

RESEARCH SUMMARY:

Mapping Offshore Markets Update 2005

By neoIT

**How will your
company
determine the
optimal location
for its
operations?**

Abstract

This research report updates neoIT's 2003 and 2004 *Mapping Offshore Markets* reports.

Specifically, this follow-up issue examines how the offshoring ecosystem has evolved over the past year as nearshore and offshore markets have adapted to rising demand for Information Technology Outsourcing (ITO) and Business Process Outsourcing (BPO) by clients in the US and Western Europe.

Mapping Offshore Markets Update 2005 offers a unique look at the specific factors that influence a country's ITO and BPO attractiveness. Leveraging our extensive knowledge and experience, we've indexed each country's unique ITO and BPO advantages to create a map of today's global sourcing landscape – a map that will help our clients optimize their firms' outsourcing decisions.

Key Findings: Although India and Canada remain leaders in the ITO and BPO industries, several Central and Eastern European (CEE) countries are emerging as favorite nearshore destinations for Western European countries. The Philippines, Malaysia, and Mexico are also becoming increasingly attractive as outsourcing destinations.

Background

The purpose of outsourcing is to transfer a business process or function – typically not a core function – to an organization that has specific expertise in the area. Outsourcing generally satisfies two principal objectives:

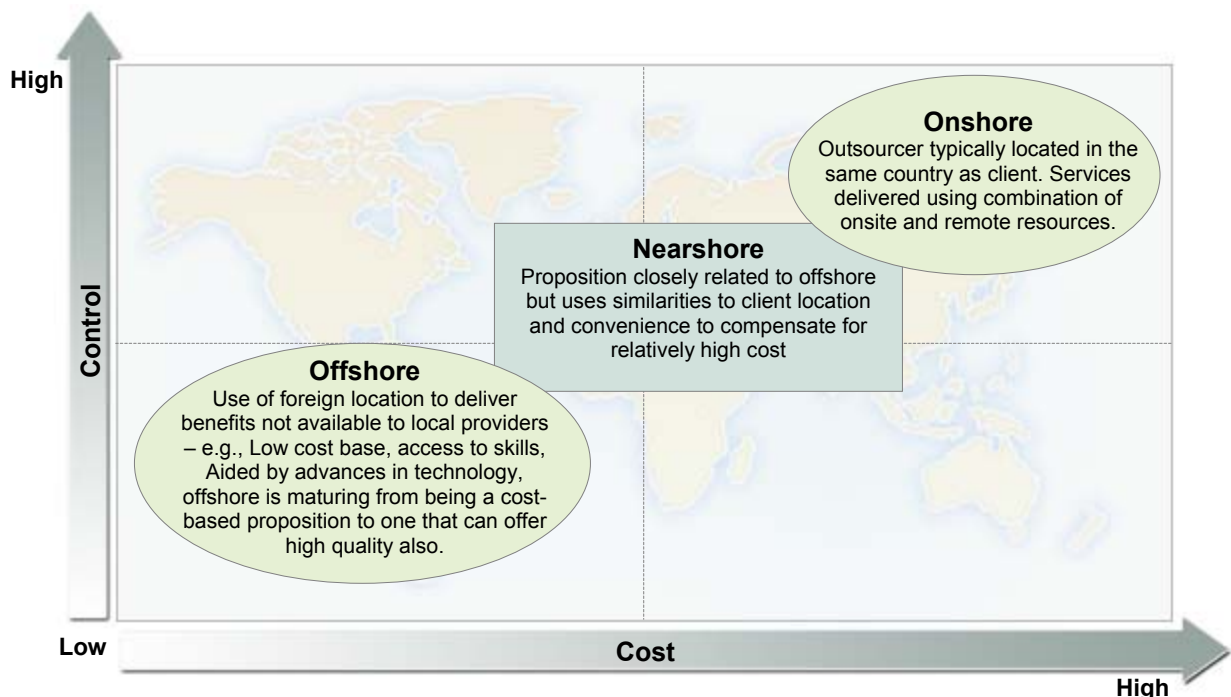
- To save on the cost of operation by transferring non-core operations to a specialized organization that is more productive than an internal team could be. Suppliers achieve this higher rate of productivity through their specialization and expertise in a particular field and through economies of scale – by supplying one type of service to a wide variety of organizations a supplier can minimize the service's marginal costs.
- To improve the quality and value of an organization's products or services by transferring its non-core operations to an organization with the specialization, best practices, and scaled infrastructure to optimally manage them.

In essence, outsourcing allows firms to focus on what they do best. Suppliers can specialize in their particular business process or function, passing the advantage of that specialization on to their clients, while the outsourcing organization can in turn focus on its core competencies. The results are improved business processes and functions, and lower costs of operation across the board.

Considering these broad objectives, in the course of this report we'll look at a selection of common outsourcing destinations, their relative advantages and disadvantages, and the complexities involved in selecting the best offshore destination.

The following figure highlights the characteristics of a firm's three outsourcing location options: offshore, nearshore, and onshore.

Figure 1: Onshore, Nearshore, and Offshore Market Characteristics



When a firm outsources operations to an onshore supplier, its cost savings potential will not likely be realized through wage rate differences. To achieve net cost savings, then, a firm must outsource to an onshore operation that offers at least one of the following capabilities:

- Very specific domain expertise
- An infrastructure that reduces the marginal cost of operations by spreading total cost across multiple clients (economies of scale)
- Operational superiority compared to internal benchmarks

Offshore suppliers generally offer the most significantly lower costs than any other outsourcing location, derived primarily from a large wage rate differential between developed onshore and nearshore markets and developing offshore markets. Of course, the benefit of lower labor costs – while the most significant – is not the only potential benefit that can affect the desirability of an offshore location. Other factors – potential benefits and potential costs – include time-zone advantages (making 24-hour operations viable, for example), ease of scaling up, geopolitical risks, data and IT security, macroeconomic climate, and governmental support (or lack thereof).

Nearshore operations, as Figure 1 demonstrates, generally fall in between onshore and offshore locations in terms of cost and control. Some of the benefits a nearshore location may offer are:

- Lower labor costs than in onshore locations – but generally not as low as in offshore locations
- Language and cultural compatibility
- An understanding of – and commonalities in – micro- and macroeconomic business and legal structures
- Nearshore locations also can leverage the benefits of trade agreements that may exist with onshore locations

