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Abstracts of papers presented at

RSA Research Network Seminar

## **Outsourcing and Offshoring Business Services: Theoretical Perspectives and Global Trends**

4<sup>th</sup> - 5<sup>th</sup> September 2008

Centre for Contemporary European Studies,  
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## Explaining the Geography of Foreign Direct Investment in Export Services

Proinnsias Breathnach

While investment in services now dominates global foreign direct investment (FDI) flows, the great bulk of this investment is in activities which serve the local markets in which they are located. At the same time, the last twenty years have seen particularly rapid growth in FDI in "export services" i.e. service activities which primarily serve markets other than the markets of the countries in which they are located. Such FDI can be divided into two categories: that which involves activities whose market is the home country from which the investment emanates (the term "offshoring" strictly refers to this kind of investment) and activities whose main markets are other than the home country.

This paper addresses two key questions relating to the rapid growth of FDI in export services:

- Why does this type of investment take place at all?
- What factors determine the destinations in which this type of investment is located?

While early offshoring of this type of FDI, like its manufacturing counterpart, was strongly influenced by the search for cheap labour, the range of factors driving overseas investment in export services has become increasingly complex (especially as the types of services in question have become increasingly sophisticated), and includes the search for skilled labour and tax incentives, regional rationalisation of TNC operations, the need to have back-up sites for global operations and the need to facilitate round-the-clock availability of certain services.

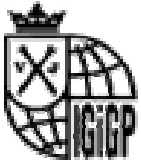
The increasing range and sophistication of export services has meant that investors are correspondingly demanding and selective in their choice of locations for such services. Among the location factors identified in the paper are: cost and quality of labour, availability of tax and other incentives, availability of ICT and other business infrastructures, a conducive business and political environment, linguistic and cultural compatibility, and the locations of previous investments.

These factors are illustrated by reference to the case of the Republic of Ireland which, despite its small size, has become the leading global destination of FDI in export services. Such services now account for over 40 per cent of total exports, and have become the main source of dynamism in the Irish economy. FDI in service exports in Ireland has been confined to a limited number of key activities: financial services, software and centralised administrative support for TNC operations spread throughout Europe. The paper concludes with some observations on the future outlook for FDI in export services, and on the ensuing implications for Ireland's role as a key location for such services.

### **The growing significance of Ireland as a centre for internationally traded business services**

Patrick Collins, Seamus Grimes

With the rise of newly emerging regions both in Asia and Eastern Europe, there has been a considerable shift in investment from more developed regions to these lower cost regions, with China attracting huge growth in manufacturing investment and India attracting investment in services. The rise of these lower cost regions has had a major impact on the geography of competitiveness internationally, with the growing trend in outsourcing and offshoring manufacturing activity, particularly, but also increasingly services also. Higher cost regions such as Ireland, which initially benefited considerably from significant inward investment in high technology manufacturing, primarily from US corporations seeking a location within the European market, are now facing increased competition from these lower cost regions and are undergoing a major change in the profile of their inward investment and their economies generally.



This paper will examine this major change in emphasis in Irish economic activity away from manufacturing towards an increasing focus on business services. This shift is partly explained in the Irish context by a significant growth in financial and business services, whose main concentration is Dublin's Financial Services Centre, but have also resulted from the widespread evolution that has occurred in Ireland's inward investment technology sector from producing goods and equipment to servicing the European, Middle East and African markets on behalf of technology corporations. This significant development reflects the emergence of Ireland as a major services hub within this triadic region somewhat akin to the role of Singapore in Southeast Asia. Using aggregate comparative data, the paper will examine the growth in internationally traded services in Ireland in recent years and identify the major subsectors driving this growth. The paper will also pay particular attention to a number of major case studies of technology companies in Ireland reflecting this shift from manufacturing to services.

These changes present significant challenges both at the theoretical and policy levels. Academic analysis of service activity to date indicates a failure to develop an effective conceptual framework capable of dealing effectively with the integrated nature of a wide range of servicing functions often within a production environment. The traditional focus on sectoral boundaries between manufacturing and services, together with the traditional statistical categories and metrics for measuring economic activity in the different sectors, make it difficult to develop workable frameworks to capture the nature of the change taking place. Rather than a snapshot ranking of the comparative advantage of regions according to their attractiveness as locations for the outsourcing of specific service functions, an evolutionary approach which seeks to track the changing roles of particular regions within value chains may be more effective. Based on the Irish experience of subsidiary evolution from manufacturing to services, this paper will argue in favour of a more integrated way of evaluating the significant emergence of internationally traded services in Ireland in recent years. The policy implications for adopting such an integrated framework will also be explored.

