



# GLOBAL SOURCING ISSUES PAPER

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## INTRODUCTION

Increasing attention is being paid to the movement of Information Technology (IT) and IT-Enabled Services (ITES) work, such as call-centers, from one country to another. The destination country receiving the most attention is India, though China, the Philippines, Russia and the Ukraine are all countries, among many others, seeking to capitalize on the phenomena.

According to Gartner, it is expected that ITES services performed in a country other than the country of origin will grow from US\$1.3 billion in 2002 to US\$ 24.3 billion in 2007, and will represent 14 percent of the total ITES market by 2007. These figures do not include IT direct services such as software development. India's revenue from ITES will grow from just under US\$1 billion in 2002 to US\$ 13.8 billion in 2007, estimating India's share of supply to be 57 percent of the global market.<sup>1</sup>

The National Association of Software and Service Companies (NASSCOM), estimates worldwide ITES spending at US\$712 billion. The Americas clearly dominate the market accounting for 63% of worldwide ITES spending. Asia-Pacific accounts for merely 15% of worldwide ITES spending. However NASSCOM estimates that by 2006 Asia-Pacific will be the largest growth market, with growth of 14.7% (compound annual growth rate).

It is clear that these markets are both large and growing. Increasingly, concern is being expressed by many individuals, organizations, and governments that work being performed in a country other than its origin is detrimental to the workforce and the economy. This paper will identify the issues from what is becoming known as the offshore outsourcing phenomenon and indicate possible future work for the WITSA.

## DEFINITIONS

**Outsourcing** is the process of contracting to have work done outside a business or agency that could be done by the organization itself. The work can either be work that is currently being done by the organization, or it may be work that is new to the organization.

**Offshoring** occurs when the outsourced work is performed outside the home country.

This paper focuses on non-manufacturing services work. The range is quite broad, however, from information technology services and consulting to software programming; financial services such

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<sup>1</sup> Scholl et al, 2003, *India Will Generate \$13.8 Billion From Offshore BPO Exports in 2007*

as tax returns, mortgage application review and check processing; architectural services such as compliance of architectural drawings with local building codes; health care such as reading x-rays or other imaging analysis; and call-centers.

## **DRIVERS**

For the ICT industry and its customers, the primary driver for offshore outsourcing is the reduction of costs. Some estimate that costs can be reduced by 40 percent and sometimes by as much as 70 percent for offshore destinations such as India, China and the Philippines. These cost savings are directly attributed to reduced labour and other business costs.

A snapshot of average base salaries for programmers around the world shows that a US programmer cost on average approximately US\$ 63,350 in 2002, substantially more than many of their overseas counterparts. A professional of similar skills costs US\$ 40,000 in Australia, US\$ 5880 in India, US\$ 6564 in the Philippines, US\$ 7200 in Malaysia and US\$ 8952 in China.

In some cases, like for China, IT and ITES outsourcing may assist global or overseas firms to establish a presence in the region of the outsourcer (e.g. China or Asia), hence assisting those companies to expand their businesses globally and benefiting their home economies.

In the particular case of India, its success first in software development and now in ITES is driven by a number of additional advantages. A focus on demonstrating quality services has proven to be a significant factor in gaining market share. According to NASSCOM, the Indian software industry continues to receive international recognition for its quality in software development. Out of the top 300 companies, more than 216 have already acquired ISO 9000, SEI or other certification. As far as SEI CMM (Software Engineering Institute Capability Maturity Model) Level 5 is concerned, the Indian software industry emerges as the global leader, having 50 companies certified with SEI CMM Level 5 out of a global total of 74. Russia is also in a very fast process of overpassing the gap in quality assurance, with the first European certifications to the new SEI CMMI Level 4 and 5.

Additionally, the success of the Indian software companies such as Infosys, Wipro and TCS, means they now have significant financial resources, able to invest in expanding their market reach and capability as has been evidenced with the expansion into the U.S. and Australia of many Indian software firms. Also, the number and quality of graduates with IT related skills is of great benefit. Each year, India's tertiary education system produces more than 130,000 highly skilled graduates. A similar pool of highly educated talented people graduate from Universities in Russia. A strong move towards higher education in software development is being undertaken by China, Philippines, Singapore and other Asian nations.

The role of government in the success of the software industry in India has been secondary to the drive and initiative of individual entrepreneurs, but has nevertheless been significant. The investment in education has been substantial, as has the investment in infrastructure (especially low cost, high speed, satellite-based communications) for the export processing zones in such centres as Bangalore, Puna and Chennai. As an added incentive, export income generated in export zones is generally tax-free.

Most developing countries in Asia and elsewhere are trying to emulate India's success. The Philippines is already successful and other countries such as China, Vietnam, Bangladesh and Sri Lanka are making significant investments in education and infrastructure in an effort to obtain offshore business.

