Prelude

Of the four Asian regions, Southeast Asia is home to major outsourcing destinations such as The Philippines, Malaysia, Vietnam and Singapore while the most dominant player - India, lies in South Asia. Offshore outsourcing in the Asian region is predominantly centered in three countries namely India, Philippines and China – combining to account for 75% of the global outsourcing market revenue as of 2007.¹

Countries in the Asian region, with the exception of Japan, experienced record highs in economic growth rates in 2007 averaging a collective 8% increase in GDP.² However, with the global economic crisis impacting the region, economic growth cooled in 2008 and is expected to begin recovery only by 2010.³ Unlike the US and UK, where the finance and business sectors were most severely hit, manufacturing and export industries in Asia were the two most aggravated industries. On the other hand, the services sector and in particular, the outsourcing industry in Asia proved to be one of the more stable sectors in the region during the downturn. In fact, NASSCOM⁴ estimated a 12% growth in total BPO spending amidst cost cutting measures by multinational companies in the US and UK. Another example is the Philippines, where instead of laying-off workers, the local outsourcing industry actually increased employment by about 70,000 workers in 2008, a 25% YoY increase.

Needless to say, Asia has not been immune to the maladies induced by the recent economic slowdown and spiraling prices of commodities. Even so, its widespread impact is not expected to be comparable to the 1997 Asian Economic Crisis, and recent signs of recovery have prompted analysts to speculate that regional recovery to occur earlier than many developed economies in the West.

China in the Asian Outsourcing Market

China may arguably be the most observed economy in all of Asia as it has posted record numbers of double-digit GDP growth from 2002-2007. As the global financial crisis loomed, China’s economy slowed down in 2008 while registering 9.3% GDP growth rate, the lowest since 2002 following a 13-year high of 14.7% in 2007 – still a remarkable figure when considering that most countries in the region (and across the world) were struggling to merely sustain flat growth during the same period. This gives indication to a stronger and more mature economy – which continues to look more at its vast domestic market to fuel growth.

The Chinese sectors hit hardest by the global downturn were that of the manufacturing and export-related industries which account for 60% of total GDP. The services sector on the other hand, which comprises 32% of China’s GDP, also felt downward movement from 14.7% in 2007

¹ Source: Business Processing Association of the Philippines
⁴ National Association of Software & Services Companies
to 9.5% in 2008.\(^5\) Though this is the case for the services sector, contract value of China’s outsourcing industry – which is part of the said sector – still managed to rise by 32.5% to US$2.6 billion in the first half of 2009.\(^6\)

### China’s Current Outsourcing Landscape

The current outsourcing ecosystem of China, though still considered to be in its nascent stage, has been a dynamic one, and especially in the last five years.

While two of the most progressive outsourcing/offshoring counterparts in Asia - India and the Philippines started in the late 1980’s through the 1990’s respectively - China has seen its services sector pick up in the last five years, and as government and industry leaders have shifted focus beyond the manufacturing and industrial sectors to explore the services industry. Estimates show that China currently houses about 3,000 outsourcing providers with over 320,000 employees, comprising a 3% share of the global offshore BPO market, and still trailing the incumbents - India (51%), Philippines (21%) and Ireland (7%).\(^7\)

China is seen as a diverse destination which offers both ITO and BPO processes while the more pronounced segment of the outsourcing industry in the country remains to be in the ITO space. The reason behind this may be traced in China’s outsourcing industry lineage which initially began with local software companies fulfilling domestic requirements, later transitioning to other ITO services and eventually including a wider spread of BPO services as more opportunities arose. The country offers a wide-array of high-end processes in ITO such as Software Development, Research & Development and Applications Development Management, to low-value services in Testing, Maintenance and Software Localization. BPO processes are also offered in China but not as prominent as its ITO offerings. Some of these include Human Resource processes in Customer Relations Management, logistics as well as low-end services in the Finance & Accounting space.

