations. Especially the region’s innovation sector seems not to be sufficiently developed as only 18% of overall implementations going to this region, refer to the increasingly important area of product development. For the separately listed country of Mexico the situation is not any better, while the Philippines show a weaker ratio in this sector.

Consequently, it can be stated that compared to Latin America, future “product development projects are more likely to go to [India], China and other Asian regions, but less to the Philippines” (Lewin, Massini, & Peeters, Offshoring Research Network, 2008, p. 24).

### **3.11 New Developments on the Service Outsourcing Horizon**

As technology advances, new opportunities of providing services arise. Two of the most rapidly growing trends in the outsourcing landscape are the so-called shared services as well as the cloud computing –option.

#### **3.11.1 Shared Services Centers**

Shared services is a term defining an operational philosophy that involves centralizing those administrative functions of a company that were once performed in separate divisions or locations. Services that can be shared among the various business units of a company include finance, purchasing, inventory, payroll, hiring,

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<sup>31</sup> Excludes the separately listed country of Mexico

and information technology. For example, a central headquarters might control all the hiring for an entire chain of retail stores. (US Legal, 2011).

The main driver for companies to implement such a shared services model is usually the cost-saving aspect. Indeed, by standardizing procedures and practices, by reducing investments in technology and office space and by creating economies of scale, considerable cost-savings can be achieved. Consequently, it is not surprising that this model is described as “one of the hottest trends in business today” (US Legal, 2011, ¶3).

What makes this model particularly interesting for offshoring and outsourcing experts, are basically two aspects. First, multinational companies with an integrated shared services model will obviously have the option to also offshore the newly created service center. Then, rankings and the respective scores of a country will play a decisive role again. According to the provided taxonomy of offshore-outsourcing, this activity would then be referred to as captive offshoring. Second, the role of the created service center must not necessarily be reduced to the one of an internal vendor. Once the center appears to excel in its provided services, the company may decide to sell its services to a third party, too. This would then be considered as a classical outsourcing activity. Of course, the multinational may also have foreign clients served by its shared services center. This would represent an international outsourcing activity.

For the purpose of an estimation of the current situation of shared services in Latin America, a recent survey of the British consultancy Ernst & Young proves to be particularly valuable. In its comprehensive study which was published in 2008, the consultancy analyzes the actual situation, the most relevant tendencies as well as the different applied practices of shared services in Latin America (Ernst & Young Chile, 2008). First, the increasing importance of shared services centers is documented. According to this study, 54% of all surveyed companies have already operating such a service model, 11% have been implementing it at the time of the study, and even the half of the remaining 35% has decided to do so in the near future. Indeed, the main driver for these companies to implement such a services

model is cutting costs through simplification and standardization processes (Ernst & Young Chile, 2008).

Whereas these figures can clearly be considered as good news, the study also provides quite disillusioning information: On average, the already implemented shared services centers of the region are only one to five years old. In other words, Latin America has not gained much experience in this area yet. Consequently, most of the existing services centers serve local or regional companies. The missing experience as well as the region's weaker position in compensation costs (see chapter of rankings) has led to the fact that Europe's big multinationals already moved their global services centers to Asian countries and not to Latin America. In particular, India has gained significant experience in this area and, combined with favorable labor costs, has greatly benefited from Europe's trend to offshore these activities (Ernst & Young Chile, 2008).

Concerning the above mentioned offshore-outsourcing option Latin America is not pictured in a good shape, either. Only 13% of the already existing shared services centers also sell their services to a third party. Moreover, 83% of the existing centers do still possess a type of exclusivity-right (Ernst & Young Chile, 2008).

This means, that the implemented center is not competing with any external service provider. In other words, the company's business units are obliged to engage the services of their own service center. Although this information might not be very surprising due to the fact that shared services centers in the region are still in a state of maturation and stabilization, it is still a major weakness that needs to be eliminated in order to gain competitiveness in this area.

### **3.11.2 Cloud Computing**

Another upcoming trend which could rapidly change, in particular, the global IT-outsourcing landscape can be reduced to the term of cloud computing. Cloud computing basically refers to the delivery of any kind of hosted services over

Internet and can be distinguished from traditional hosting by the following three characteristics:

It is sold on demand, typically by the minute or the hour; it is elastic -- a user can have as much or as little of a service as they want at any given time; and the service is fully managed by the provider – the consumer needs nothing but a personal computer and Internet access (Searchcloudcomputing.com, 2007, ¶2).

These characteristics, the improved access to high-speed internet through cloud computing as well as many companies' difficult financial situation has led to a growing interest for this new technology and has definitely triggered its fast evolution. Today, the cloud computing related services can be broadly divided into three categories: Infrastructure-as-a-Service ([IaaS](#)), Platform-as-a-Service ([PaaS](#)) and Software-as-a-Service ([SaaS](#)) (Searchcloudcomputing.com, 2007).

Infrastructure-as-a-Service basically refers to the option of storing data online. In this case, cloud computing allows a company to store any desired amount of data online, uniquely paying for the capacity which is thereby occupied. As this option works on a pay-per-use basis, it is also referred to as utility computing. The name of this option comes from the idea that infrastructure – the necessary hardware to store the client's data - is provided by the vendor in the form of a service. By platform-as-a Service it is meant that the service vendor provides software and product development tools for the client on its own infrastructure. The last cloud model, Software-as-a-service, is probably the one with the broadest market. In this option the vendor not only supplies the hardware infrastructure and the software product, but also interacts with the client (Searchcloudcomputing.com, 2007).

One of the biggest advantages of this IT option is that buyers' up-front costs are eliminated and their total cost of ownership is considerably reduced. As the clients acquire IT on demand, they can also switch software anytime they want or need to. Certainly, this gives them an important competitive advantage (Goolsby, Kathleen,

2010). All these facts have brought Gartner to forecast that “by 2012, 20 percent of businesses will own virtually no IT assets” (Overby, Stephanie, 2010, ¶4).

Of course, these changes will have a huge impact on IT outsourcing. IT providers' will need to integrate cloud services to their existing portfolios as fast as possible, as costumers' demand for flexible IT solutions on an as-needed basis will certainly grow. Companies that do not jump on the bandwagon now, risk falling behind quite soon. Those IT service providers that are not able to develop cloud services themselves will have to align with partners that do. Accordingly, a lot of alliances between cloud providers and outsourcing vendors are likely to be observed in the near future. For those companies that succeed in adapting to the growing cloud services trend, new business opportunities arise. Especially the small to mid-size businesses sector represents a great market potential which is still largely unexploited (Overby, Stephanie, 2010).

The cloud computing trend will most probably also bring many outsourcing providers to move up the value chain and to start providing consulting and information management services to their customers. Such consulting activities would then be focused on how the client should organize its systems and business process workflows (Goolsby, Kathleen, 2010). Whatever the exact developments will look like, the traditional IT services industry is likely to be turned on its head. Consequently, all IT outsourcing providers are well-advised to gain experience and expertise in this area soon, as the seeds for this trend are already sewn.

With this section the literature review is closed. Without any doubt, this part of the paper has been useful to identify Latin America's current situation in terms of service outsourcing. Nevertheless, it does not help to estimate how the region's respective future can or will look like. However, the next chapter will try to contribute to the answer of this question.