Building on a strong R&D foundation, transitional; economies, such as Russia, Ukraine and Belarus, have demonstrated strong capacity for addressing complex technical issues. A

Altogether, Eastern Europe has become a strong IT region with broad potential for providing global outsourcing services, particularly in the “near-shore” IT outsourcing to Europe.

Not all countries entering the offshore outsourcing market are entering at the low-end. The Ukraine, for example, is attempting to leverage its considerable project management and high-end skills obtained through years of doing work for the Russian military.

In the end, however and particularly in the commercial sphere, the customers of IT services are under intense pressure to reduce costs in order to be competitive in the global market. IT service companies, in turn, are being driven to reduce their costs by sourcing globally in order remain competitive in today’s marketplace.

## **INHIBITORS**

While there are strong cost arguments in its favour, offshore outsourcing may expose customers to some risks, including:

- cultural misunderstandings;
- project management difficulties;
- infrastructure failures;
- security and privacy considerations;
- language barriers;
- political factors;
- inadvertent knowledge transfer; and
- contract and liability issues in foreign legal system.

These inhibitors will not stop the use of global IT outsourcing, however they may act as an inhibitor to highly skilled processes being outsourced. Currently, most jobs performed by outsourcers in offshore locations are application development and management, low-level clerical, call centre operations and back-office transaction processing. It is expected, however, as the offshore outsourcing market matures, highly skilled tasks will be performed offshore.

## **IMPLICATIONS**

The offshoring phenomenon may affect levels of ICT investment. Perhaps most significantly, virtually all the global ICT firms have established significant development centres in India and other low cost locations, including China and the Philippines.

There has certainly been an increasing concern and public debate about the possible implications for developed economies such as the US, UK and Australia. This has been fuelled by businesses outsourcing offshore a portion of their software support and services, which has generated concern among their existing suppliers as well as more generally.

There has also been considerable media commentary about global sourcing.

Ovum has been tracking the offshore phenomenon for some time, saying if the backlash against offshore outsourcing continues to build momentum it will not be long before it becomes an issue that moves beyond the tech sector.

Vnunet.com, the UK technology news, reports that offshore outsourcing is gaining momentum as more and more companies realise the potential benefits to be gained from using third-party experts to run their IT systems.

Offshore outsourcing is now a "mega-trend", according to Gartner analysts quoted in the *Indiatimes* news daily. Gartner anticipates that in the US the backlash will continue in the short term, as concern in local communities grows, offshore service providers should not get too alarmed, because the backlash is an inevitable part of the process and will dissipate as the economy improves<sup>2</sup>. The impact of such a backlash remains to be seen.

Most experts seem to agree that offshore outsourcing is here to stay, and global backlash is unlikely to stem its tide. Major global companies in most industry sectors, including ICT are moving to global sourcing policies, seeking best value services from any location.

One aspect of offshore outsourcing that is just beginning to be explored is its potentially positive impact on a country's economy as a whole. Catherine L. Mann, Senior Fellow at the Institute for International Economics, reported that:

*Globalization of IT hardware production is a model for the global evolution of IT services and software. Although technological change is the most important driver of IT price declines, globalized production and international trade made IT hardware some 10 to 30 percent less expensive than it otherwise would have been. These lower prices translated into higher productivity growth and an accumulated \$230 billion in additional GDP (1995-2002). Real GDP growth might have averaged 0.3 percentage points less per year from 1995 to 2002, if globalized production of IT hardware had not occurred.<sup>3</sup>*

## REACTIONS

Some commentators have advocated government action to limit offshore outsourcing. This movement appears to be particularly strong in the U.S. and to a lesser, but growing degree in countries such as the U.K. and Australia. Some US States are considering legislation that would restrict offshore outsourcing for government contracts, according to the National Conference of State Legislatures, a bipartisan US association that tracks legislation at the state level. Recent Federal legislation in the U.S. limits competition for work currently being done by government employees to U.S. workers. U.S. Federal regulators may also consider imposing limitations on the sort of work that regulated private sector corporations take offshore.

A generic list of examples of initiatives that have either been discussed or are actually underway to limit offshore outsourcing follows:

- Limiting national government IT work to signatories of the WTO Government Procurement Agreement or similar such regional agreements
- Bans on government work outside of the procuring country
- Bans on provision of work by non-nationals or holders of Visas from specific countries
- Country of origin labelling for call centers and Internet-enabled services
- Regulatory bans on work being performed outside of the host country in specific sectors such as financial services and health based on privacy, security, identity theft, etc.
- Mandatory investigations of individuals offshore handling "sensitive" information
- Immigration restrictions

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<sup>2</sup> Chohan et al, April 2003, *Management Update: Job-Loss Backlash won't Stop the Offshore BPO Trend*

<sup>3</sup> Mann, *Globalization of IT Services and White Collar Jobs: The Next Wave of Productivity Growth*, International Economics Policy Briefs, December 2003, Institute for International Economics

