April 2007

Guest CEO Editorial

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Ismail Radwan manages a number of high profile projects for the Bank in Sri Lanka and the region, including the e-Sri Lanka initiative. Ismail is a prolific author whose recent publications include "Offshore to Sri Lanka: Finding Sri Lanka's Offshoring Niche", "Offshore to India: Understanding India's Offshoring Success", and "Sri Lanka and the Knowledge Economy". Ismail is known for his inspirational speeches on a variety of ICT related and general management topics. Ismail studied economics and politics at Oxford University and then received a masters degree from the University of Pennsylvania. He has lived and worked in more than thirty countries. Prior to joining the World Bank in 2000, Ismail was a principal consultant with PricewaterhouseCoopers London in the economics and strategy department. Ismail is originally from Cairo Egypt and has been based in Colombo since January 2005.

Offshoring in Paradise:

Sri Lanka has the potential to become a global hub for offshored accounting and financial services. The island's long history of excellence in accounting practices and standards dates back to colonial times. More recently, the closure of the university system for long periods during the height of the civil conflict left many school-leavers with little alternative for higher education other than training as accountants. The growth of the internet and the rise of offshoring means that Sri Lanka can now turn what appeared to be a handicap into an asset – the country can draw on this legacy to develop the island into an offshoring financial services hub offering high value services to the rest of the world, especially the US and UK.

Exporting Professional Services

As a small island economy, Sri Lanka has no alternative but to develop its export markets. When the governments of the past have realized this truth and sought to promote export oriented trade, rapid economic growth has followed. This trend started in the late 1970s when government liberalized the economy and enacted a series of trade reforms. Again in the 1990s the privatization of the plantations led to a remarkable rise in the volume of tea and other commodities exported. A similar opening of the telecommunications industry to private investors and liberalization of the international gateway in the mid 1990s led to massive increases in fixed and mobile communications and a dramatic reduction in the price of an overseas telephone call.

Today, the key success factors of Sri Lanka's future economic growth are no different. "Export or perish", remains a truism for the island. It is *what* can be exported that has changed in a twenty-first century economy. In the past, goods and capital could be exported relatively easily while services and labor could not. Those were the days in which Sri Lanka's economy was based on the export of raw commodities such as cinnamon, coir, ivory and gems. In those days a successful economic strategy was one that attracted capital to an economy in order to produce more goods that could be exported and traded for objects that could not be produced at home. However, the technological advances of the late twentieth and early twenty-first centuries mean that it is no longer true that goods are tradable while services are not. Although it is still not possible to export haircuts or hot dinners, more and more services are easily tradable. These are the services that can be digitized and sent great distances at little cost, over the internet. And countries that are realizing this are reaping great benefits from adapting their economies to be able to better compete in services trade.

The advances that have made this possible include: cheap mobile connectivity, high speed internet access, and digital convergence as well as the increased liberalization of trade in services and the forces of globalization. These advances have created a truly global marketplace for services, especially those that are labor intensive and can be commoditized and digitized; services such as financial management, accounting, legal advice and management consulting services, ICT services, software development, IT training, and perhaps most famously of all – call centers.

In the industrial era, such services were delivered domestically and often produced very close to the point of demand. Twenty years ago, your accountant or lawyer was usually someone who worked close to your head office and almost always in the same town. Nowadays your accountant can be just as effective from anywhere in the world. This new capability has opened up domestic markets to international competition. Increasingly, such services are being produced in the locations that are able to deliver the lowest cost and the highest quality product.

It is likely that services that will be offshored in the future will go far beyond the traditional call-centers and back-office functions and will include; investment and financial services, human resources, health services, retail functions, logistics and customer support functions. It is estimated that this will result in 18 million jobs being offshored with a multiplier effect that could in turn create a further 60 million jobs in developing countries.

And it looks certain that this trend is just beginning and will continue to grow exponentially for the foreseeable future. It is currently estimated that the Sri Lankan BPO market turnover is US$45m and has the potential to grow to US$500m by 2012. Like an incoming tide, this trend cannot be rolled back, and it offers tremendous opportunities for developing countries and foreign investors.

Sri Lanka's leaders have realized that governments that ignore technological advances and their implications will be left behind, unable to compete in a global economy where protectionism is no longer a viable option. Government has put in place a generous package of incentives offered through the Board of Investment, Sri Lanka's world class inward investment authority (see www.boi.lk).

Seizing the Opportunity

Offshoring now represents a US$100 billion market that is growing at more than 30 percent per annum. In India, a global leader in this area, offshored exports account for close to US$20 billion and almost half of total export revenues. The total number of jobs created in the Indian Business Process Outsourcing (BPO) industry is close to one million, many of them filled by women.

Developing ICT and professional services offshoring opportunities should be a high priority for development-oriented countries such as Sri Lanka. Not only will the development of this industry segment create job and export opportunities, it will also create positive spillovers such as: enhanced incentives for education, technology and knowledge transfer, environmental protection and an improvement in the quality of locally provided services.