China’s outsourcing market provides a healthy spread of services to the three main outsourcing segments – Offshore, Nearshore and Onshore. As previously noted, contract value of its outsourcing industry still posed significant growth at 32.5% - giving indication of the reach of markets the country captures. Even as the US and UK were hit hard by the economic crisis, the deals China receives from neighboring countries has helped compensate for embattled Western accounts. As an offshore destination, it provides services to the US and UK which is mainly low-end processes in ITO such as Testing and Maintenance. Its second largest client group comes from the nearshore markets of Japan and South Korea where China offers Engineering Design as well as high-end ITO services for the automotive, entertainment and chemical industries. Finally, the thirds largest contributor to its outsourcing market revenues is domestic driven - a mix of both ITO and BPO, with a majority of revenue taken from the latter process, particularly in the Contact

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\(^6\) Source: Ministry of Commerce, Republic of China  
\(^7\) Source: Business Processing Association of the Philippines
Support space, and fueled by China’s large domestic market. Figure 1.1 shows the breakdown of revenues by client geography. With only about 2% of the outsourcing revenues coming from the global market, this is an indication of the potential of China to expand in the global market. This is expected to increase as service delivery matures in the country, as service offerings expand, and new markets are explored. For instance, business expansion in Asia can be greatly improved by tapping certain markets – in the case of Taiwan, it has the opportunity for shared service center development, including R&D processes catering to the high-tech sector. Another potential client market is the Chinese speaking population living in Asia where the Customer Support services segment can be targeted.

Figure 1.1

Revenue Breakdown by Client Geography

The most mature and established cities in China considered as outsourcing hubs remains to be Shanghai and Beijing. Though other Tier II and III cities in China are beginning to make waves in the outsourcing industry and are slowly positioning themselves as destinations of choice. These cities include Dalian, Shenzhen, Chengdu and Guangzhou. In a recent study conducted by Tholons – the Top 50 Global Emerging Outsourcing Destinations – the above mentioned cities were all included in the list.

The growth of China’s outsourcing industry and the emergence of several cities as outsourcing venues may be attributed to the following factors:

**Scalability:** China has an incredibly vast labor pool catering to diverse industry sectors while offering immense scale in its talent pools. With about 1,900 HEI’s across 31 regions in China, the country graduates more than 4.4 million students each year. 700,000 of which are IT professionals.

**Competitive Labor Cost:** China offers an unparalleled cost arbitrage of about 10-20% lower (overall) cost when compared to India, making the country an attractive destination for service providers looking to establish footprints in the East.

**Business Catalyst:** The increasing awareness multinationals, in accepting China as a viable destination to offshore specific services has proven to be a significant catalyst in continuing the influx of MNCs such as IBM, HP, EDS and Accenture. The entry of these companies, with their

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8 Source: Accenture & China Council of International Promotion Study 2008

9 Source: China Statistical Yearbook 2008
industry Best Practices in tow, has proven to be a key driver in the advancement of China’s outsourcing industry.

**Domestic Demand of Outsourced Services:** The demand for outsourced services in China has been driven not only by the world market, but also by the growth of China’s domestic economy – reflected in the country’s 9% GDP growth in 2008. Domestic consumption in turn has produced a subsequent increase in demand for services.

### Opportunities of China: The Asian Market Advantage

Considered by many as the “next India” in the outsourcing space, China’s foray into the global outsourcing market has been relatively discrete, especially when compared to other more prominent industries in the country. As the potential of the outsourcing industry in the country emerges, more stakeholders are beginning to take interest in China and its potential of scale. With its present capabilities, identifying and addressing the right potential is key in order for China to develop its outsourcing sector.

China’s opportunities in the Asian outsourcing market lies in **three main areas:** its local market, its current position in regional market and the presence of India and Philippines in the region.

