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Service offshoring takes off in Europe – In search of improved competitiveness

Summary

The first comprehensive study on the offshoring strategies of Europe's largest companies shows that various service processes are increasingly being shifted abroad. So far, the focus is on back office services, but most service processes are potential future candidates for offshoring. While they lag behind their U.S. rivals, European companies – especially from the United Kingdom – see offshoring as a way to reduce costs and improve their competitiveness. Most offshoring projects remain on the European continent, but India – as the most frequently mentioned single destination – tends to attract larger offshoring projects in terms of the number of jobs offshored. More than 80% of companies with experience of offshoring are satisfied with the results, reporting cost savings in the range of 20%-to-40%.

A. European companies have been surveyed about service offshoring for the first time

The survey by the United Nations Conference on Trade and Development (UNCTAD) and Roland Berger Strategy Consultants analyzed the service offshoring strategies of a representative sample of the top 500 European companies.

While service offshoring has become established practice and has already been addressed by various studies for the U.S., it has only recently attracted public attention in Europe. Given the attractiveness of the phenomenon and the potential implications for competitiveness at all levels of development in Europe and other parts of the world, there is a need for more analysis on the corporate strategies underlying this trend.

The survey addressed key questions such as:

- Why do companies consider offshoring and why might they oppose it?
- What are the associated benefits and risks for both firms and countries?
- Which business models do companies use to go offshore?
- What types of services are affected?
- Which are the (potential) target countries – and how are they selected?
- What role should policy play?

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More than 100 interviews with top-executives provided the answers to these questions. The companies included in the survey account for over 20% of total revenue of the European top 500.

B. British companies lead continental Europe

Europe seems to fall into two categories with regard to offshoring agility. Almost 40% of companies polled have relocated services in the past. Regarding future activities, almost half of all companies are planning to offshore (further) services within the next years. Companies that have offshored in the past are generally the ones that are also planning to offshore in the future. Almost 50% of the companies have no offshoring experience, nor are they planning to offshore in the near future.

The majority of offshoring projects from European companies originates in the UK, which alone accounts for almost two-thirds of all service jobs offshored to date by the companies polled. Another 30% of jobs offshored come from Germany and Benelux.

The size of offshoring projects depends on the type of services. For example, projects relating to IT or call center services tend to be larger than those concerning purchasing or HR services. Overall, almost 80% of the total volume of service jobs offshored to date is accounted for by projects involving less than 300 jobs per project.

C. Cost savings are the main driver so far

Offshoring of services reflects new information and communication technology that allows companies to reconfigure their value chains with a view to increasing their competitiveness. Companies that have offshored services are very satisfied with the outcome. Four out of five consider their projects successful, while only 3% deem them unsuccessful. A comparison of the overall ratings for different regions shows that companies in Germany, France, Austria and Switzerland – traditionally high cost countries – rate the overall success particularly high. While benefits go beyond the obvious cost savings and include extended and improved quality of services as well as access to skills and infrastructure, cost reduction is the prime driver. Cost savings achieved through service offshoring are typically in the range of 20%-to-40% with an average of almost 30%. Expectations are often exceeded; every third company that has offshored services reports that improvements in service quality have surpassed their expectations. At the same time, the risk of a decline in service quality is the most frequently mentioned risk associated with offshoring.

The overall volume of the offshoring phenomenon may previously have been underestimated. Some companies prefer to keep their offshoring strategies out of the public domain to avoid negative press in their home countries. Others follow a very straightforward approach. They argue that offshoring is essential to keep up with increasing competitive pressure and that the public must simply come to terms with it. Only one out of five companies experienced in offshoring considers the public backlash triggered by offshoring to be a major risk. This is also reflected by the fact that external communication ranks last among factors that are considered most

difficult in the offshoring process. Implementation and coordination as well as internal communication are considered the greatest challenges.

D. Back office services dominate – but there are no "sacred cows"

The full range of services from front office to back office functions is considered suitable for offshoring. Finance, accounting, IT support and human resource services together with other back office services are involved in some 60% of all current or planned offshoring projects by the European companies interviewed. A third of the companies mentioned offshoring front office services (e.g. customer interaction).

Overall, there are no "sacred cows"; most kinds of services are potential candidates for future offshoring. While about 80% of companies mentioned at least one service activity that they would not consider for offshoring, no business process was explicitly excluded from offshoring considerations by more than 20% of the respondents. Reasons for not offshoring an activity include concerns related to client handling, loss of core competence, intellectual property rights and confidentiality considerations.

Captive and third-party business models are applied equally often for offshoring services. For third-party offshoring services are mainly transferred to local specialized companies in the respective target country. Ease of control, flexibility and organizational feasibility are the main drivers when selecting business models for offshoring.

E. Costs strongly drive the selection of target countries – but soft factors matter beyond the benchmarking of hard facts

Cost reduction remains the overarching objective of offshoring by large European firms. Costs also rank first in the list of hard facts benchmarked for the selection of target countries (mentioned by seven out of ten companies). The next important factors relate to the quality of staff and local services. But location criteria go beyond benchmarking of hard facts and is influenced by soft factors such as following competitors, promotion by target countries and internal lobbying by a foreign affiliate. Such soft factors have influenced location decisions taken by more than 40% of the companies.

In terms of target destinations, half of all offshoring projects have been undertaken within Europe. The top European locations include such Western European countries as the UK, Ireland, Spain and Portugal, as well as Central Eastern Europe (e.g. Poland, Hungary, and Romania). The offshoring of services also opens up opportunities for exports and jobs in developing countries. Meanwhile, four out of ten projects go to Asia, notably India. In job terms, Asia's share is much higher, however, as projects offshored to Asia tend to be the larger ones. There is potential for more countries to benefit as long as they provide the right package in terms of cost, skills availability, infrastructure and time zone.

While European companies generally lag behind in comparison with their U.S. rivals in the area of offshoring, more than 50% of the companies consider a U.S. framework for offshoring not to be applicable in Europe. Main perceived differences are regulations and flexibility of the European labour markets, diversity of culture, and the proficiency of English as a world language.

F. Impacts on home countries are to be balanced – policy influences the framework selection for offshoring

According to the companies polled, home countries generally benefit from offshoring, but potential negative effects need to be taken into account. Potential benefits include:

- increased competitiveness and lower prices,
- positive feedback cycles from target countries (through repatriated earnings in captive models and increased market share of exports from home countries), and
- labour redeployment on better paid jobs.

According to the companies interviews, these effects are to be balanced against potential adverse effects including for example

- increased dependence on imports,
- job losses, and
- downward pressure on wage levels due to increased competition.

Companies that have already offshored some services are more optimistic with regard to the potential impact on home countries. Almost 80% of them see benefits for their home countries. In contrast, less than half of companies that have not offshored any services share this opinion. This suggests that offshoring may be important for the overall competitiveness of European corporations vis-à-vis their U.S. competitors.

Every second company polled thinks that additional measures by their home country Governments are needed to facilitate more offshoring of services. Potential measures mentioned mainly aim at reduced protection of local markets (e.g. by changing tax regulations) as well as further development of basic infrastructure (e.g. for transportation). One out of three companies considers the current framework just right.

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