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# ASIA – AN ATTRACTIVE REGION FOR OFFSHORING?

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**Abstract:** Offshoring is a process consisting in moving an enterprise's production or services beyond its motherland. Recently it has been observed that this phenomenon has been growing and covering new fields of business activity. Asian states are the most frequently selected localizations for such a type of undertakings and India, China and Malaysia have been leaders for many years. Nevertheless, it is significant that such states are trusted simple services provision, e.g. call centre, while advanced services are provided in more developed economies. The goal of this paper is to show the offshoring phenomena in Asian states with use of generally-available statistical data and rankings provided by international institutes. An effect of his analysis will be specification of factors having an impact on this region's investment attractiveness.

**Keywords:** Asia, BPO, offshoring.

## 1. Introduction

Globalization is related to permanent changes in the world economy in terms of localization of jobs, production processes or services. More and more frequently the offshoring is mentioned among plenty of globalization mechanisms.

According to the definition of the United States Conference on Trade and Development (UNCTAD), offshoring is a process of services provision in the territory of other state.<sup>1</sup> In the subject-matter literature two categories of the phenomena in question can be observed:

1) *captive offshoring* – within an enterprise's internal activities. As an example one may indicate a company establishing a section, branch or subsidiary in other state and controlling the process of services provision in such a company. This type of offshoring enables enterprises to have a significant control over a business activity of an entity situated in a territory of other state but it also simplifies the company's confidential data protection like data related to its business (generated products or provided services). Selection of this strategy might be compared to a decision on foreign investment localized directly in other state, which, firstly, requires plenty of

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<sup>1</sup> *World Investment Report 2004. The Shift Towards Services*, United Nations Conference on Trade and Development, UNCTAD, New York and Geneva 2004, p. 147.

capital expenditures and, secondly, is extremely risky. Such a form of foreign markets expansion is usually selected by enterprises experienced on a particular market, such as: Citibank, American Express, General Electric or JP Morgan Chase. They count on benefits, mostly financial ones, but also those related to quality and efficiency of provided services. However, the will of reduction on business activity costs – as the typical financial factor – and creation of a company's image on new markets (marketing factor) constitute the most significant determinant.

2) *offshore outsourcing* – conducted by foreign partner per a company's request, with help of outsourced resources.<sup>2</sup> Selection of this form of offshoring means that an enterprise makes a decision to outsource some of processes which can be fulfilled by external company situated in another state. Under such circumstances an enterprise has not got an opportunity to supervise and monitor quality of produced goods and provided services continuously. What is more, long-term business relation management with a foreign partner might be quite difficult. The strategy in question is used by companies not being heavily experienced on foreign markets and they intend to obtain necessary knowledge and practical skills due to a foreign partner.

For many years the Asian states, namely India and China, have been the most attractive localizations for foreign investments in the form of the offshoring. They are characterized by low labour costs and availability of high-quality workforce. The goal of this paper is to show the offshoring phenomena in Asian states on the basis of generally-available statistical data and rankings provided by international institutes. The conclusion of the paper shall come in form of rating of the investment attractiveness of such states with consideration given to the offshoring as well as specification of determinants having a significant impact on the phenomenon in question.

## 2. Offshoring in the Asia region

For many years the Asia and Pacific region has been target localization for foreign direct investments. In the annual A.T. Kearney ranking *Global Services Location Index*,<sup>3</sup> rating potential of 50 states to attract investments within the global services sector, the Asian states hold leading positions. This ranking takes 43 determinants into consideration, which enables comparison of particular states. The determinants are divided into three groups of parameters:

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<sup>2</sup> *Outsourcing* refers to sub-contracting to specialized external entities all actions necessary to be completed to assure the contracting company's operation. Such actions could successfully be fulfilled/provided by a contracting company, nevertheless, their performance by external company is perceived by the contracting company to be more effective. Such actions/services might pertain to: legal services, IT services, security services, services in terms of booking and cleaning. More and more often production process is outsourced to states offering cheap workforce.

<sup>3</sup> [www.atkearney.com](http://www.atkearney.com) (12.02.2010).

- **financial attractiveness**, interpreted as the operational costs or business activity costs; this group covers labour costs, infrastructure and taxes which must be paid by an entrepreneur;
- **employment market**, described by accessibility and qualifications of employees, level of their education and knowledge of foreign languages; moreover, a significant factor for this category is a risk rate related to unplanned reduction on the workforce;
- **business surrounding**, which is economic and political situation of a state, legal and institutional solutions, tolerance and openness for foreign investors as well as intellectual proprietary rights protection level.