1. **Opportunities in a potential-rich Domestic Market**

   Though the presence of a large domestic market plays a vital role in China’s outsourcing industry, it is still an opportunity that is yet to be maximized. As local IT Service providers begin to mature and as they expand across the country and region - expanding to more complex processes such as Applications Development Management, Testing & Design, Enterprise Relations Management, HR management, Finance & Accounting, and Customer Support in a central site - opportunities in the ITO and BPO sectors in the local market will begin to surface. This is expected to be followed by an increase in the maturity of their service delivery models. However, Tholons sees that the service capacity levels of these companies in serving the local market is underutilized due primarily to two factors: the industry’s still low service delivery maturity and the lack of awareness of local companies of service provider capabilities.

   The first factor is directly linked to the industry’s lack of awareness and confidence in the shared services delivery model. This is a classic example of mitigating risk scenarios. Once a company “sinks” in a comfortable position with its current traditional set-up, it will be difficult for the organization to adapt certain change management processes for a transition to take place, moving towards a more liberal approach. This is especially seen with SME service providers and clients in the country. SMEs tend to play it safe veering away from risks the shared service model entails which involve issues dealing with intellectual property rights, additional expenses due to change management process while moving from one business model to another (which may also lead to revenue losses since it involves the risk of business discontinuity during change management) or simply, the fear (or apprehension) that the model may not work with the company. The second factor is unfamiliarity local companies have of the capabilities of local service providers. This is also a reflection of the need for China to better develop and promote local service providers in both the domestic and international arena - the same way that a Tata, Wipro or Infosys is known in India and in Western markets alike.
To better illustrate the above mentioned scenario, let us take a look at 3 cases. The first involves Singapore. Singapore is a city-state which is a smaller destination with a population of only 4 million people. Though this is the case, it shows a global standard business environment that evolved through the presence of foreign MNCs operating in the country. There are more than 7,000 MNCs operating in Singapore, with 60% of them making the city-state their regional headquarters. Because of the presence of these MNCs in the country, best practices have been transferred to the local business environment. As such, the development of skill sets has been beneficial to the local labor force because of the multinationals. For instance, with the presence of MNCs such as Citigroup, HSBC and Credit Suisse, Singapore is now considered as one of the best locations for high-end Finance & Accounting and Analytics processes. Similarly, another example is that of the Philippines. The country also does not necessarily have a huge local market for outsourced services but with local characteristics such as a huge English speaking labor pool fit for its current outsourcing niche (Contact Support), captives and third party service providers continue to locate in the country. In roughly ten years, the country is now considered as one of the most mature global outsourcing destinations, particularly in the BPO segment, with more than 400,000 employees working for the outsourcing sector.

Finally, India is a prime example of a country which benefited from years of prudent planning and service delivery expansion in the outsourcing arena. With more than 20 years of experience in shared services industry and the emergence of home-grown MNCs such as Wipro, TCS and Infosys being at par with foreign MNCs - India has climbed the ladder while improving their service delivery capabilities in the outsourcing industry. This allowed the country to take more than 50% of outsourcing market revenues in the global market while servicing its local market as well. NASSCOM reports that out of the total US$71.7 billion revenues in 2008, 1/3 comes from the domestic demand.

In the case of China, Tholons believes that the local market opportunity is definitely a segment to consider, but in order for them to capture the market, companies need to mature in terms of its service delivery capabilities in order to bring in the local clients. In a study conducted by the Ministry of Information Software and Integrated Circuit Promotion Center (CSIP), it was estimated that almost 80% of the 3,000 outsourcing companies in China were established from 2000 onwards (see Figure 1.1). This reiterates the fact that the service level maturity of Chinese companies must be further improved as the bulk of the organizations still lack industry experience. Moreover, the two major verticals (aside from electronics and banking and finance industries) in terms of client spending are dominated by the government and communications industries, while opportunities in manufacturing, retail, health and education sectors remain untapped. In a survey study conducted by Accenture & the China Council of International Promotion, 32% of client respondents in both the government and communications sector spend for outsourced services.
With still low service delivery maturity levels, China will most benefit from leveraging and learning from mature service providers with a higher degree of delivery expertise. This is where the presence and role of Indian service providers in China will be crucial.