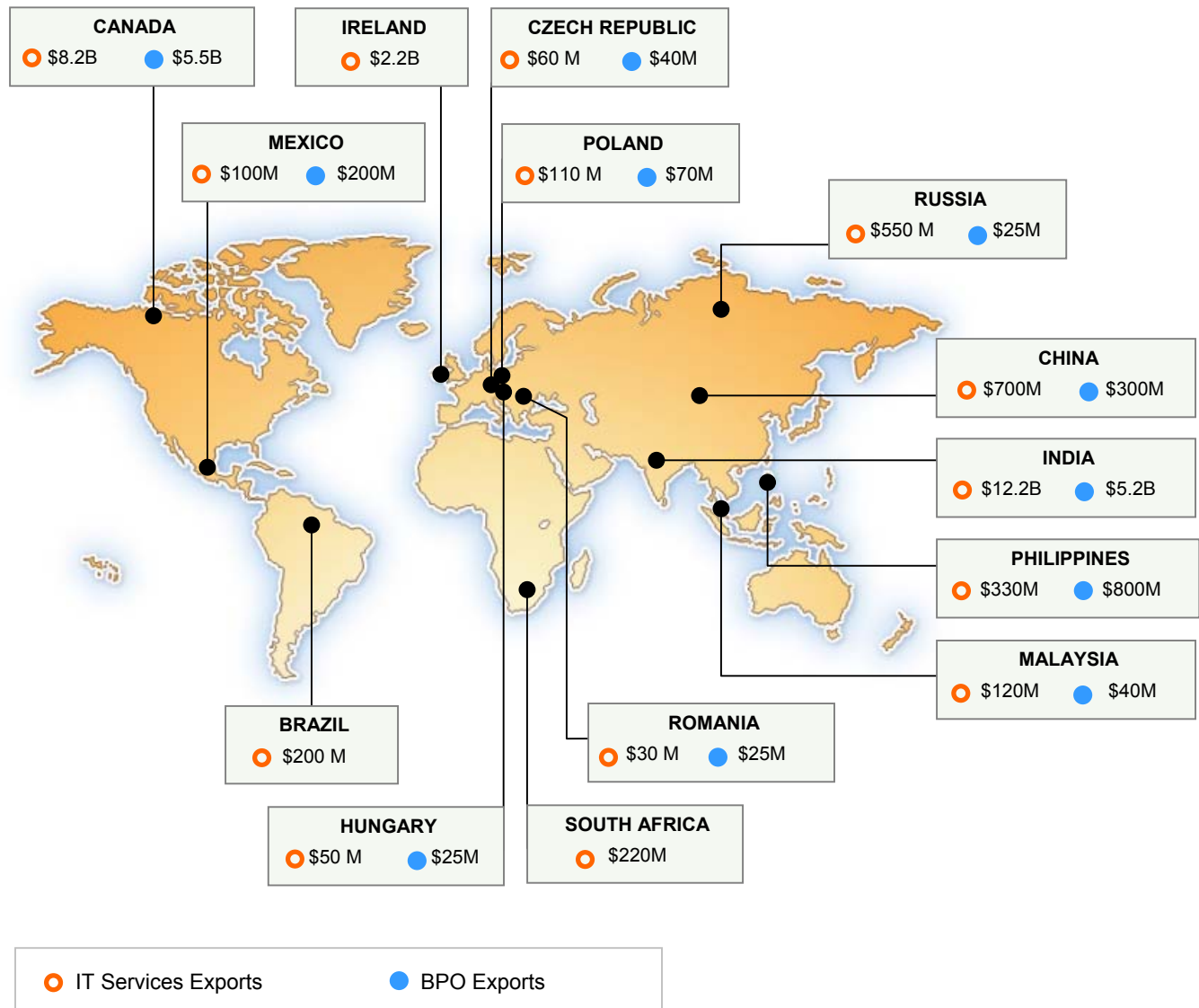
The cost and control factors of ITO and BPO operations at onshore, offshore, and nearshore locations are, as the figure and discussion above demonstrate, inversely related. The more control a firm wishes to have over its IT and BP operations, the more costly the outsourcing arrangement will be – and vice versa. The key, then, is to strike a balance – a balance that is necessarily unique to each outsourcing organization – between cost savings and operational control.

In the sections that follow, this report offers a method for striking that balance.

Services Exports of Key Countries at a Glance

2004 witnessed significant growth in services exports in countries such as India, the Philippines and Russia. At the same time countries such as the Czech Republic, Poland, Hungary and Mexico emerged from relatively insignificant markets to legitimate contenders for market share in the growing IT and Business Process outsourcing market. The following illustration provides the current market sizes of key players active in offshore outsourcing arena.

Figure 2: ITO and BPO Industry Size in Outsourcing Destination Countries, 2004



Source: neoIT

neoIT Offshore Attractiveness Index

Because of the differences between onshore, offshore, and nearshore locations, a firm must understand the specific costs and benefits associated with its particular decision about where to locate outsourced IT and BP operations. To aid in this process, neoIT has developed the Offshore Attractiveness Index, which rates each location's characteristics to generate a rank for the location as an outsourcing destination. Based on our ongoing research, relationships with clients at various stages of the outsourcing process, and a comprehensive understanding of global sourcing, we've designed the Index to help our clients make informed – and optimal – outsourcing location decisions.

The Index is based on a country's aggregated ratings on five factors that are critical to the success of an outsourcing initiative; these factors are weighted according to their relative importance in the determination of an outsourcing project's success or failure. Specifically, the process for generating the Index is as follows:

- We selected a set of countries for analysis based on the current and future potential sizes of their offshore industry.
- Tapping our extensive global sourcing experience and knowledge base, we identified the factors that most influence the success of offshoring arrangements in a given location. These five Level 1 factors are:
 - Financial Benefit
 - Service Maturity
 - People
 - Infrastructure
 - Catalyst
- Each country's Level 1 factor was derived from a set of unique sub-factors (Level 2 factors), which are described in Appendix 1. These sub-factors are weighted according to their importance in ITO and BPO – to reflect their relative influence on the corresponding Level 1 factor.
- We conducted comprehensive primary and secondary research on each of the countries analyzed in this report, diligently capturing information on each sub-factor in order to accurately measure the Index for each unique location.
- Using the country-specific data, we assessed the relative position of each country in terms of the Level 2 sub-factors.
- Based on this assessment we rated each country on a scale of 1 (low) to 5 (high) representing how well the country aligned with the Level 2 sub-factors.
- We then multiplied these Level 2 sub-factor ratings by their respective weights to arrive at a final weighted rating for each Level 2 sub-factor. The weights we assigned are based on each factor's importance to ITO and BPO respectively (each factor's weight may be different for ITO and BPO).
- We then added together the weighted Level 2 sub-factor ratings for each corresponding Level 1 factor to generate a cumulative Level 1 factor rating for each country.
- Finally, we added together each country's weighted Level 1 factor ratings for a cumulative rating for each country that represents that country's status as a global sourcing destination for ITO and BPO.

The Level 1 factors and Level 2 sub-factors that we have used to create the Index are listed in the table below along with the weights we've assigned to each Level 1 factor.

Table 1: *Components of the neoIT Offshore Attractiveness Index*

	Level 1 Factors	Level1 Weights	Level 2 Sub-factors
1	Financial Benefit	30%	<ul style="list-style-type: none"> • Labor cost • Cost advantage – operating and capital expenditures
2	Service Maturity	25%	<ul style="list-style-type: none"> • Process maturity and competency of suppliers • Industry size and growth • Security/IP protection
3	People	25%	<ul style="list-style-type: none"> • Labor pool and skill level • Language proficiency • HR • Educational system
4	Infrastructure	5%	<ul style="list-style-type: none"> • ICT & physical infrastructure
5	Catalyst	15%	<ul style="list-style-type: none"> • Governmental support • Geopolitical environment • Physical and time zone displacement • Cultural compatibility