At the final stage of the analysis of the above-mentioned elements it is assumed that the final rate is affected mostly by operational costs – 40%, while two remaining parameters are rated by 30%.

**Table 1.** Attractiveness of the Asian states in terms of location of global external services (ranking of A.T. Kearney *Global Services Location Index*)

Position in the ranking	State	Financial attractiveness	Workforce	Business surrounding	Result
1	India	3.13	2.48	1.30	6.91
2	China	2.59	2.33	1.37	6.29
3	Malaysia	2.76	1.24	1.97	5.98
4	Thailand	3.05	1.30	1.41	5.77
5	Indonesia	3.23	1.47	0.99	5.69
7	Philippines	3.19	1.17	1.24	5.50
9	Jordan	2.99	0.91	1.59	5.49
10	Vietnam	3.21	1.02	1.24	5.47
16	Sri Lanka	3.13	0.95	1.17	5.25
20	Pakistan	3.12	1.08	0.91	5.11
33	Russia	2.39	1.45	1.08	4.92
35	Singapore	0.72	1.55	2.62	4.90

Sources: author's report on the basis of data from *The Shifting Geography of Offshoring. The 2009 A.T. Kearney Global Services Location Index*, A.T. Kearney, 2009, p. 2.

Presented in Table 1 results of attractiveness of the states, which are the best localizations for business processes like offshoring, enable concluding that India, China, Malaysia, Thailand and Indonesia have remained leading localizations for this phenomenon. Two first states attract 50% of offshoring business processes in the world, and value of revenues generated due to the offshoring is estimated at the level of USD 30 billion and it has increased by 25% for two years. Nevertheless, the global crisis affected this business activity field as well. In the period from October

2008 to January 2009 the value of newly-signed offshoring contracts was lower by 38% compared to analogous period of the previous year. The reason for such a large decrease was reduction on the financial services branch in offshoring. In India 40% of the offshoring business activity is run by banks and consequently, the world-scale financial crisis worsens the results generated by this sector as well. As an effect of the crisis banks made 5% of their personnel redundant. Globally the number of dismissed persons amounted to 250,000.

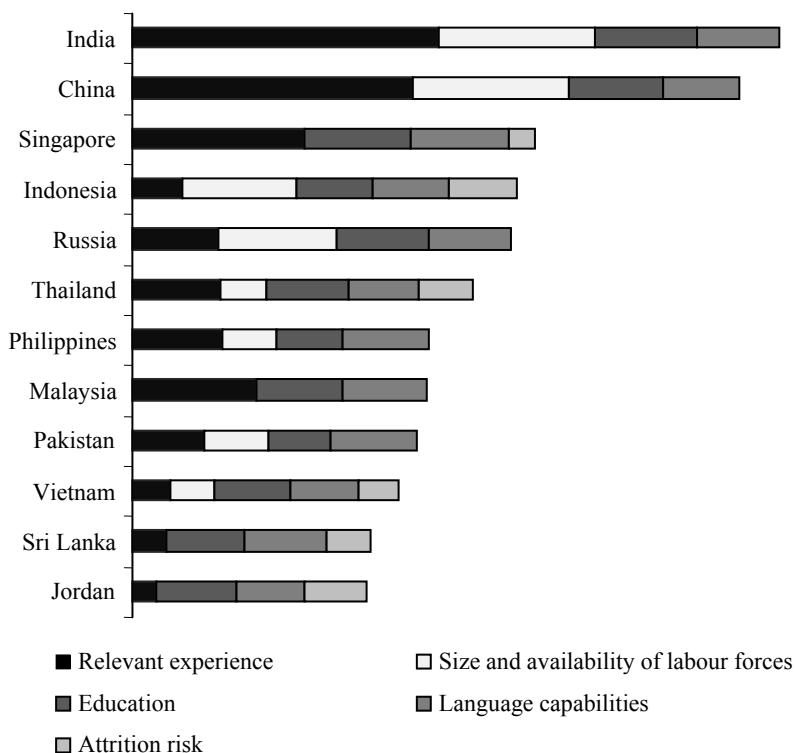
Other Asian states are also classified at good positions. They are ahead of Central-East Europe's states which were previously considered to be very attractive for such undertakings by investors. The situation can be explained by the fact that in European states in the recent years there has been observed a rapid increase in business activity costs and expenses resulting mainly from the appreciation of currencies such as euro or British pound in relation to the American dollar. What is more, in Europe employees require increasing in their salaries more and more frequently. Consequently, rate of the attractiveness of these states is badly affected. The most noticeable drop down in the ranking, as the result of currency appreciation since 2000 resulting in accelerated increase in labour costs, was suffered by Poland and Slovakia.