2. Established Regional Clientele: South Korea and Japan

Surprisingly, about one-third of China’s outsourcing revenues are derived exclusively from two countries in Asia: South Korea and Japan. Not even India or the Philippines have this kind of market capture China has in catering to these markets due to the Guanxi\(^\text{10}\) effect, where not having local presence in China is critical to springboard into these markets. For instance, South Korean electronics giant Samsung began to outsource in China in 2006, moving its international outsourcing center from Hong Kong to Shanghai while leveraging on cutting costs and enhancing business efficiency. The center now runs offices in Tianjin and Shenzhen. Japan, on the other hand, is outsourcing more than 60% of their software needs to China. Tholons believes that the control of China to the South Korean and Japanese markets lies in two underlying factors:

**Cultural Affinity:** China shares a somewhat similar cultural background with its two regional clients, making it relatively easier for the Japanese and Korean clients to negotiate deals. These points of affinity can be as broad and encompassing as culture to as particular as technical compatibilities. China for example, has an advantage in the use of similar keyboard character set.

\(^{10}\) Loosely translated as “relationships”, it is a concept in Chinese society that is more than what its literal translation provides. It signifies power in the business world in having connections that support and cooperate with one another. Without Guanxi, doing business will be a challenge.
As Japan and Korea use the unique “double-byte” system used to generate their country’s character set, Chinese programmers are also familiar with this type. In addition, the emergence and Development of an anchor outsourcing city such as Dalian gives the advantage to China in attracting Japanese clients. Dalian, with its geographic proximity to Japan also has a sizeable segment of its labor pool highly proficient in the Japanese language - a skill that most Japanese firms find a necessity. As of 2007, it was estimated that Dalian had nearly 20,000 people working in the ITO sector and about 70% of them speaking the Japanese language.

**Proximity:** The proximity of China to Japan and Korea, particularly the northeastern cities of China such as Beijing, Dalian, Tianjin and Shenyang, also gives China an advantage to this market, with the cities a mere 2-3 hour flight from Seoul and Tokyo respectively. Considered as a nearshore destination, China offers “offshore rates” because of the significant cost savings it generates MNCs outsourcing to China. Moreover, geographical proximity allows Japanese and Korean clients the benefit and ability of employing a ‘hands-on’ management model because of the distance (or lack of) – a factor that high level management values.

Beyond the above mentioned factors, there are also a number of characteristics of China that pull Japan and Korea to their advantage. These include cost savings, infrastructure readiness, scalability of talent pool, and business opportunities present in China. Tholons believes that because of these two co-existing conditions – cultural affinity and proximity – that Japan and Korea will continue to prefer China over neighboring countries such as Singapore, Malaysia, Philippines, Vietnam and India.

There is little doubt that China leads in market share when viewing outsourced service delivery for Japan and Korea. The question is, is China maximizing the market opportunity from these two client nations? The majority of China’s outsourcing industry capture in both Japan and Korea lies in three industries, namely the electronics industry, banking and finance services industry and chemicals industry \(^\text{11}\) (supporting software development, engineering, research and development, supply chain management, bioinformatics outsourcing, others). With inherent advantage on the Japanese and Korean markets, China has the opportunity to increase market scale by expanding their service portfolio to include other verticals such as electronics, automotive and animation/game development industries from these client nations.

### 3. Presence of the Top 2 Outsourcing Providers in the Region

The presence of India and the Philippines as two mature outsourcing destinations in the region is an advantage to China as it gives the country opportunity to absorb the positives from the ripple effects emanating from the said countries.

In the case of the outsourcing industry, the influence of having an expert neighbor (India) can be seen in countries of Sri Lanka and Pakistan. Because of India’s growth in the outsourcing space, it has caused a ripple effect where nearby countries have been able to absorb and benefit from the development of the India’s own outsourcing industry. Though in a much smaller scale, development is nonetheless significant.