Source: neoIT

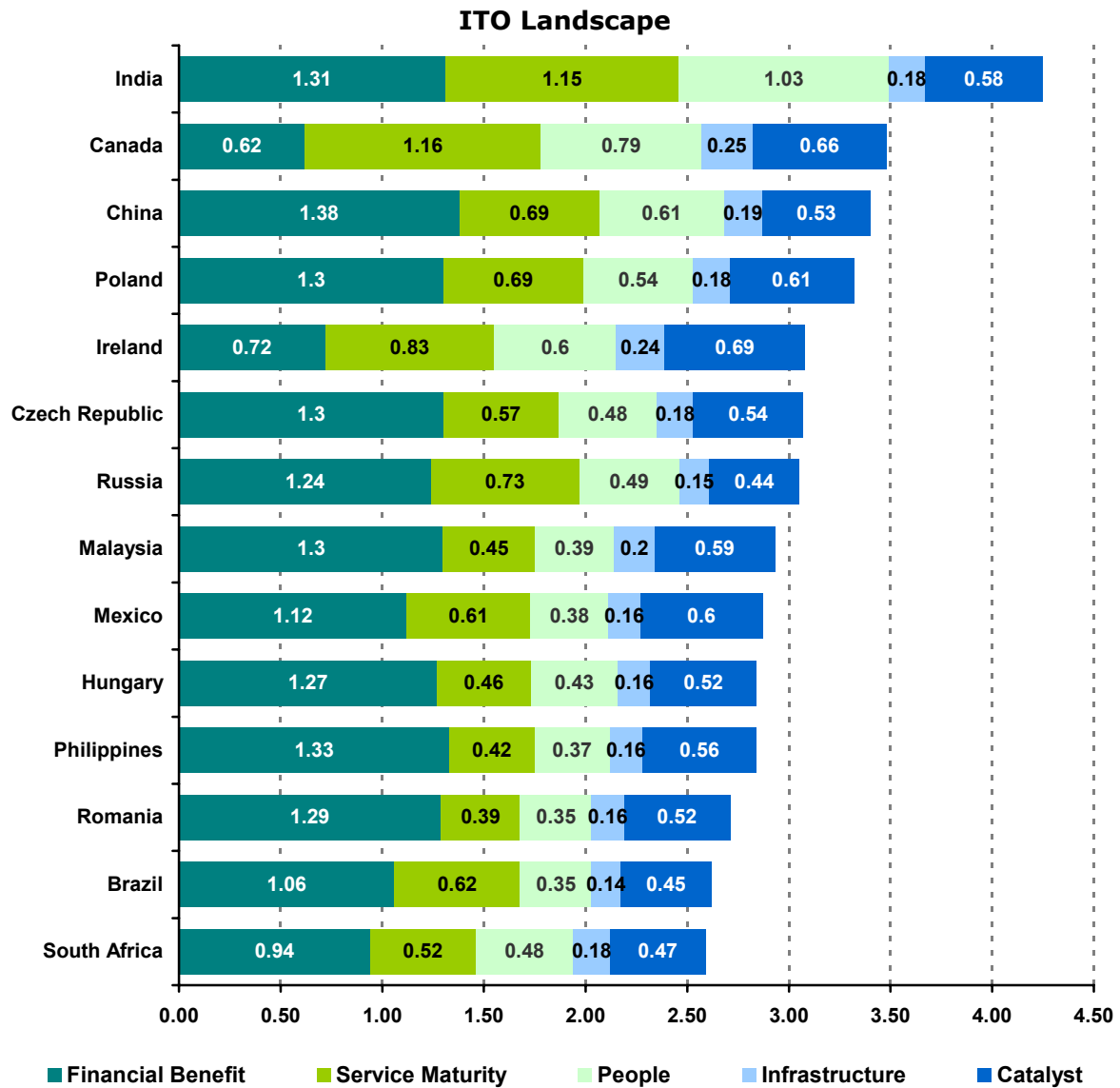
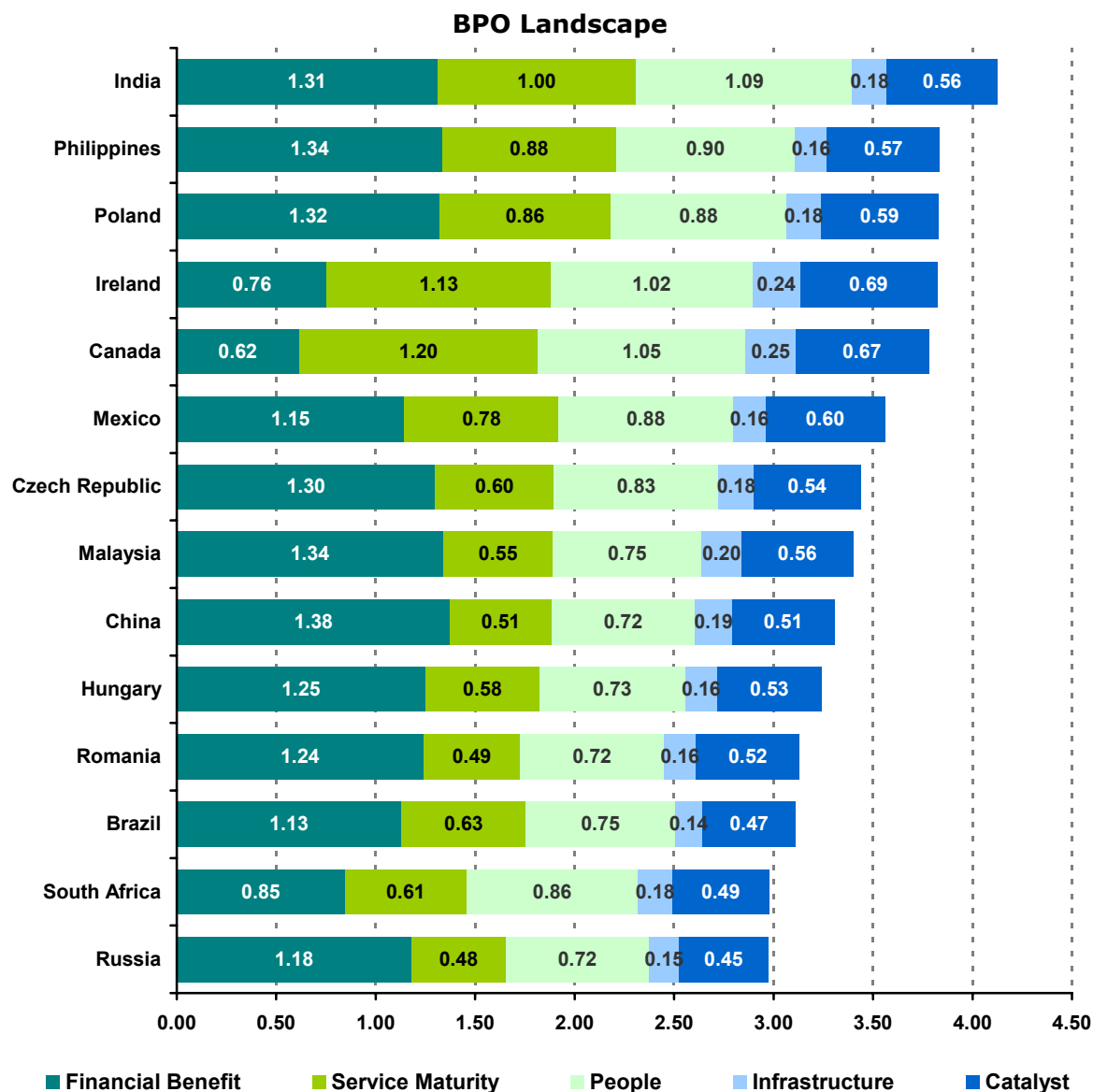
Figure 3: neoIT Offshore Attractiveness Index - ITO**Source:** neoIT

Figure 4: neoIT Offshore Attractiveness Index – BPO**Source:** neoIT

As Figure 3 and Figure 4 demonstrate, India continues to dominate both the ITO and BPO landscapes – consistently receiving high scores on all five parameters. India's dominance follows its cost competitiveness, a large, highly skilled labor pool, and suppliers' high level of service maturity. Two factors on which India does not score highly are Infrastructure and Catalyst. Depending on a firm's priorities and requirements India may represent the largest net benefit of all outsourcing destinations.*

Canada trails India quite significantly as the second-highest ranking country in ITO, and the fifth in BPO. The country's attractiveness stems from its geographical proximity to the lucrative US market, its high level of service maturity, a skilled labor force, and excellent infrastructure and business environment, though the cost-saving allure is relatively small. Still a more attractive outsourcing market than most emerging low-cost destinations, Canada will continue to lag in competition with lower-cost countries like India and, in the near future, China.

