Offshoring of Services – Practices, Risks and Benefits

Offshoring Research Network workshop
ULB - October 28th, 2010

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Florence Duvivier and Julien Gooris
Offshoring Research Network (ORN)

- Initiated in 2004 at Duke University, US
- Expanded to partners in Europe and Asia:
  - Denmark (Copenhagen Business School), Spain (IESE Business School), UK (Manchester Business School), Netherlands (Erasmus Rotterdam School of Management), Germany (Otto Beisheim School of Management), France (EMLyon Business school), Belgium (ULB – Solvay Brussels School of Economics and Management)
  - Australia (Macquarie University), Japan (University of Tokyo), Korea (Kyung Hee University)

Objectives:
- Track evolution of offshoring over time
- Study offshoring benefits, risks, and strategies
ORN activities

Academically rigorous knowledge relevant to business

• 2 major surveys
  – Corporate clients (1400+ firms)
  – Service providers (400+ firms)

• Case studies

• Debriefing workshops

• Corporate events

• Publications:
  – Reports, in-depth analyses and thematic studies
  – Academic papers
Offshoring: definition

• Process of sourcing and coordinating tasks and business functions, across national borders

• Support domestic or global rather than local operations (>< sales)

• Both captive and outsourced activities

• Focus on Administrative and Technical services
  – BPO
  – ITO and software development
  – Technology
  – Contact centers
  – *No manufacturing production in ORN project*
Offshoring as internationalization of value chains

Diagram showing offshoring of services in different areas:
- Procurement
- Technology Development
- Human Resource Management
- Infrastructure
- Inbound Logistics
- Operations
- Outbound Logistics
- Marketing
- Service
Project scope

• All administrative and technical business services:
  – IT, software development, R&D, engineering…
  – Finance, accounting, HR, sales support…
  – Contact centers

• All locations:
  – India, China, South East Asia, S. America, East. Europe, Africa…

• All delivery models:
  – From fully captive to fully outsourced, joint ventures…

• All industries:
  – Manufacturing and services

• All companies that do offshore, do not, or are considering
Corporate client survey design

- Corporate/BU-wide strategies guiding offshoring
- Strategic Drivers
- Internal and External Risks
- Processes, Locations, Models
- Performance Outcomes
- Future Plans

Offshoring of services - Risks and benefits © Carine Peeters
Demographics

- 49% of EU companies and 46% of US companies
- More than 4000 offshore implementations
  - 300 from companies in Belgium
  - 75% implemented, 25% in planning phase
- Size repartition

**Small: up to 50 employees; medium: 51-250 empl.; large: >250 empl.**
What functions are offshored?

- IT?
- Contact centers?
- Administrative?
- Software development?
- Engineering, design services?
- R&D?
**Distribution of functions offshored**

- **BPO = 32%**
  - Finance & Accounting (F&A), Procurement (Proc), Marketing & Sales (M&S), Human resources (HR), Knowledge processes (Know), Legal services (Leg)

- **Technology = 22%**
  - Product design (Des), Research & Development (R&D), Engineering services (Eng)
Where are these functions offshored?

- India?
- China?
- Sri Lanka?
- Poland?
- Czee Republic?
- Morocco?
- Tunisia?
- Brazil?
Preferences for offshore locations

**US sample**

- Asia = 69%
- 1 of 2 projects goes to India
- 2nd best location = China & SE Asia

**EU sample**

- Asia = 41%
- 1 of 4 projects goes to India
- 2nd best location = East & West Europe

Source: ORN Global Survey
### Offshore locations by US and EU companies

#### US (%)

<table>
<thead>
<tr>
<th>Location</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>India</td>
<td>47</td>
</tr>
<tr>
<td>China</td>
<td>10</td>
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<tr>
<td>Philippines</td>
<td>7</td>
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<tr>
<td>Eastern Europe</td>
<td>6</td>
</tr>
<tr>
<td>Western Europe</td>
<td>6</td>
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<tr>
<td>Africa</td>
<td>1</td>
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</table>