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\(^{11}\) Source: Accenture & China Council of International Promotion Study 2008
Similarly, with this scenario, it gives China an advantage over other Asian countries since it has specific characteristics (such as abundant labor pool, low labor cost, low cost of doing business) to better absorb the ripples coming from India and the Philippines. With the presence of these dynamic and mature provider nations, there will be definite opportunity for China to attract providers from these countries, and its domestic market will serve to be a further incentive.

In addition, the awareness that India and Philippines bring to clients – particularly coming from the US and UK – that select Asian countries can deliver services effectively pulls China into the mix, a country originally known for manufacturing processes.

**The India Effect**

India and China remain as the two fastest growing economies in the world today. While posting GDP growth rates of 5.3% and 9.3% respectively for 2008, both countries also managed to increase their FDI inflow as part of the developing economies of the world which increased its share of the global FDI allocation by 40%. India for instance acquired US$46.5 billion in investments in 2008, an 85% increase from 2007 which was at US$25.1 billion. China on the other hand posted US$83.5 billion in FDI for 2007 and is the highest among developing economies and 6th in the world. China is also considered as the 3rd most attractive destination for FDI inflow, a spot higher than India.\(^\text{12}\)

As mentioned, having India in the region gives China leverage in the outsourcing industry. Though the effect that India has done to China is a phenomenon that was not intended and was realized because of the underlying characteristics of both countries, this occurrence – the China-India relationship – proves to be a connection that is a two-way street and not exclusively beneficial to China alone (since India’s service delivery model is more mature than China). On the contrary, both countries benefit from the presence of the other, the question is, how well they manage their relationship in order to utilize the presence of the other to its full capacity. As an example, with Indian service providers starting to locate in China, this relationship shifts to the next level as China will eventually learn from India while adopting best practices from Indian service providers.

**Coopetition: The China-India Relations**

The maturity of China’s service delivery capability is not a question of it happening but a question of when it will materialize, and especially as the industry has taken rapid strides over the last five years. On the other hand, though the global financial crisis threatened the stability of India’s outsourcing industry, the country showed resilience amidst the downturn and continues to flourish as the number one outsourcing destination. With the potential of China, and India as the incumbent leader in the outsourcing arena, it is inevitable that competition eventually arises between the two nations, more so since China shares common traits with India – the same characteristics that has propelled India’s stature in outsourcing. These include scalability, an IT-skilled labor pool, cost arbitrage, and sizable city centers equipped with robust infrastructure.

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12 Source: UNCTAD Report 2009
These traits will be the foundation for China to challenge India and the Philippines in the regional outsourcing landscape. But, Tholons believes that the evolving competition between these two nations is not at all unhealthy. In contrast, this is where coopetition (cooperative competition) or healthy competition and direct cooperation between the two nations, will be more beneficial.

Below are some comparative points of India and China and how both present opportunities to the other:

**Presence of Domestic Market:** China and India represent 37% of the world population with 1.33 billion and 1.17 billion inhabitants respectively – the world’s two largest consumer markets. With increased economic development in both nations, GDP per capita rise also indicates increased consumer spending. Both countries will benefit from this trend as each may tap and expand presence within their own markets. However, this opportunity is more pronounced in China as there is greater room to expand services in the local ITO/BPO space, for both Chinese and Indian service providers alike. China’s focus on tapping its local market will not only increase revenue for domestic ITO/BPO spending but also help develop its outsourcing industry. In developing its capabilities, utilizing India’s expertise (and presence) can be crucial as India can provide the required knowledge to fast-track the maturity of China’s service delivery capabilities.

**India’s Expertise:** With India’s mature service delivery capability, establishing Indian MNCs in China gives it an advantage in the receiving end. Best practices by Indian companies, as mentioned above, will be beneficial to the outsourcing ecosystem of China as Indian MNCs locate in the county, transferring domain knowledge and expertise, helping develop China’s service delivery capabilities.

**Home-Grown Service Providers:** Supporting the first point, the presence of providers from India and China in either location also has the potential to open new business opportunities for both nations. For instance, Indian providers have been in the industry longer allowing it to establish stronger relations with US and UK client markets. As Indian service providers expand in China, they bring this value add to the table. On the other hand, companies in China pose a stronger relationship with Eastern Asian countries that gives India an opportunity to expand in region once Indian service providers set up shop in China.

