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The Case for China

Business Services Transformation

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You’ve probably heard a lot about shared services and outsourcing

For some time now the value in freeing an organisation to focus on its core functions has been recognised.

But a competitive global market means the best offshore locations for service centres continue to change.

In this paper, we look at the issue of offshore locations, and investigate China as a destination of choice.

PwC's perspective on China's emerging Shared Services & Outsourcing capabilities

China is one location that has started to attract attention and have an impact on the established players in the shared services and outsourcing market.

But the combination of growing hype and great distance (both geographical and politico-cultural) mean many companies hesitate when considering this new contender or even overlook it completely. We believe China is worthy of serious consideration for both outsourcing and shared services, so our outsourcing experts have travelled the country, researching its progress in the Shared Services & Outsourcing (SS&O) space, to help deliver our clients a fair assessment of the reality behind the growing myth.

Selecting the location for your SS&O solution is a key moment in transforming your business services – with the destination locked in, several pieces of the programme puzzle can slide into place. The development of the detailed business case can begin, the vision of the target operating model can be brought to life and core elements of your planning for implementation and operation can be locked in.

It's a moment when momentum really starts to build, and also often a moment of relief because getting the decision right is a complicated undertaking.

You need to compare the way each potential location fits your requirements, and that means assembling evidence across a broad range of criteria: infrastructure, language, the labour pool, costs, educational programmes and facilities, political, social and economic environments, government incentives, business maturity, and cultural compatibility.

And all the while new countries are emerging onto the SS&O scene – and one of the new players might turn out to be the best fit for your requirements.

Our SS&O Advisory Board conducted site visits, met with industry leaders, provider executives and government officials, and evaluated the situation first-hand. The team left with some keen insights about the case for China, in terms of its capacity, pricing, government support, and culture and also flagged some potential issues that our clients will need to consider, discussed below.

Catching up to the competition

China is already an economic force and global business resource, especially in manufacturing.

Its growing back-office service offerings to the US and UK and near-shore markets of Japan and South Korea amount to about 4% of the global offshore business process outsourcing (BPO) market, and we expect this figure will continue to grow. With its impressive economy and compelling GDP growth of the past decade – even through the economic downturn – China is aggressively positioning itself as a top SS&O location.

With singular determination and a visionary national agenda, the country has made major strides in building a fit-for-purpose SS&O service market foundation. Central and local government support for this long term vision is reflected in massive infrastructure investment, broad-based university partnerships and heavy promotion – and most impressively, change at an incredibly rapid pace.

"China represents 4% of the global BPO market and is aggressively positioning itself as a top SS&O location."

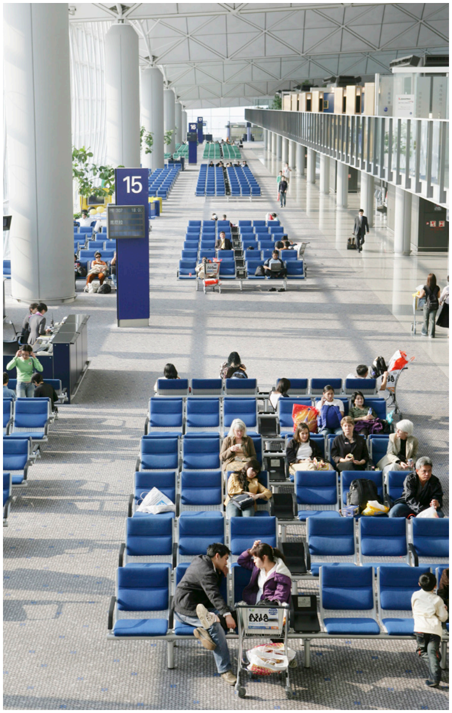
A strong, broad foundation

China's approach is a dramatic example of the "if you build it, they will come" philosophy.

In five years infrastructure has advanced remarkably – roads, transit, ports, air terminals, utilities and telecommunications are all top notch, and with around 700,000 college-educated IT professionals graduating per year, China's labour pool is vast and flexible.

The country has focused on improving the capacity and capabilities outside of Beijing and Shanghai. Second tier cities like Huzho, Changzhou and Suzhou have been developed by setting an atmosphere of favourable corporate and personal tax regimes, better work life balance and a suburban lifestyle – all major draws for evolving urban centers.

These benefits only add to the appeal of China's reputation for growing prosperity and uncompromising business discipline. However, there are still some areas where China hasn't yet caught up to its key competitors, and some areas where they may find it difficult to tailor their services to their clients' needs.



Finding the right price point

Getting a general sense of price in China can be complicated.