Poland's entry to the offshore supply market is relatively recent – triggered by the country's EU accession and its geographical proximity to Western Europe. In just the last couple of years, Poland has generated significant interest among WE- and US-based companies alike in its attractiveness as a nearshore/offshore destination. On the neoIT Offshore Attractiveness Index it ranks at the fourth in ITO and third in BPO. The country received a high Financial Benefit score as a result of its low ITO and BPO wage rates and low overall business operations cost. The country also benefits from its language and cultural connections with Western Europe.

Two other CEE countries that are becoming more attractive as outsourcing destinations for WE organizations are the Czech Republic and Hungary. The Czech Republic ranks sixth in ITO and seventh in BPO, while Hungary ranks tenth in both categories. Like Poland, these two countries scored well on the Financial Benefit and Catalyst factors, but they fell behind on the Service Maturity and People factors. Because they are new markets that are still relatively small, the level of service maturity in both countries is low.

Nevertheless, the Czech Republic and Hungary represent part of a growing group – including Poland – of emerging contenders in the ITO and BPO markets.

A CEE country that has not been able to develop its attractiveness to the same extent as its neighbors is Romania, which ranks twelfth in ITO and eleventh in BPO. Romania is the most cost-competitive CEE nation, though its low scores on other factors, including Service Maturity, generally overshadow that benefit. As its ITO and BPO labor pools are small and inexperienced, the country also ranks low on the People factor. The Catalyst score is low because Romania is not an EU member and because its geopolitical climate is riskier than otherwise comparable countries.

China, which is the most cost-competitive destination for both ITO and BPO, ranks highly in ITO but only moderately in BPO (its ITO and BPO rankings are third and ninth, respectively). The country's attractiveness in both ITO and BPO comes not only from its low cost but also from a large pool of skilled labor, rapidly improving infrastructure, and strong government support behind the outsourcing industry there. The country's Service Maturity factor is negatively affected by the lack of English-language proficiency within the Chinese workforce, though this disadvantage affects BPO (which relies on oral communication) much more heavily than ITO (which generally does not rely on oral communication). China also received a low score on the Catalyst factor.

* To obtain a more detailed analysis of each country's ITO and BPO landscapes, including complete discussions of each country's neoIT Offshore Attractiveness Index ratings, please contact Juliana at juliana@neoIT.com.

Traditionally considered a leader in ITO and BPO, Ireland ranks fifth in ITO attractiveness and fourth in BPO attractiveness. As an early mover in the outsourcing market, Ireland received high scores on the Service Maturity, Infrastructure, and Catalyst factors. Like Canada, Ireland is highly attractive in terms of the control factor, but not so in terms of the cost factor. As developed markets, ITO and BPO wage rates in Ireland are not significantly lower than in onshore locations. Compounded by a small labor pool, high wage rates significantly reduce the net benefit of Ireland as a nearshore or offshore destination.

Russia is a study in contrast – it ranks seventh in ITO but fourteenth (last) in BPO. Though it is a cost competitor, the country scored low on the Infrastructure and Catalyst factors due to the unpredictable political and business climates there and a general lack of adequate governmental support. The country ranks moderately high on the Service Maturity and People factors for ITO (Russia has a highly skilled IT labor pool) but ranks quite low on those same factors for BPO, due in part to the general lack of English language proficiency within the workforce there.

The Philippines, another study in contrast, is a highly attractive destination in the BPO market – ranking second behind India – though its attractiveness ranking is quite low (eleventh) in the ITO market. The country's high scores on the Financial Benefit and Catalyst factors that help its BPO attractiveness have not managed to overshadow the Philippines' low scores on Service Maturity and People factors in ITO.

Malaysia ranks eighth in both ITO and BPO. The country's moderate attractiveness follows the country's planned approach to its engagement in the outsourcing industry. Malaysia received high scores as a cost-competitive location as well as on Infrastructure and Catalyst factors, including governmental support. The country's attractiveness in these areas, however, has so far been mitigated by low scores on the Service Maturity and People factors.

Of the two Latin American countries that we analyzed, Mexico is more highly attractive. The countries (Mexico and Brazil) offer some similar benefits, including large domestic IT markets, and time zones compatible with those in the US. Those benefits are tempered, however, by moderately high wage rates in ITO and BPO as well as moderate levels of service maturity. Mexico's scores on the Infrastructure and Catalyst factors are higher than Brazil's because of Mexico's superior infrastructure, geographical proximity to the US, and greater cultural compatibility. Overall, Mexico ranks ninth in ITO and sixth in BPO while Brazil ranks thirteenth in ITO and twelfth in BPO.

South Africa ranks fourteenth (last) in ITO and thirteenth in BPO. Moderate scores overall keep South Africa's attractiveness as an offshore destination low.

Outlook for Offshore Destinations

The neoIT Offshore Attractiveness Index provides a comprehensive map of the most active ITO and BPO destinations available today. It will allow organizations to tailor an outsourcing decision to their unique needs based on a complete knowledge of what each country can offer.