Among all of Asian states being subject of the A.T. Kearney analysis, India has the second in the world potential of the workforce. Additionally, Indian employees are characterized by an impressive experience within the BPO field (*Business Process Offshoring*), which makes this state more attractive for the already existing and potential foreign investors. The second position in terms of the workforce is assigned to China. The China is characterized by cheap and well-qualified employees. It is significant that China has significantly enhanced its image for 5 years in the world when it comes to the workforce offer. In the A.T. Kearney ranking dated 2004<sup>4</sup> within the category of workforce costs and availability this state held 7<sup>th</sup> position providing cheap workforce but inexperienced in terms of the BPO process completion. Qualifications of employees and their foreign languages skills were rated poorly as well. Then hope occurred on the occasion of the Olympic Games in 2008 and a need to obtain language and logistic skills, which could expand the China's position on the offshoring investments market. The report dated 2009 proves this state perfectly used its chance and presently holds the third position in the world, it is characterized by educated, knowing foreign languages personnel, matching to the leader of the ranking, which is India.

Third position in the attractiveness ranking is held by Singapore, although the costs of the workforce are relatively high there, it is also an interesting localization to attract the offshoring investments. The good position of the Singapore in the ranking results mostly from a good business climate, high level of employees' education, good language skills of the employees and a well-developed infrastructure.

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<sup>4</sup> *Making Offshore Decisions. A.T. Kearney's 2004 Offshore Location Attractiveness*, A.T. Kearney, Chicago 2004, p. 2.



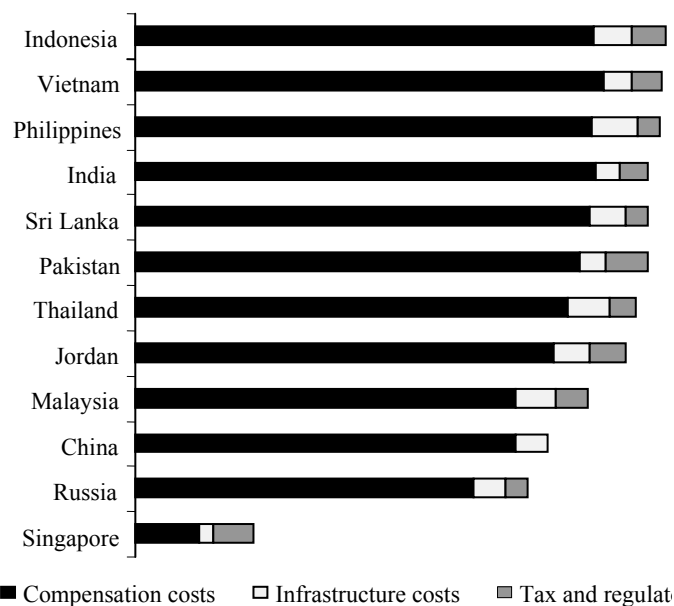
**Figure 1.** Offshoring attractiveness of Asian states in terms of availability and education level of the workforce

Sources: author's report on the basis of data from *The Shifting Geography...*, p. 4.

Financial attractiveness, which constitutes 40% of a state's rate in terms of the offshoring business activity localization, consists of labour costs, costs of infrastructure, including costs related to real estate renting, electric energy prices as well as cost of communication and transport services, tax charges, corruption rate and frequency of state's currency appreciation or depreciation.

Figure 2 shows that Asian region states offer relatively cheap workforce and infrastructure. The Singapore is the only exception since it is characterized by high expenses when hiring people. However, it offers great conditions for business activity. The state-city has a great technical and legal infrastructure, efficient judicial system and low crime and corruption rates. Investors appreciate it since it observes the highest requirements pertaining to the data and intellectual proprietary rights protection.