#### EU (%)

<table>
<thead>
<tr>
<th>Location</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>India</td>
<td>23</td>
</tr>
<tr>
<td>China</td>
<td>9</td>
</tr>
<tr>
<td>Philippines</td>
<td>3</td>
</tr>
<tr>
<td>Eastern Europe</td>
<td>19</td>
</tr>
<tr>
<td>Western Europe</td>
<td>18</td>
</tr>
<tr>
<td>Africa</td>
<td>4</td>
</tr>
</tbody>
</table>
Offshore locations by companies in Belgium

BE companies prefer staying in Europe
- EE: 30%
- WE: 28%

If not they go to India (13%) or increasingly Africa (10%)

Eastern Europe: Poland (7%), Romania (5%), Rep Czech (3%), Bosnia (3%), Russia (2%), Slovakia (2%), Lithuania (2%), Bulgaria (1%), Hungary (1%), Moldavia (1%), Slovenia (1%), Macedonia (1%), Ukraine (1%)

Western Europe: France (6%), Netherlands (5%), Luxembourg (3%), Germany (3%), Spain (3%), Portugal (2%), UK (2%), Ireland (2%), Switzerland (1%)

Africa: Morocco (3%), South Africa (3%), Tunisia (2%), Algeria (1%)
Characteristics of offshore markets

- Eastern Europe and India have similar functional profiles
  - But India attracts more US firms and Eastern Europe more EU firms
- China differentiates in technology activities (40%) and procurement (15%)
  - Access to engineers + co-location with manufacturing
  - Management of procurement close to Asian low cost inputs
- Western Europe differentiates in Contact Centers, Marketing & sales, and HR
  - Activities that have to do with firms’ customers and employees (= human dimension)
- African and Eastern European offshore markets dominated by EU firms: 84% and 75% of implementations from EU
- Offshoring to Africa is mostly about IT (36%) and CC (27%)
What service delivery model?

• Captive?
• Outsourcing?
• Joint venture?
• BOT?
• Pseudo-captive?
Companies moving away from captive model

<table>
<thead>
<tr>
<th>Year</th>
<th>% Outsourcing</th>
<th>% Joint Venture</th>
<th>% Captive</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990-1994</td>
<td>22</td>
<td>4</td>
<td>74</td>
</tr>
<tr>
<td>1995-1999</td>
<td>39</td>
<td>2</td>
<td>59</td>
</tr>
<tr>
<td>2000-2004</td>
<td>49</td>
<td>3</td>
<td>48</td>
</tr>
<tr>
<td>2005-2009</td>
<td>55</td>
<td>5</td>
<td>40</td>
</tr>
</tbody>
</table>
Country differences in preferences for models

US

- Outsourcing: 58%
  - Captive: 40%
  - Joint Venture: 2%

EU

- Outsourcing: 39%
  - Captive: 49%
  - Joint Venture: 12%

BE

- Outsourcing: 20%
  - Captive: 60%
  - Joint Venture: 20%
Model depends on function offshored

BPO
- Outsourcing 41%
- Captive 51%
- Joint venture 8%

IT - Software
- Outsourcing 58%
- Captive 36%
- Joint venture 6%

Contact centers
- Outsourcing 61%
- Captive 36%
- Joint venture 3%

Technology
- Outsourcing 39%
- Captive 51%
- Joint venture 10%
Why do companies offshore?

• Labor arbitrage?
• Other cost savings?
• Non cost drivers?
## Ranking of strategic drivers by country