Almost all the current demand for offshored services comes from developed countries such as USA, Europe and Japan. On the supply-side, India is by far the largest player in the offshored services industry closely followed by China, Mexico and Brazil. At the moment, services trade remains geographically segmented with Latin American companies serving North America and Eastern European countries serving Western Europe. It is clear that what is emerging is that on the whole, customers would prefer to deal with countries that are closer to them culturally or within a similar time zone. This phenomenon is called "near-shoring" and it presents Sri Lanka with a distinct opportunity.

What Investors Are Looking For

The original driver for firms to move parts of their operations to offshore locations was to reduce operating costs, reduce their capital requirements and to increase productivity, global competitiveness and operational efficiency. Increasingly firms are also moving offshore to tap into the global pool of talent to source skills that are in short supply domestically, reduce their time to market and deepen their local knowledge. Countries wishing to attract offshored investments must therefore offer a politically and economically stable climate, a low cost structure, an educated workforce that is open to innovation and a sound infrastructure.

How does Sri Lanka compare in terms of these key criteria? Although the country boasts some of the cheapest labor and office rental costs in the region, it remains hampered by high telephone and electricity charges as well as rigid labor legislation. Due to its population size, the island cannot offer the sheer numbers of ICT and professional employees that India and China can. It cannot compete easily to develop generic call centers or R&D facilities.

What Sri Lanka Can Offer

In such a situation, Sri Lanka must look for high-end niches in which it can excel. A promising strategy for Sri Lanka lies in developing the niche market area of common corporate functions, not just finance and accounting services but also HR, legal, and IT services. In accounting, the demand for offshored services is likely to come from the US and countries in Europe. Given Sri Lanka's capabilities in English it seems sensible to target both the UK and US markets. However, for a number of reasons the UK market would be the most promising – what management consultants might term the low-hanging fruit. Sri Lanka is already well equipped to tackle this market as it boasts the highest number of CIMA and ACCA qualified accounts of any country in the world outside the UK, and their numbers are growing by more than a thousand per year. Even India with its much larger population does not come close in absolute numbers to Sri Lanka when it comes to UK-qualified chartered accountants, as it has traditionally shunned international qualifications in favor of local certificates. This gives Sri Lanka a big edge in developing a series of high value-added services from simple tax returns to more complex estate planning, audits and corporate financial services.

The US market also offers promising pickings for companies able to offer back office functions, either individually or as a package. The World Bank itself has recently offshored all its financial management functions to Chennai and is now looking into ways to offshore additional services such as procurement, human resources and IT services to other offshored locations.

India's dominance provides Sri Lanka with another opportunity. India's success has lead to a situation where many companies that have offshored services there now have several facilities operating within India… often in many different locations. With increased tensions in the region as well as the usual cyclical business factors, companies are now re-examining their operations with a view to ensure that all their eggs are not in one Indian basket. This is the key driver behind the recent establishment of global researching centers in Colombo for companies such as HSBC and WNS.

In many ways, Sri Lanka would be an ideal location for offshoring companies wishing to diversify country risk. Being in the same time zone as India (following the April 2006 time adjustment) it is well poised to provide disaster recovery and business continuity services to companies currently offshored in India. Colombo is closer to Chennai, Hyderabad and Bangalore than is Delhi. With excellent air links to all of India's cities, it is just a short additional hop for executives visiting their facilities in Southern India. Moreover, the close cultural ties with India mean that companies that have opened up operations in India and are considering locating additional facilities in Sri Lanka will largely know what they are getting into.

Offshored accounting services therefore plays to Sri Lanka's current strengths, including the huge number of qualified accounts on the island as well as the cheaper cost structure (including cheap office accommodation and lower wages). Although Colombo rental costs have risen rapidly since 2002 they remain at 60% of prevailing rates in Delhi. Offshoring also avoids some of the key constraints such as poor road connections and expensive power. Supplying accounting services remotely does not require significant amounts of electricity nor does it draw heavily on voice telephony -- another area where Sri Lankans pay a relatively high price compared to their neighbors on the other side of the Palk Strait.

The government and the private sector, through their trade associations, could encourage the development of such an industry. This could be done by mobilizing the Sri Lankan diaspora to form joint ventures with accounting companies in Sri Lanka to offer services to the countries in which they are resident. The Board of Investment has recently announced a series of generous incentives for investors considering new investments in this area, and thus the initial groundwork has been set for the creation of a large and important industry. Some of the better known accounting companies in Colombo have already started offering such services. They are finding Sri Lankans personable and loyal, with an attrition rate less than 7 per cent – the lowest in South East Asia. Their expatriate executives enjoy living in Sri Lanka, a country that ranks 73^{rd} on the livability index way ahead of India at 145^{th}. Foreign direct investment more than doubled in 2006 to $603m from just $287m a year earlier. And it is only a matter of time before more and more companies jump onto the bandwagon, as the economy is growing at a healthy 7% per year. Those that take the plunge early will find that there is a big advantage to being the first mover in terms of finding suitable office space as well as the best human resources.

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