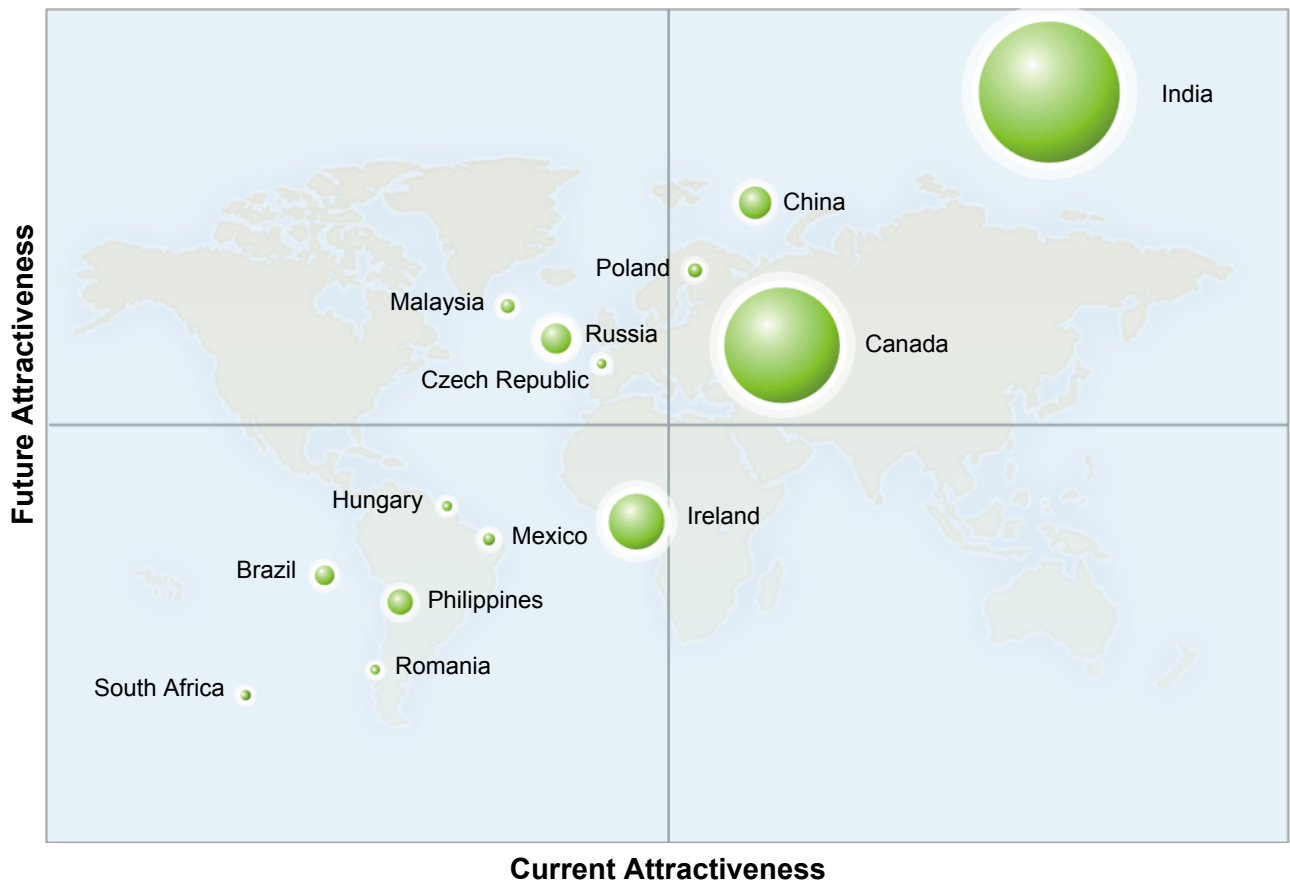
But the Index is based on the countries' current ITO and BPO landscapes – on micro and macro conditions that are continuously evolving. Not only will the size of ITO and BPO industries in each country change, so will the characteristics on which we based our five Level 1 factors.

Looking to the future, what is true today may not be true tomorrow. Based on each country's position in the outsourcing cycle, the rate of ITO and BPO growth, and the type of transitional growth that each country is experiencing in the ITO and BPO markets – along with many other social, political, and economic factors – a country's attractiveness may look quite different tomorrow than it does today.

In the section that follows we'll analyze these potential changes and what they may mean for outsourcing decisions today.

The following figures provide a visual representation of current as well as predicted future attractiveness prospects in each location. Note that the size of the circles signifies the size of the market for that destination.

Figure 5: *Evolution of Offshore Nations - ITO*



Source: neoIT

Figure 6: Evolution of Offshore Nations - BPO

Source: neoIT

The Indian outsourcing industry is currently entering a new stage of evolution. Facing increasing competition from emerging low-cost destinations in the Far East and CEE, Indian suppliers have begun to look for an advantage beyond cost competitiveness. Firms there are working to build capabilities and competencies to increase their position on the value ladder. Most companies are focusing on improving value-added at all skill levels, from low-end maintenance to high-end IT consulting in ITO and Knowledge Process Outsourcing in BPO.

Indeed, the leading Indian suppliers have global plans – setting up offices across the world and acquiring other companies overseas. While it is certainly capable of global operations, the industry must take care to maintain industry-specific knowledge and a presence near its target markets.

Domestically, top-tier Indian companies are leveraging their superior project management skills, delivery capabilities, and broad service portfolios to attract lucrative contracts. With middle-tier companies struggling to catch up to these flourishing top suppliers, we expect to see significant mergers and acquisitions activity among middle-tier business aiming for their own edge.

Secondary education in India is increasingly targeted toward the IT industry, working to ensure the continued availability of a large skilled labor pool. Nevertheless, the high demand for skilled labor in the Indian outsourcing market threatens to shrink the labor supply-demand gap that has thus far kept Indian wage rates so low.

While domestic competition and growth could eventually dampen India's status as an attractive outsourcing destination, India will continue to be a leader among outsourcing destinations for a long time to come due to a proven ability of suppliers there to evolve and the existence of an excellent outsourcing ecosystem.

The only country with the potential to challenge India's dominance of the ITO and BPO industries is China. But its potential is still small. Though the country boasts a large pool of inexpensive, skilled labor and a vibrant domestic IT industry, its international activity has been minimal (with the exception of Chinese suppliers' success in the Japanese market). More importantly, Chinese suppliers lag miles behind their Indian counterparts in process maturity and project management capabilities. Decades of isolation have made English language proficiency uncommon in China, largely depriving the country's suppliers of access to lucrative US and UK markets. Though the Chinese government has put its force behind a drive to build the ITO and BPO markets there, it's unlikely that the country will be able to catch up to India in the near future. Nevertheless, China is a favorite destination for low-end volume-driven IT jobs and BPO jobs that don't involve oral communication.

The heightened ITO and BPO activity in China is reverberating through Far East countries like the Philippines and Malaysia. Growth in the Philippines is concentrated in the BPO market; the country's colonial past and strong cultural ties with the US foster a high rate of English language proficiency and enable suppliers to better understand the US business process – thereby becoming more effective service providers. The country's ITO market, in contrast, remains largely unattractive as a result of small pool of appropriately skilled labor and a general lack of IT project management skills.

Malaysia, too, hears echoes from China's growing outsourcing industry. As an emerging nation with strong government support and focused planning, Malaysia is building an ecosystem that the outsourcing industry will thrive in. The country's governmental policies, infrastructure, educational curriculum, and business environment are attuned to the needs of the outsourcing industry and prepped for growth – though we predict that growth in the ITO markets will be more significant than in the BPO markets due to a greater acceptability of IT jobs among the local workforce. Malaysia will be a major contender in the outsourcing industry in the near future.

Another group of emerging contenders in the ITO and BPO markets come from the CEE. Countries like Poland, the Czech Republic, and Hungary have benefited – and will continue to benefit – immensely from accession into the EU. In part because of their membership, these countries are seen in a preferred light, in a sense, by other EU members that view CEE countries as attractive nearshore outsourcing destinations. Indeed, the attractiveness of CEE countries (namely Poland, the Czech Republic, and Hungary) as nearshore destinations for WE firms is precipitated by their close cultural ties, compatible time zones, and common language proficiencies – all advantages that countries like India and China cannot offer.

Of the three CEE countries mentioned, all are cost competitive and have excellent educational systems that breed a skilled workforce. Poland leads in ITO and BPO activities, as it has a larger labor pool and a higher level of service maturity than the other two countries. In fact, the relatively small labor pools in the Czech Republic and Hungary could make scaling up in the future difficult. Until that difficulty presents itself, however, these countries will continue to be attractive destination for both ITO and BPO operations.

Russia continues to present pockets of growth opportunity in the ITO and BPO markets. While the BPO industry is largely absent from the country now, Russia is an attractive

location for small, high-end, complex IT operations. The country's geographic distance from most onshore locations, its language incompatibility, and its relative lack of project management and service delivery capabilities have kept the outsourcing industry there muted, despite Russia's highly skilled labor pool (the one reason the country is attractive for small, complex projects). Combined with an unfavorable geopolitical climate, legal complexities, and widespread corruption, these disadvantages will keep Russia's ITO growth moderate and its BPO growth quite low.