- Limiting offshore work to countries with “open” trading regimes
- Withdrawal of tax incentives for work performed or companies performing work outside of the country

## WITSA Members

<b>Argentina</b>	Cámara de Empresas de Software y Servicios Informáticos (CESSI)
<b>Australia</b>	Australian Information Industry Association (AIIA)
<b>Bangladesh</b>	Bangladesh Computer Samity (BCS)
<b>Brazil</b>	Sociedade de Usuários de Informática e Telecomunicações - Sao Paulo (Sucesu-SP)
<b>Bulgaria</b>	Bulgarian Association of Information Technologies (BAIT)
<b>Canada</b>	Information Technology Association of Canada (ITAC)
<b>Chinese Taipei</b>	Information Service Industry Association of Chinese Taipei (CISA)
<b>Colombia</b>	Colombian Software Industry Federation (FEDESOFIT)
<b>Czech Republic</b>	Association for Consulting to Business (Asociace Pro Poradenství v Podnikání - APP)
<b>Ecuador</b>	Association Ecuatoriana de Tecnología de Información y Servicios (AETIS)
<b>Egypt</b>	Egyptian Software Information & Communication Technology Chamber
<b>Finland</b>	Federation of the Finnish Information Industries
<b>France</b>	Syntec Informatique
<b>Greece</b>	Federation of Hellenic Information Technology and Communications Enterprises (SEPE)
<b>Hong Kong</b>	Hong Kong Information Technology Federation (HKITF)
<b>India</b>	National Association of Software and Service Companies (NASSCOM)
<b>Indonesia</b>	ASPILUKI - Indonesian Telematic Software Association
<b>Israel</b>	Israeli Association of Software Houses (IASH)
<b>Italy</b>	Associazione Nazionale Aziende Servizi Informatica e Telematica
<b>Japan</b>	Japan Information Technology Services Industry Association (JISA)
<b>Jordan</b>	Information Technology Association - Jordan
<b>Kenya</b>	Computer Society of Kenya (CSK)
<b>Lithuania</b>	Association of the information technology, telecommunications and office equipment companies of Lithuania (INFOBALT)
<b>Malaysia</b>	Association of the Computer And Multimedia Industry Malaysia (PIKOM)
<b>Mexico</b>	Asociación Mexicana de la Industria de Tecnologías de Información (AMITI)
<b>Mongolia</b>	Mongolian National Information Technology Association
<b>Morocco</b>	l'Association des Professionnels des Technologies de l'Information (APEBI)
<b>Nepal</b>	Computer Association of Nepal (CAN)
<b>Netherlands</b>	Federation of Dutch Branch Associations in Information Technology (Federatie Nederlandse IT - FENIT)
<b>New Zealand</b>	Information Technology Association of New Zealand (ITANZ)
<b>Northern Ireland</b>	Momentum - The Northern Ireland ICT Federation

<b>Norway</b>	ICT Norway (IKT Norge)
<b>Panama</b>	Asociación Panameña de Software (APS)
<b>Poland</b>	Polish Chamber of Information Technology and Telecommunications (Polska Izba Informatyki i Telekomunikacji - PIIT)
<b>Portugal</b>	Associação Portuguesa das Empresas de Tecnologias de Informação e Comunicações (APESI)
<b>Republic of Korea</b>	Federation of Korean Information Industries (FKII)
<b>Romania</b>	Association for Information Technology and Communications of Romania (ATIC)
<b>Russia</b>	Russian Information & Computer Technologies Industry Association (APKIT)
<b>Senegal</b>	Senegalese Information Technology Association (SIT'SA)
<b>Singapore</b>	Singapore infocomm Technology Federation (SiTF)
<b>South Africa</b>	Information Industry South Africa (IISA)
<b>Spain</b>	Asociación Española de Empresas de Tecnologías de la Información (SEDISI)
<b>Sri Lanka</b>	Sri Lanka Information and Communications Technology Association (SLICTA)
<b>Sweden</b>	The Association of the Swedish IT and Telecom Industry (IT-Företagen)
<b>Thailand</b>	The Association of Thai Computer Industry (ATCI)
<b>Turkey</b>	Turkish IT Services Association (TUBISAD)
<b>United Kingdom</b>	The Information Technology, Telecommunications and Electronics Association (Intellect)
<b>United States</b>	Information Technology Association of America (ITAA)
<b>Uruguay</b>	Uruguayan Chamber of Information Technology (CUTI)
<b>Venezuela</b>	CAVEDATOS - Venezuelan Chamber of IT Companies
<b>Vietnam</b>	VINASA - Vietnam Software Association
<b>West Bank &amp; Gaza</b>	Palestinian IT Association (PITA)
<b>Zimbabwe</b>	Computer Suppliers' Association of Zimbabwe (COMSA)