Indian service providers includes TCS, Infosys, Wipro, Mahindra Satyam, Patni and HCL while Chinese counterparts includes companies such as Neusoft Corp., Hisoft Tech, Vance Info, UFIDA, Asiasoft, DHC, Chinasoft, Beyondsoft, etc.

**Employed in Outsourcing Sector:** India has an employed labor pool of about 1.76 million working in the offshore outsourcing segment of the country. China in comparison, only has an estimated 320,000 employed in its industry, and despite the country graduating more than 4.4 million students annually - this shows the country’s potential scale - an opportunity for both Indian and Chinese service providers to tap.

Arguably, it can be said that China may benefit more from the value brought by India since the latter is the more mature destination of the two, the coopetition-based relationship between these nations should be sought and developed in the near-term in order for them to maximize the opportunities at hand. The figure below illustrates what each country lacks and what value-add they can bring to the other.
With the increased presence of Indian service providers in China, it will naturally transfer best practices and service delivery knowledge to its counterparts and will eventually lead to the capture of this market and additionally increase its international market share as it progress. As of date, a number of Indian companies have already invested in China which includes Infosys, Mahindra Satyam and Wipro technologies. Though this occurrence may be viewed as giving life to the most formidable competitor of India, Tholons believes that Indian MNCs already present in China identified the opportunity at hand and has first-mover advantage. As India transfers knowledge and contributes to the development of China’s service level maturity, it is in turn doing two things to its advantage:

**The Benefits of Outsourcing:** India as a client of China to outsource its non-core processes virtually gives the country what it offers US and UK clients. When using the outsourcing business model, India saves cost while it enhances its business efficiency.

**Penetrate New Client Markets:** Establishing strong relations base in China could potentially lead to the Korean, Japanese and even the local Chinese markets that Indian companies have long prospected for.

In return, China will improve its service delivery capabilities while expanding across client markets – which now will include India aside from the already established Japan and Korean markets. In a similar case which will be discussed in the latter section of the article, US captive providers who started operations in India and the Philippines eventually lead to the maturity of their niche services in ITO processes and Contact Support operations. Another example is how US manufacturing firms transferred techniques to Japan’s electronics and automotive industries. Japan, as the receptor country, initially was intended to supply services for captive operations in the said industries. However, it ultimately became more skillful in these ‘transferred process.’
Tholons sees the China-India relationship to be in a similar situation where each country may be viewed both as contributing to the development and growth of the other.

**Points to Consider: The Road Ahead**

The past decade saw rapid growth of the global outsourcing industry across all horizontals and verticals. Beginning from non-core/low-end processes in the BPO sector, growth has carried through high-end ITO services, and more recently, across KPO processes. Moreover, virtually all industries increased demand for outsourced services – led by the banking and finance sector, technology and communications, manufacturing, entertainment, retail trade, health and transportation (see Figure 1.4).

![Vertical Market Exposure for Industry Exports](image)

**Source:** NASSCOM Factsheet 2008

It is interesting to see how China has evolved through the last decade in comparison to its Asian counterparts and also see what lies ahead of China. The figure below shows a timeline of the evolution of the outsourcing industry in relation to India, China and the Philippines:
India’s path in outsourcing began as early as the 1980’s. During the period, technological limitations restricted service providers from expanding across geographies and applying the shared services model. While offshoring and outsourcing were still not prevalent terms, India was already underway in developing non-core processes for the soon to be recognized industry. As first movers, Nortel and GE established captive service delivery operations in the country, inadvertently laying the foundation for India to develop its now massive outsourcing industry. Once these captives settled and with advancements of technology infused into the ecosystem, India began to enhance and expand its lower-end BPO services. At the onset, back office processes and bulk-oriented services such as contact center, payroll, transcription, etc. were fulfilled by a host of small and medium sized Indian providers. In the succeeding decade, and as the services industry matured, Indian companies became more aware of demand trends and slowly transitioned work to higher-end knowledge and technical based processes as found in the ITO and KPO spaces. This gradual process of development and movement from non-core services to specific niche capabilities gave India the edge and market control over other service provider nations. The sub-continent slowly, but surely learned from its outsourcing experience, while continuously while fine-tuning delivery processes and capabilities.