<table>
<thead>
<tr>
<th></th>
<th>US</th>
<th>EU</th>
<th>BE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Labor costs</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Other costs</td>
<td>3</td>
<td>2</td>
<td>5</td>
</tr>
<tr>
<td>Access qualified personnel</td>
<td>2</td>
<td>3</td>
<td>6</td>
</tr>
<tr>
<td>Growth</td>
<td>5</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>Flexibility</td>
<td>4</td>
<td>5</td>
<td>3</td>
</tr>
<tr>
<td>Efficiency</td>
<td>7</td>
<td>6</td>
<td>7</td>
</tr>
<tr>
<td>Innovation capacity</td>
<td>12</td>
<td>7</td>
<td>8</td>
</tr>
<tr>
<td>Competitive pressures</td>
<td>8</td>
<td>8</td>
<td>2</td>
</tr>
<tr>
<td>Global strategy</td>
<td>6</td>
<td>9</td>
<td>11</td>
</tr>
<tr>
<td>Speed to market</td>
<td>9</td>
<td>10</td>
<td>8</td>
</tr>
<tr>
<td>Location specific advantage</td>
<td>11</td>
<td>11</td>
<td>14</td>
</tr>
<tr>
<td>Improving services</td>
<td>10</td>
<td>12</td>
<td>12</td>
</tr>
<tr>
<td>Shortage of qualified personnel</td>
<td>14</td>
<td>13</td>
<td>8</td>
</tr>
<tr>
<td>Accepted industry practice</td>
<td>13</td>
<td>14</td>
<td>13</td>
</tr>
<tr>
<td>Access to new markets</td>
<td>15</td>
<td>15</td>
<td>15</td>
</tr>
</tbody>
</table>
Why firms offshore depends on what they offshore

Source: ORN Global Survey

- Labor cost savings
- Access to new markets
- Access to qualified personnel
- Domestic shortage of qualified personnel
- Enhance capacity for innovation
- Increasing speed to market
- Part of a larger global strategy
- Business process redesign
- Increase organizational flexibility
- Competitive pressure
- Growth strategy
- Competitive pressure

Source: ORN Global Survey
What risks do companies face?

- Internal
  - Loss of control?
  - Resistance?
- External
  - Cultural?
  - Political?
## Ranking of perceived risks by country

<table>
<thead>
<tr>
<th>Risk</th>
<th>US</th>
<th>EU</th>
<th>BE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low quality of service</td>
<td>1</td>
<td>1</td>
<td>4</td>
</tr>
<tr>
<td>Threat to data security</td>
<td>2</td>
<td>2</td>
<td>15</td>
</tr>
<tr>
<td>Loss of managerial control</td>
<td>6</td>
<td>3</td>
<td>5</td>
</tr>
<tr>
<td>Loss of operational efficiency</td>
<td>4</td>
<td>4</td>
<td>1</td>
</tr>
<tr>
<td>Loss of internal capabilities</td>
<td>7</td>
<td>5</td>
<td>9</td>
</tr>
<tr>
<td>Cultural differences</td>
<td>9</td>
<td>6</td>
<td>3</td>
</tr>
<tr>
<td>Lack buy-in in corporate culture</td>
<td>5</td>
<td>7</td>
<td>1</td>
</tr>
<tr>
<td>Offshore wage inflation</td>
<td>14</td>
<td>8</td>
<td>7</td>
</tr>
<tr>
<td>Resistance from internal clients</td>
<td>3</td>
<td>9</td>
<td>9</td>
</tr>
<tr>
<td>Resistance from customers</td>
<td>12</td>
<td>10</td>
<td>16</td>
</tr>
<tr>
<td>Offshore employee turnover</td>
<td>8</td>
<td>11</td>
<td>6</td>
</tr>
<tr>
<td>Loss of IP</td>
<td>11</td>
<td>12</td>
<td>16</td>
</tr>
<tr>
<td>Legal and contractual risks</td>
<td>10</td>
<td>13</td>
<td>8</td>
</tr>
<tr>
<td>Industry relations and unions</td>
<td>18</td>
<td>14</td>
<td>18</td>
</tr>
<tr>
<td>Offshore political instability</td>
<td>17</td>
<td>15</td>
<td>12</td>
</tr>
<tr>
<td>Difficulty to find qualified personnel</td>
<td>15</td>
<td>16</td>
<td>11</td>
</tr>
<tr>
<td>Loss of synergies across firm activities</td>
<td>13</td>
<td>17</td>
<td>12</td>
</tr>
<tr>
<td>Political backlash at home</td>
<td>16</td>
<td>18</td>
<td>14</td>
</tr>
</tbody>
</table>
Perception of risks change with experience

Operational efficiency
Service quality
Cultural differences
Lack of buy-in of offshoring in corporate culture
Loss of internal capabilities / process knowledge
Loss of managerial control
Data security
Lack of acceptance from internal clients
Lack of intellectual property protection
Legal/contractual risks
Wage inflation
High employee turnover
Loss of synergy across firm activities
Increasing difficulty in finding qualified personnel...
Lack of acceptance from customers
Political backlash at home
Political instability
Industrial relations / trade unions at home

Underestimated risks

Considering offshoring
Already offshoring
What do companies gain from offshoring?