Analyzing the financial attractiveness of the Asian region one may feel intrigued by poor China's position. This situation is affected mostly by the increase in the labour costs reflected by dynamic increase in payments in the recent years. It



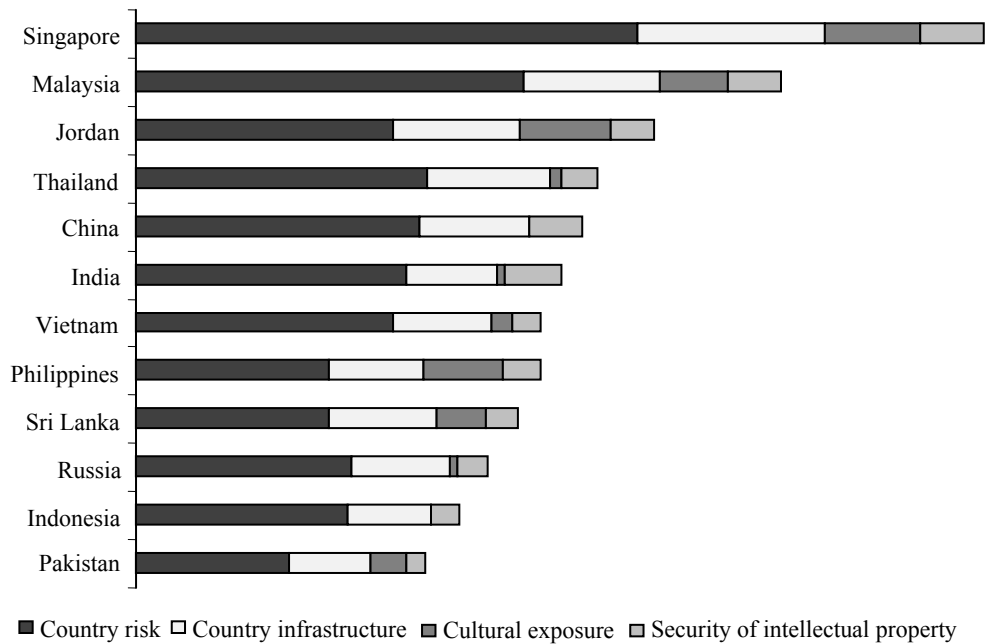
**Figure 2.** Offshoring attractiveness of Asian states in terms of labour costs, cost of infrastructure and tax costs

Sources: author's report on the basis of data from *The Shifting Geography...*, p. 7.

persuades investors to move their businesses to other states in the region, offering more attractive financial conditions, such as Indonesia, Vietnam or Philippines. Moreover, China is considered to suffer from the “red tape” heavily. In the territory of the China corruption is frequent and intellectual property is stolen.

Within the business surrounding category the Singapore was rated the best. The second position is held by Germany and Great Britain while the third position by Canada. It is the sole category within which the European states are leaders and the sole exception there is the first position held by the Singapore. Another state of the Asian region – Malaysia, held 16<sup>th</sup> position in the ranking, while Jordan – 25<sup>th</sup>. As it was previously mentioned, the Singapore is an attractive localization for the offshoring investments, in particular, when it comes to entrepreneurs appreciating the data and intellectual property protection. For many years it has been a favourite localization for IBM and Hewlett- Packard, among other companies. Considering the fact it is rather “small”, the Singapore shall stay a niche-localization for the offshore type investments.

In the ranking of the attractiveness of states for BPO, despite the analysis focus on India, China and Singapore, also Malaysia holds a good position. Malaysia offers to investors a safe business surrounding and high-quality labour at a very good price. An entrepreneur can rely on a support provided by a government, which is also



**Figure 3.** Offshoring attractiveness of Asian states – investment risk, infrastructure, cultural exposure and intellectual property protection

Sources: author's report on the basis of data from *The Shifting Geography...*, p. 10.

significant information. Labuan has become a favourite localization for investments, in particular International Offshore Financial Centre – IOFC. All actions and campaigns promoting the Labuan are regulated and coordinated by The Labuan Offshore Financial Services Authority – LOFSA, which controls the stock exchange operation and other financial services such as banks, insurances, stocks or mutual funds. Operation of the Centre in the Labuan is not a subject of Malaysian rules and legal regulations. With reference to this fact all overseas transactions in Labuan do not constitute a subject of a restriction on the currency exchange since accounts are held in foreign currencies. Another advantage for offshore companies is a low tax rate. Dependably on type of business activity the tax rate amounts to: 3% on net profit, proved by an audit, or 20,000 MYR in form of one-time lump sum for an enterprise dealing with trade and tax-free first year of its functioning, than 20,000 MYR lump-sum, etc. Foreign natural persons employed as managers within the Labuan overseas zone may take benefits from lower rates of tax on salaries, up to 50% of total income generated by a work position they hold.<sup>5</sup>

<sup>5</sup> *Malaysia bank and financial system*, www.kualalumpur.trade.gov.pl (12.02.2010).

In the latest ranking by Gartner<sup>6</sup> examining localizations for offshoring type services in the Asia and Pacific region, analytics found out that India and Singapore are the best states for such a type of business activity. China and Philippines were rated high among other Asian states as well. The analysis was based on 10 criteria, including: language skills, government support, labour pool, infrastructure, educational system, cost, political and economic stability, cultural compatibility, globalization maturity, security and privacy.