The Philippines on the other hand, started in the late 1990’s. In just ten years in the industry, the country has become the second largest outsourcing destination in terms of offshore market revenue, and despite having an outsourcing labor pool that is only 25% of India’s size. Similar to India, captive operations and in addition, large third party service providers were the catalysts for industry growth. However, the essential difference is that growth was centered around the
Contact Support industry, an industry having characteristics of lesser complexity when compared to high end BPO/ITO processes (such as those found in India). This allowed the industry to develop at a relatively faster clip when compared to India and knowledge and Best Practice transfers were also noted to have transpired in a more fluid manner.

Similar to the Philippines, China's outsourcing industry began in earnest early this decade. Though this is the case, the industry has not matured in the scale the former has. This is due to several factors that differentiate the two countries such as English language capabilities, cultural affinity to the North American market, cost arbitrage, etc. Beyond these factors, Tholons sees that the primary difference is the type of service processes which China initially focused on as a determining factor for industry development. China started servicing mid to high end ITO services banking on the capabilities of its IT sector and labor pool. These are considered complex processes and have only begun to show accelerated growth in China over the last five years. In contrast, the Philippines covers the lower-end BPO segment in Contact Support which needs minimal technical skill sets when compared to ITO processes. This set-up allowed the Contact Support industry in the Philippines to scale faster unlike complex processes which needs more time to mature properly. As mentioned earlier, India took 20 years to develop and reach the service maturity level it has now with its ITO processes, a feat that China is just starting.

The Road Ahead: From Opportunity to Reality

As many analysts would say, “China is the next India” – a mantra whose resonance has become increasingly loud in the last few years. Tholons perceives that because of the continued maturity of components across the outsourcing landscape (both from buyer and provider perspectives) – innovation in technology, emergence of competing geographies, maturity of service providers, evolving demands of service buyers and client nations – global market shares will slowly level off and will become more evenly distributed across geographies. This will undoubtedly include China (see figure 1.3). A single country dominating the global share (as exemplified by India over the last decade) is not indicative of the long-term landscape of global outsourcing.

While China is concentrating on developing ITO services such as Applications Development Management, Testing Design, Infrastructure Management Systems Outsourcing and Enterprise Resource Planning, the trend that is seen in the industry now is the transition from a process to a knowledge driven delivery model. ITO service providers are now focused on competing for the next wave of processes such as Embedded Systems, Cloud Computing, Software Research and Development, Software as a Service (SaaS), Green IT and virtualization. As China’s ITO industry matures, the country can move to these new processes and capitalize on the market prospect it brings since the country has been ITO focused to begin with.
China should look at accelerating its outsourcing industry to further capitalize on current ITO opportunities, and especially as more emerging providers from different global regions are beginning to mature in the same manner China is experiencing. These include South American countries such as Brazil, Chile, Argentina and Uruguay while Eastern European countries such as Poland, Russia, Czech Republic and Romania are also fast developing. Below are several factors that will help improve China’s position in the outsourcing industry:

**M&A and Funding:** Though there has been significant increase in mergers and acquisitions and investments from venture capitalists over SMEs in China in recent years, the country needs to attract more deals coming from Indian companies. Investments by Indian service providers in the country either by setting up shop in China or getting involved in M&A deals will eventually lead to the transfer of their best practices to the local outsourcing ecosystem.

**Service Delivery Maturity:** China should also focus on developing its service level maturity first before expanding its geographical footprint to Tier II cities across China. There are more than 100 cities with a population of 1 million and above in China which gives them scalability. But before China scales (or expands in the global stage), it should first focus on improving its service delivery capabilities. Moreover, the opportunity that the local market brings should not be overlooked as it may well be the first market that should be addressed. As the shared services model is adapted by local companies in tapping local service providers, it will then be easier for these service providers shift its services from local clients to the international market.