The two developing countries active in the outsourcing industry, though they have similar pasts, have divergent futures. Both Canada and Ireland are early movers, possess a high level of service maturity, offer a wide range of services, have excellent infrastructures, and skilled workforces. They are both also not cost competitive and face increasing pressure from low-cost suppliers in nations like India.

As service maturities improve in low-cost countries, Canada and Ireland's narrowing advantages will slim even further. For Ireland, the future of the outsourcing industry is doubtful. But Canada may still be able to leverage its unique advantage: geographical proximity to the US.

The ITO and BPO industries in Mexico and Brazil have a lot of potential for expansion, especially in the offshore BPO market. With large labor pools, room to scale up, large domestic markets, and Spanish language proficiency our outlook for these two countries is positive provided they continue to work to build their industries.

South Africa has a vibrant domestic BPO sector and a skilled labor pool with strong English proficiency. But the industry is congested with a large number of unorganized players that lack scale and maturity and the government has been largely unresponsive to industry needs (though those needs are rarely voiced coherently).

Telecommunications deregulation and price decreases in the country may precipitate a growth change – which, if combined with policy and infrastructure support, could lead to South Africa's emergence as a moderately attractive offshore destination. If such a turnabout fails to materialize, however, South Africa's disadvantages – including a relatively high wage rate – make the future of the country's outsourcing industry doubtful.

The following table highlights each country's strengths and weaknesses, growth opportunities and threats to growth, as well as neoIT's predictions of the country's future attractiveness, and any activities that the country must engage in for growth to materialize.

Table 2: Growth Opportunities, Threats, and Future Prospects

	Strength	Weakness	Opportunity	Threat	Future Attractiveness (ITO)	Future Attractiveness (BPO)	Necessary Activities
India	<ul style="list-style-type: none"> • Huge skilled labor pool • Superior service maturity • Strong governmental support • Cost competitiveness 	<ul style="list-style-type: none"> • Infrastructure • Bureaucracy 	<ul style="list-style-type: none"> • Move up the value chain • Expand into countries other than US 	<ul style="list-style-type: none"> • Emerging low-cost nations • Unstable geopolitical situation • Rising costs 	High	High	<ul style="list-style-type: none"> • Maintain a continuous supply of skilled labor
Canada	<ul style="list-style-type: none"> • Geographical proximity to US • Excellent business environment • Excellent supplier capabilities 	<ul style="list-style-type: none"> • High wage rates 	<ul style="list-style-type: none"> • Further penetrate US market using geographical proximity as leverage • High-end niche jobs 	<ul style="list-style-type: none"> • Increasing service maturities and capabilities of low-cost nations 	Moderate	Moderate	<ul style="list-style-type: none"> • Maintain attractiveness as nearshore location for US firms • Develop high-end niches for sustenance
China	<ul style="list-style-type: none"> • Very cost-competitive • Large labor pool • Strong government support 	<ul style="list-style-type: none"> • Low service maturity • Lacks of English proficiency • Negative perception of geopolitical risk; generally low country image 	<ul style="list-style-type: none"> • Further penetration into Japanese market • Penetration into English-speaking countries • Non-voice BPO 	<ul style="list-style-type: none"> • Increasing salary levels that may dilute low-cost advantage 	High	Moderate	<ul style="list-style-type: none"> • Maintain cost-attractiveness • Improve service maturity • Develop English language proficiency
Poland	<ul style="list-style-type: none"> • Proximity to Western Europe • EU membership • Compatible time zones • Cultural compatibility 	<ul style="list-style-type: none"> • Lack of service maturity • Comparatively smaller labor pool 	<ul style="list-style-type: none"> • Lucrative WE market 	<ul style="list-style-type: none"> • Other CEE nations 	High	High	<ul style="list-style-type: none"> • Build up size and competency of labor pool • Differentiate capabilities from other countries'
Ireland	<ul style="list-style-type: none"> • High level of service maturity • Highly skilled labor pool • Excellent infrastructure • Cultural compatibility 	<ul style="list-style-type: none"> • High cost of labor • Labor demand/supply gap 	<ul style="list-style-type: none"> • High-end niches 	<ul style="list-style-type: none"> • Low-cost countries in the region 	Low	Low	<ul style="list-style-type: none"> • Position for high-end niche jobs • Improve labor situation
Czech Republic	<ul style="list-style-type: none"> • Proximity to WE • Language and cultural compatibility • Cost competitiveness 	<ul style="list-style-type: none"> • Low-level maturity 	<ul style="list-style-type: none"> • Further penetration into WE market 	<ul style="list-style-type: none"> • Other CEE nations 	High	High	<ul style="list-style-type: none"> • Build up labor pool • Enhance service maturity • Differentiate capabilities from other countries'
Russia	<ul style="list-style-type: none"> • Low wage rates • Highly skilled ITO labor pool • Ability to carry out complex ITO projects 	<ul style="list-style-type: none"> • Lacks of project management skills • Unfavorable geopolitical situation • Lack of English or WE language proficiency 	<ul style="list-style-type: none"> • High-end niche IT jobs • Technical non-voice BPO 	<ul style="list-style-type: none"> • Brain drain • Government apathy 	Moderate	Low	<ul style="list-style-type: none"> • Maintain high-end niche activity • Enhance policy support for the industry • Develop English and WE language proficiencies

Malaysia	<ul style="list-style-type: none"> • Strong governmental support • Excellent business environment • Cost competitiveness 	<ul style="list-style-type: none"> • Low service maturity • BPO jobs not popular 	<ul style="list-style-type: none"> • Leverage as firms' secondary location to spread risk 	<ul style="list-style-type: none"> • Small labor pool 	High	Low	<ul style="list-style-type: none"> • Build up labor pool • Enhance service maturity • Differentiate capabilities from other countries'
Mexico	<ul style="list-style-type: none"> • Geographical proximity to US • Large labor pool • Spanish language proficiency 	<ul style="list-style-type: none"> • Lack of English language proficiency • Low maturity • Not very cost competitive 	<ul style="list-style-type: none"> • Leverage nearshore opportunities with US • Other Spanish speaking countries 	<ul style="list-style-type: none"> • Other emerging Latin American countries 	Moderate	Moderate	<ul style="list-style-type: none"> • Enhance English language proficiency • Improve policy support for the industry • Enhance attractiveness as nearshore location for US firms
Hungary	<ul style="list-style-type: none"> • EU membership • Language and cultural compatibility 	<ul style="list-style-type: none"> • Small labor pool • Low service maturity 	<ul style="list-style-type: none"> • Penetrate the WE markets, particularly Germany and France 	<ul style="list-style-type: none"> • Other neighboring countries 	Moderate	Moderate	<ul style="list-style-type: none"> • Build up labor pool • Focus on niche markets for sustenance
Philippines	<ul style="list-style-type: none"> • Cost competitiveness • Excellent English language proficiency 	<ul style="list-style-type: none"> • Low maturity for ITO • Labor pool not highly skilled in ITO • Unfavorable geopolitical situation • Lacks Infrastructure 	<ul style="list-style-type: none"> • Leverage existing relationships with BPO players to get ITO deals • Penetrate English speaking markets other than US 	<ul style="list-style-type: none"> • Emerging low-cost nations (especially for non-voice projects) 	Moderate	High	<ul style="list-style-type: none"> • Improve service maturity • Develop more highly skilled labor pool
Romania	<ul style="list-style-type: none"> • Cost competitiveness • Cultural and language compatibility 	<ul style="list-style-type: none"> • Very small labor pool • Low maturity 	<ul style="list-style-type: none"> • Likely accession into the EU in 2007 	<ul style="list-style-type: none"> • Neighboring countries have a head start 	Low	Low	<ul style="list-style-type: none"> • Build up labor pool • Develop niche markets for sustenance • Integrate with regional economy
Brazil	<ul style="list-style-type: none"> • Large labor pool • Compatible time zone • Vibrant domestic ITO and BPO markets 	<ul style="list-style-type: none"> • Lacks English proficiency • Low service maturity 	<ul style="list-style-type: none"> • Spanish language projects in US and Europe 	<ul style="list-style-type: none"> • Other emerging Latin American destinations 	Moderate	Moderate	<ul style="list-style-type: none"> • Develop English proficiency • Develop export orientation
South Africa	<ul style="list-style-type: none"> • Superior English language proficiency • Time zone compatibility with WE 	<ul style="list-style-type: none"> • High wage rates • Education system incompatible with ITO • Low maturity 	<ul style="list-style-type: none"> • UK market 	<ul style="list-style-type: none"> • High cost structure 	Low	Moderate	<ul style="list-style-type: none"> • Improve education system for better supply of human resources