The costs of outsourcing or locating a shared service center in China vary widely, depending on a range of factors including region and the type of work under consideration. Cities in the more rural, western areas offer greater cost advantage than more central and eastern regions. But that isn't the only fiscal aspect of choosing a locale – central and local tax and regulatory regimes are complex across the country, and must also be factored into the total cost of SS&O. And there are central and local programmes offering offsetting incentives that should also be considered.

In terms of the costs for talent, China has the advantage at the lower end of the talent pool, where prices are approximately 20 – 30% lower than India's. Middle level positions are approximately the same price as the competition, but China's highly technical staff are typically more expensive, partly because English proficiency is not as widespread.

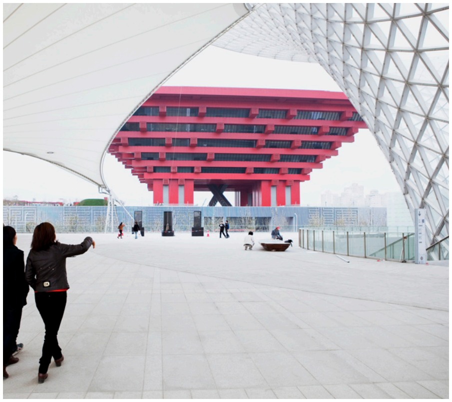
In general, China's cost advantage is shrinking due to climbing labour costs (fuelled by new labour laws and workers' growing awareness of rights), recently reductions in tax preference programs and rising land, water and energy costs.

India is not the only benchmark; in many instances Mexico, Vietnam, the Philippines, Russia and Romania are less expensive – though not necessarily comparable on other criteria such as infrastructure.

"..at the lower end of the talent pool, prices are approximately 20 – 30% lower than India's"

The benefits of government investment and support

Beyond people and infrastructure, China's emergence is also being driven by strong government support and aggressive investment.



In 2006, the Ministry of Commerce launched its 1000-100-10 Project to promote the development of 10 Chinese cities as outsourcing bases, with a goal of attracting 100 international firms and 1000 large and medium-sized providers to assist with business requirements, and some big international names have started to settle in.

Additionally, the government has backed investments in 21 economic zones across the country, with each zone focusing specifically on one SS&O business need, such as technology, manufacturing, and back office. Since each investment zone is specifically tailored to a business need, it also has corresponding social and economic advantages and disadvantages beyond those of the country as a whole, and which must be considered during a location analysis.

In particular, the IT sector has been well supported by the government, and due to the Chinese government's assertive and entrepreneurial approach, has attracted both domestic and international interest with recent investments by IBM, HP and Accenture.

Just the domestic market potential in China is remarkable. Chinese financial institutions and other large companies are fuelling growth with their continuing interest in outsourcing and shared service centers. This domestic trend will likely create a ripple effect that will draw in international interest, and the Chinese providers refine their offerings and seek growth in other markets.

Working to prevent a culture clash

Culturally speaking, China faces different issues than its key competition. There is a wider cultural gap to overcome, compared to countries long connected with Western society. For example, the Chinese treatment of intellectual property is a concern. The regimes and regulations are similar to others in the international community, but its laws are weak and often do not have an adequate support structure for enforcement.

And China isn't as familiar with global needs and has not yet matured in the way it deals in, and with, global markets. In particular many buyers may be concerned about ethics and human rights, areas of business responsibility of increasing importance worldwide.

English competency in the country is still a challenge, though it is being aggressively addressed through heavy government investment at the university level.

Spreading the word

India has proven very effective at selling and marketing their abilities but China still struggles with its sales pitch. While infrastructure is indeed impressive, Chinese leaders have difficulty conveying their business proposition effectively; with the result that many buyers are unaware of what it has to offer. However, given their current capacity, commitment to investment and sheer unyielding drive, China is likely to rise to this promotional challenge.

Weighing up the case

While no destination will be perfect, for some organisations China will compare favourably to other top SS&O locations.

We would certainly suggest it is included in any thorough analysis of destination countries.

Determination in approach and discipline in action are the hallmarks of China. The central and local government drive to promote and support SS&O development is sincere and substantial, and is likely to lead to significant increases in market share over the next three years. The Chinese infrastructure and people are poised for uptake, though we advise careful scrutiny of capability with respect to higher level operations.

Other key considerations should include calculating the total cost of locating, including both the cost of set up and the cost of operation over the entire length of the contract. This will involve the costs of labour arbitrage as well as utilities, taxes, cost of living, logistics, facilities and the inevitable travel. And we advise vigilance around intellectual property and ethics issues.

As in all SS&O feasibility assessments, organisations must determine their objectives and needs, set their priorities, conduct their research and then be ready to compromise. Without fail, as we have found, a site visit is imperative to confirm fit and findings.

We consider offshore locations and other key issues relating to SS&O at our quarterly briefings.

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