**Coordinated Effort in China:** An Apex body for streamlining the effort and directing the outsourcing industry of China is needed so that different organizations involved in the industry will have a consistent and specific goal. The body should act as the standard bearer of the country when promoting China’s outsourcing industry while becoming a liaison among different outsourcing stakeholders in the country. Ideally, this should be similar to a NASSCOM (India) or BPA/P13 (Philippines) counterpart that will specifically promote the outsourcing industry in China. The apex body should lead coordinated efforts by devising national policies, forging strategic partnerships at national & international level (especially with Indian service providers) providing guidance and support to the industry.

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13 Business Processing Association of the Philippines
**Collaboration – NOT Competition:** Taking the last point forward, provinces in China must work with each other instead of purely competing against one another. The environment of pure competition created by these provinces is detrimental to the development of China’s outsourcing potential and has turned out to be unhealthy for the China Outsourcing brand. Initially, China needs to enhance and develop the “China Outsourcing Brand” first before specific provinces/cities move into this competition. Without a strong hold of the brand the country is offering, it cannot move into one direction. As an example, India positioned itself as a complete value proposition from the offshoring client’s perspective. Prominent offshore locations like Bangalore, Mumbai and Delhi have always been separate chapters in the India story, at the same time never competing directly in the eye of the client. India hence was able to showcase a broadened services outsourcing capability and ability to scale-up further towards a broad-based sustainable growth. Similarly, China needs to strengthen the collaboration between these provinces and focus on the task at hand – enhance China’s service delivery capabilities.

**Labor Pool Capability:** One of the more pressing issues that need to be addressed by China revolves around labor pool employability (skill-set related). The vast workforce can become inconsequential if large portions of the pool are in fact unemployable by the outsourcing industry. Specifically, the segment of the pool with less than adequate levels of English proficiency and technical skill sets. Emphasis on English has improved and there is progress in the right direction, however there is still ways to go for China to fulfill its potential, as it often remains inhibited by language and cultural barriers. For example, China churns out an estimated 700,000 IT professionals annually, far greater than India’s 300,000. Though this is the case, China is still far behind India in the ITO services space. India’s equally talented labor pool, its strong English capability, service delivery maturity and cultural affinity to major US/UK clientele, give the country the momentary edge over China in this particular outsourcing front.

**Enhance Japan/Korea relations:** While the past several years have been considered to be still the developmental stages for China’s outsourcing industry, the country still managed to capture two promising client nations in Japan and Korea. As stated in the previous section, this is an advantage that is not fully materialized.

China has an outstanding position in the global outsourcing arena today. While its good hold of the Asian market is extremely limited to Japan and Korea, it is of importance to note that these are the two most profitable Asian client nations. In addition, the country also has a fast growing confidence level from the US and UK clients. The position of China in these two parameters gives them a definite advantage which is why it is only a matter of time when China gets a bigger pie of the offshore outsourcing industry. Though this is the case, and because of the rapid industry dynamics and the mature outsourcing ecosystem seen in the industry today, China does not have the luxury of time that India may have had before, where India was the lone, dominant industry player, allowed to grow and mature at its own pace. China needs to act quickly in order to capture current potential market and should address its most pressing concerns in order to accelerate the industry’s maturation process.
Tholons is a Services Globalization and Investment Advisory firm that combines "Best of Breed" consulting experience with deep execution expertise and investment insights to deliver truly effective services to its clients. Tholons offers a detailed understanding of business processes and combines it with practical hands-on expertise in executing the strategy. Tholons draws upon the considerable experience of a hand-picked team, which has successfully formulated and executed globalization strategies to unlock value for Global Fortune 1000 companies. Service providers leverage Tholons expertise to optimize their global delivery model. Tholons advisors engage with government bodies to build compelling strategies for making countries attractive destination for outsourcing.

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