Source: neoIT

neoIT Competency-Destination Matrix

A country's macro characteristics – labor costs, governmental support, infrastructure, and the other factors we've discussed so far – don't tell the whole story of a country's suitability for any given firm's offshore or nearshore operations. To get the whole story we'll have to consider micro characteristics as well – those factors that individual suppliers have much more control over.

The following table details each country's suitability on a variety of business factors. The circles indicate that the corresponding country's suppliers possess the given competency.

Table 3: ITO Competency-Destination Matrix

ITO Functions														
	Brazil	Canada	China	Czech Republic	Hungary	India	Ireland	Malaysia	Mexico	Philippines	Poland	Romania	Russia	South Africa
CAD	●	●	●	●	●	●	●	●	●	●	●	●	●	●
QA/Testing			●	●		●	●						●	
Application Management & Support	●	●		●	●	●	●		●	●	●		●	
IT Consulting		●				●	●				●			
System Integration/ EAI	●	●	●			●	●		●		●		●	
Packaged S/W Implementation		●				●	●	●					●	
S/W Localization			●	●	●				●			●		
Infrastructure Management Services	●	●				●			●					

Technology Domains														
e-business	●	●				●	●				●		●	
Embedded Technology			●			●							●	
Multimedia & Animation		●	●	●	●	●	●	●	●	●	●	●		●
Web-Based Applications	●	●	●			●	●	●		●	●	●	●	●
Wireless Technology		●	●			●	●						●	
EA (ERP, CRM, SCM, DW/BI, KM)		●		●	●	●	●				●			

Source: neoIT

Table 4: BPO Competency-Destination Matrix

	BPO Functions													
	Brazil	Canada	China	Czech Republic	Hungary	India	Ireland	Malaysia	Mexico	Philippines	Poland	Romania	Russia	South Africa
Sales/ Customer Care (Call Center)														
Contact Center														
Claims Processing														
F&A														
HR														
Payroll Processing														
KPO														
Medical Transcription														
Technical Support														

Source: neoIT

Conclusion

Outsourcing can be a very beneficial arrangement as it allows each firm – both the client organization and the service provider – to do what it does best. But, as we've said before, not all outsourcing locations are created equal. Nor do one location's benefits mean the same to one firm as to another.

As we've shown in this report, cost savings and operational control are usually inversely related. A firm's optimal outsourcing location will depend on an appropriate balance between that cost-saving potential and the level of operational control a firm desires.

But a destination's cost-saving potential and the level of operational control it allows a client are not the only factors that determine the optimality of any given outsourcing destination to a particular client. Other important determinants, which we've discussed in detail in this report, include the financial benefit that a destination can offer; the destination's level of service maturity; its labor supply; infrastructure; and other factors such as the level of governmental support, cultural and language compatibility, and geographical proximity.

Of course, a destination's current level of attractiveness for ITO and BPO activities is only part of the picture; each country's future potential is also an important factor to consider when determining a firm's optimal outsourcing destination. So we've included in the report educated predictions of each destination's future status on each of the attractiveness factors we've considered.

In the end, the optimal outsourcing destination for any firm will depend on finding a successful match between its unique requirements and the services each destination may offer. This report provides firms a way to measure at least half of that equation; it provides a detailed qualitative analysis as well as quantitative measurements of each country's attractiveness as an outsourcing destination.

For a more detailed analysis of each country's ITO and BPO landscapes, including complete discussions of each country's neoIT Offshore Attractiveness Index ratings, please contact:

Juliana Gidwani

Marketing Manager

San Ramon, California

juliana@neoIT.com

925-355-0557

www.neoIT.com

Appendices

APPENDIX 1: EXPLANATION OF LEVEL 2 SUB-FACTORS

1. Financial Benefit

- **Labor Cost:** Cost savings, generated primarily from lower labor costs in offshore locations, is the single most significant driving factor of an offshoring decision – making a reliable assessment of the factors influencing a country's labor costs an important part of the decision-making process.

Labor costs are affected primarily by macroeconomic factors, including a country's gross national product, trade balance, monetary and fiscal policies, and the general economic climate and structure. While not within the control of an outsourcing company or its potential supplier, these factors are at least easily measurable.

The advantage of this kind of informed outsourcing decision can be substantial: for a typical US outsourcing organization the labor-cost difference could be as much as 70 percent in countries like India or China and as much as 40 percent in countries like Ireland or Canada.

- **Operating and Capital Expenditures:** While direct-cost savings resulting from lower wages in an offshore location can generate substantial financial benefit for an outsourcing company, this benefit must be weighed against the additional costs associated with a move to an offshore location. Typical costs may include set-up, the erection of physical infrastructure, travel, communications and networks, rental costs for office space, cost of utilities, and many other costs that may or may not be very apparent. Just as wage rates differ greatly among offshore destinations, so do operating and capital expenditures – they're usually most directly related to the existing infrastructure in the offshore location.

Together, the benefits of lower wages and the costs of setting up and maintaining offshore operations determine the net financial benefit of an outsourcing decision.

2. Service Maturity

- **Process Maturity/Supplier Competency:** Cost savings may be the most significant outsourcing motivator, but the ability of the offshore location's suppliers to get the job done right is not unimportant. Differences in this ability – in competency – stem in part from a country's educational system and the existence of related industries that provide talent development as well as an available skilled labor pool.

Relevant technical skill is one component of service maturity. Suppliers that do not have access to employees with relevant skills can alternatively invest in in-house training programs and develop partnerships with universities and individual professors for access to more technically advanced capabilities.

Experience is also an asset. The employees who have worked on similar projects or with similar processes in the past have developed some degree of expertise in the domain and are thus able to be more productive – which means larger gains for the outsourcing organization. Aware of the value of experience, many suppliers encourage employees to seek certifications like CMM Level 5 and BS 7799 – as an example of their skill level and service maturity.

- **Industry Size and Growth:** Industry size – which refers to both domestic IT and BP and export ITO and BPO markets – reflects generally how long suppliers have been engaged in industry activity in a given country and how successful they've been.