• Savings?
• Innovation?
• Productivity?
• Access to talent?
• …
### Expected and achieved savings

- Most companies achieve lower than expected savings
  - 31% achieved versus 36% expected

- US firms expect but also achieve higher savings than EU

<table>
<thead>
<tr>
<th></th>
<th>Expected</th>
<th>Achieved</th>
</tr>
</thead>
<tbody>
<tr>
<td>US</td>
<td>40%</td>
<td>37%</td>
</tr>
<tr>
<td>EU</td>
<td>30%</td>
<td>23%</td>
</tr>
<tr>
<td>BE</td>
<td>31%</td>
<td>21%</td>
</tr>
</tbody>
</table>

- US higher performance holds for all functions
- But important cross country and cross functional heterogeneity in both achieved and expected savings
## Savings by home region and function

### BPO

<table>
<thead>
<tr>
<th>Region</th>
<th>F&amp;A</th>
<th>Procurement</th>
<th>M&amp;S</th>
<th>HR</th>
<th>Legal</th>
</tr>
</thead>
<tbody>
<tr>
<td>USA</td>
<td>37</td>
<td>36</td>
<td>33</td>
<td>29</td>
<td>36</td>
</tr>
<tr>
<td>EU</td>
<td>31</td>
<td>25</td>
<td>24</td>
<td>22</td>
<td>14</td>
</tr>
</tbody>
</table>

### Technology

<table>
<thead>
<tr>
<th>Region</th>
<th>Engineering</th>
<th>R&amp;D</th>
<th>Design</th>
</tr>
</thead>
<tbody>
<tr>
<td>USA</td>
<td>40</td>
<td>51</td>
<td>45</td>
</tr>
<tr>
<td>EU</td>
<td>33</td>
<td>28</td>
<td>19</td>
</tr>
</tbody>
</table>

### ITO and Contact centers

<table>
<thead>
<tr>
<th>Region</th>
<th>IT - Soft</th>
<th>Contact centers</th>
</tr>
</thead>
<tbody>
<tr>
<td>USA</td>
<td>40</td>
<td>39</td>
</tr>
<tr>
<td>EU</td>
<td>34</td>
<td>34</td>
</tr>
</tbody>
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Savings by companies in Belgium

- Extremely poor performance in IT offshoring
  - 12% savings achieved against 28% expected
  - EU achieves 27% savings and US 36% on average
  - Small firm size does not explain poor performance
- Some big failures in CC too
  - 19% savings achieved for 34% expected
- Above EU average savings in F&A offshoring, which we do less than other countries
- Africa is only region where EU companies save more than US companies, and BE companies perform even better than EU average
Achieved cost savings decline as companies increase their scale and scope of offshoring.
Companies with offshoring strategy achieve consistently higher performance

- Achieved cost savings: With Strategy 28%, Without Strategy 34%
- Increase in firm's overall competitiveness: With Strategy 50%, Without Strategy 64%
- Major product innovation(s): With Strategy 12%, Without Strategy 17%
- Breakthrough process improvement(s): With Strategy 14%, Without Strategy 24%
- Better access to new markets: With Strategy 20%, Without Strategy 20%
- Improved service quality: With Strategy 31%, Without Strategy 45%
- Improved organizational flexibility: With Strategy 45%, Without Strategy 64%
- Better access to qualified personnel: With Strategy 41%, Without Strategy 56%
- Better focus on core competencies: With Strategy 43%, Without Strategy 52%
- Firm growth: With Strategy 39%, Without Strategy 48%
- Increased productivity/efficiency: With Strategy 55%, Without Strategy 62%

Source: ORN Global Survey