Although India continues to grow in absolute terms (as measured in top-line revenue levels) of IT services being exported from India, its share of the overall worldwide totals has declined. This is because other countries have invested heavily in an effort to gain more market share. Enterprises are seeking out de-risking strategies, and India is starting to face some challenges. India's challenges include wage inflation, local attrition rates, and geopolitical issues. Only China, Thailand and Vietnam were rated less than good for language skills in the region. China, India and Singapore all demonstrated strong government support for the promotion of their countries as offshore services locations. The combination of skills, current scale and future scalability gave India and China an advantage over other countries in the region.

**Table 2.** Selected states of the Asia region in the Gartner's ranking – Offshore Outsourcing Location Ratings

Item	China	India	Malaysia	Pakistan	Philippines	Singapore	Thailand	Vietnam
Language skills	fair	very good	good	good	very good	very good	fair	poor
Government support	very good	excellent	good	fair	good	very good	fair	poor
Labour pool	very good	excellent	good	fair	good	good	fair	fair
Infrastructure	very good	fair	good	fair	good	excellent	good	poor
Educational system	good	very good	good	fair	good	very good	fair	fair
Cost	very good	very good	good	very good	very good	fair	very good	excellent
Political and economic stability	very good	good	good	poor	fair	excellent	poor	fair
Cultural compatibility	fair	good	good	fair	very good	very good	good	fair
Globalization maturity	fair	good	good	fair	good	excellent	fair	fair
Security and privacy	poor	good	fair	poor	fair	very good	poor	poor

Sources: author's report on the basis of data from *Gartner's 10 Leading...*

<sup>6</sup> *Gartner's 10 Leading Locations for Offshore Services in Asia/Pacific for 2009*, www.gartner.com (20.02.2010).



On the grounds of Table 2 one may find that the Singapore offers to investors a great infrastructure, political and economical stability and globalization maturity as well. When it comes to India, it is characterized by a fact that investors are provided with a support by public institutions and a good employment market. Pakistan and Vietnam have been rated negatively the most frequently. The latter has been appreciated for low costs of business activity in its territory.

### 3. Conclusions

The above-presented analysis of statistical data and attractiveness rankings of investments of the offshore type investments proved that the Asia region is a great localization for such undertakings. Even more the states fulfil politics of being opened for foreign investors. It was proved that India and China belong to the leaders when it comes to states which are the most frequently selected by foreign investors because of cheap and well-educated workforce knowing foreign languages. Nevertheless, investors not only take care of costs. Consequently, in spite of the fact that labour costs and other business activity costs in Singapore are relatively high, it is still an attractive localization for foreign investments. Investors in Singapore appreciate a favourable investment climate offered to entrepreneurs, good education level and a splendid infrastructure. It means that the offshoring business activity is not only moved to low-cost states but also to highly-developed states having a well-developed research and scientific infrastructure and characterized by relatively high labour costs of business activity. It is substantial that in such states as China, Singapore, and Malaysia the value of imported services exceeds the value of the export. It is a result of the fact that the offshoring is mostly focused on new values provided by enterprises due to their access to international intellectual potential sources, the latest technical innovations and opportunities to expand global markets. Finally, it is an effect of the fact that Asian states no longer want to be perceived as the states attracting so called “simple services” like call centres, but the more advanced ones such as process management, IT services, legal and financial services, which are presently located in European well-developed states.

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## AZJA – ATRAKCYJNY REGION DLA OFFSHORINGU?

**Streszczenie:** Offshoring jest procesem polegającym na przeniesieniu poza kraj macierzysty własnej produkcji lub usług. W ostatnich latach obserwuje się, iż zjawisko to nabiera tempa i obejmuje coraz to nowsze dziedziny. Jako najczęściej wybieraną lokalizację dla tego typu przedsięwzięć wskazać można kraje azjatyckie, przy czym liderami od lat są Indie, Chiny, a także Maleszja. Istotne jest jednak to, iż do krajów tych kierowane są tzw. usługi proste, np. call centre, a te bardziej zaawansowane lokowane są w gospodarkach bardziej rozwiniętych. Celem artykułu jest przedstawienie zjawiska offshoringu w krajach Azji z wykorzystaniem do tego ogólnodostępnych danych statystycznych oraz rankingów instytucji międzynarodowych. Efektem tej analizy będzie określenie czynników wpływających na atrakcyjność inwestycyjną tego regionu.