The size of a country's ITO and BPO export industries can affect its attractiveness in one of two ways: a country that has a highly developed market will likely have higher wage rates than a country with a less developed market, though the less developed market will allow an outsourcing organization fewer quality and control assurances.

The size of a country's domestic IT and BP industries can also be important, as the presence of a large and competitive domestic industry can help foster the development of a successful outsourcing industry. The larger the domestic industry, the better prepared the infrastructure will likely be to aid in the development of the outsourcing industry.

- **Security and IP Protection:** Security is always a concern. But the less control a company has over its operations, the greater a concern it becomes. Because nearshore outsourcing and, to a greater extent, offshore outsourcing involve a loss of some measure of operations control security is a greater concern than it is onshore. Unfortunately, the importance of data security is understood – and security measures implemented – at a slow rate. Piracy is very common in most countries that exist as offshore outsourcing destinations. With the exception of developed nations – most not outsourcing destinations – there are few laws (and fewer that are rigorously enforced) that cover intellectual property. However, just as suppliers have come to understand the importance of data security, governments are beginning to realize the necessity of legal IP protection. Of course, if suppliers move slowly, governments move more slowly – it will likely be several years before legal IP protections are operational in many countries.

3. People

- **Labor Pool:** While the number of people with the skills required to work in ITO or BPO jobs is one factor that an outsourcing firm looking for a long-term offshore engagement must consider, the number of people actually working in ITO and BPO industries may be more important. In China, for example, the size of the workforce with skills relevant to the ITO and BPO industries is far greater than it is in India though the number of people actually working in the industries in India is far higher.

The availability of labor also affects the wage rate – the smaller the gap between the supply of labor and its demand, the more able are employees to command higher wages. This is an important issue in CEE countries and Ireland as their ability to compete with low-cost countries is driven down by increasing wages.

- **Language Proficiency:** While language proficiency is probably the most important aspect of communication, the ability to effectively communicate in a business environment also depends on accents, the use of colloquialisms, and even body language.

In the ITO industry, that the service provider and client have a common language is critical only when a high degree of interaction between the two parties is necessary (in situations, for example, where project requirements are loosely defined). In the BPO industry, in contrast, that the service provider and client

have a common language is almost always critical, especially in voice-based BPO markets (including, for example, customer contact, employee support, telemarketing, and collections).

But language proficiency is not just about English. A demand for non-English proficiency – to address specific countries and/or communities also exists. For example, voice-based BPOs in Mexico address the Spanish speaking population in the US while CEE countries like the Czech Republic, Hungary, and Poland have employees to deal specifically with German-speaking customers.

- **HR:** BPO units across the globe are affected by high rates of attrition, for reasons that range from the repetitive nature of the work to an increasing number of new set-ups (poaching from competitors is common) and pursuit of higher education. The cost of high rates of attrition include recurring recruitment and training costs, slower advancement of process maturity, loss of continuity, and productivity loss.

Another human resource factor is specific training such as accent neutralization and the development of cultural compatibility that may be necessary to attract outsourcing organizations.

- **Educational System:** An offshore destination's educational system reflects the long-term potential of the outsourcing industry there – as educational investments are designed to generate results in the long term. Specifically, the number of graduates and those graduates' specialties can indicate how well the country's skilled labor pool will develop and what those specific skills will be. The quality of the educational system in ITO/BPO-relevant fields is also important.

Non-formal training institutions – like NIIT, Aptech, and SSI in India – can also contribute significantly to a growing supply of skilled labor within a country.

4. Infrastructure

- **Information and Communications Technology (ICT) and Physical Infrastructures:** A communications infrastructure that enables both access to and efficient use of high-speed digital communications is an essential component of the attractiveness of a given location for both ITO and BPO. Generally such infrastructure is found in countries with a deregulated telecommunications network.

Equally important (though often taken for granted) is a continuous supply of electrical power. Countries with superior infrastructure (Canada, Ireland, Malaysia, some countries within CEE, and the Philippines, for example) have enormous leverage in their ability to ensure reliable infrastructures.

Where adequate infrastructures don't exist suppliers can address the shortcomings by investing in private satellite and microwave communications networks, accessing international communication networks, and bypassing unreliable local plants. In India, for example, many suppliers have counterbalanced the country's weak infrastructure by investing sufficient capital in private networks to ensure the continuity of electrical power and high-speed digital communications necessary to support their ITO and BPO activities.

5. Catalyst

- **Governmental Support:** Governmental support of industry is important – especially in terms of developing infrastructure and protecting intellectual property, as well as providing investment and tax incentive and subsidies, and facilitating the process of starting a business.
- Most local governments in outsourcing destinations have realized this importance. Some have backed ITO/BPO industries by setting up task teams to offer advice and help develop growth strategies. Nodal agencies may also be important as liaisons between industry and the government. Growth of ITO and BPO industries in many countries – including India, Ireland, and Malaysia – may be attributed in part to the support provided by government either directly or through nodal agencies and industry associations.
- **Geopolitical Environment:** A country's geopolitical environment is another important component of the Infrastructure factor. A high level of geopolitical risk – a country's susceptibility to political, social, and/or economic instability – can render the country's business climate inhospitable. Other geopolitical factors that are important to consider include a country's memberships in trade and/or other international associations – as a high degree of openness reflected by those types of memberships is desirable.
- **Physical and Time Zone Displacement:** Physical distance decreases the opportunity for personal interaction, direct observation, provider management, and contract enforcement – though any outsourcing arrangement inherently involves a physical distance greater than is usually common within organizations.

Not directly related to distance, time zone displacement affects an organization's opportunity for real-time collaboration though it can also positively impact an organization by allowing around-the-clock operation.

- **Cultural Compatibility:** Cultural compatibility can affect language, communication, and inter-personal relationships. Consequently, when a high degree of value-added interaction is required, cultural differences may be the most significant factor determining a firm's outsourcing destination.

In high-risk, complex ITO development projects where a high degree of trust is required, cultural compatibility can accelerate the trust-building process. For voice-BPO operations, which often involve unstructured, unscripted interactions, culture affinity is especially essential.

In any nearshore or offshore location, a firm's investment in compatibility-enhancing activities can help bridge the culture gap and enhance the bottom line.

More information about the offshore outsourcing industry can be found within neoIT's research center at www.neoOffshore.com. For more details about neoIT's offshore advisory and management services, please contact:

Juliana Gidwani

Marketing Manager
San Ramon, California
juliana@neoIT.com
925-355-0557
www.neoIT.com

No part of this report may be reprinted/reproduced without prior permission from neoIT.

neoIT Global Offices**neoIT Global Headquarters**

2603 Camino Ramon
Ste. 200
San Ramon, CA 94583
Telephone: 925.355.0557
Facsimile: 925.355.0558

Asia Headquarters

210, Bellary Road
Upper Palace Orchards
Bangalore 560080 India
Telephone: +91 80 23610371
Facsimile: +91 80 23610375

neoIT Philippines

8/F Pacific Star Building
Senator Gil Puyat Ave. cor Makati Ave.
Makati City, Metro Manila, 1200, Philippines
Telephone: +63 (2) 811-5519
Facsimile: +63 (2) 811-5545

Contributors

N Roshan

Senior Analyst

Sabyasachi Satpathy

Research Director

Sambit Kumar Panda

Analyst

Editors

Atul Vashistha

CEO

Avinash Vashistha

Managing Partner

Eugene M. Kublanov

VP, Corporate Development