### **Future Bangalores? The increasing role of Central and Eastern Europe in financial services offshoring**

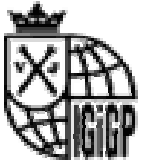
Zoltán Gál

Today offshoring in combination with the BPO (Business Process Outsourcing) activities became one of the key drivers of regional corporate concentrations in business and financial services. Offshoring means the relocation of certain financial activities from one site to another, which requires the geographical reorganization of corporate service value chains by choosing among a number of locations. My paper deals with the participation & performance of the CEECs in the world-wide BPO offshoring activities.

The paper explores 3 issues:

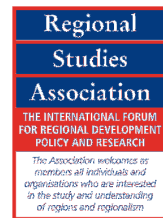
First, it builds upon the theoretical framework of the 'new paradigm of globalization, which considers offshoring as one of the most important globalizing forces recently. This resulting in a shift in global trade, namely from 'trade in goods' to 'trade in tasks' and determined by the changing trends in the division of labour. I would like to explore the spatial implications of this model demonstrating how the offshoring process is shaped by geography and involves different expertises from particular locations (regions).

Second, it explores how the European shift in the geographical distribution of business service provision, the increasing BPO offshoring activities and corporate restructuring open up new opportunities for the CEE region. This resembles the global trends, namely the growing share of services in foreign direct investment. As the EU expanded eastwards, the opportunities for European



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corporations to offshore their financial activities to these 'nearshore' locations increased. The paper gives an overview of the regional pattern of BPO offshoring of the CEE region in comparison with its global counterparts.

Third, the paper explores the role of offshoring activities in the International Financial Centre (IFC) formation process and the factors what make the CEE region and its major cities an increasingly attractive option for financial companies to relocate their BPO activities. The paper puts BPO offshoring to the wider framework of evolutionary stages of IFC formation within the CEE region and demonstrates how the offshoring became one of the key repositioning factors of these cities in question. Collecting the broader sets of factors aggregating from different indicators (financial market indicators, costs, HR, Business Environment, Market potential, Infrastructure, Real estate) I would like to set an alternative model to cost saving objectives positioning the CEE cities within the global marketplace.

### **Outsourcing, off-shoring and company restructuring: a home country perspective**

Graham Hollinshead, Jane Hardy

We examine the complexities of the outsourcing/ off-shoring process in the financial and business services sector. Drawing upon interviews conducted with senior managers and partners from two leading international banks, a multinational 'consumables' provider and a leading finance consultancy, as well as extensive published surveys, we reveal that the international re-organisation of financial services and related industries both mirrors and complicates earlier equivalent developments in manufacturing. We conclude that, despite the devolution of high, as well as low, added value functions to overseas locations by such firms, the equivalent redistribution of risk serves to ensure that the centre retains a virtually insuperable strategic position in international operations.

### **European Trends in the Outsourcing and Growth of Knowledge-Intensive Business Services**

Robert Huggins, Jonathan Day

The increasing economic focus on knowledge has spurred the growth and development of knowledge-intensive business services (KIBS) to such an extent that they have become one of the fastest growing sectors in advanced and developing economies, as well as an increasingly important source of innovation. Furthermore, the increasing focus of leading and high growth firms on their core competences has fuelled growth in the outsourcing of the types of services provided by KIBS. In Europe the growth of KIBS has outstripped the average for all sectors with much of this growth a result of development in computer and related activities. Drawing on primary and secondary data, this paper presents an analysis of the development of the European KIBS sector in recent years. It highlights the European trends in KIBS provision, especially the development of new and emerging markets, as well as the spatial – national and regional – aspects of these developments. At a regional level, London's globally competitive legal services cluster and the emerging ICT-driven KIBS cluster in Helsinki are examined to understand the drivers of change associated with the growth of these activities. The paper also presents findings from a cross-section of KIBS firms located in the UK, France, Ireland and Germany to assess future challenges to their competitiveness. From these findings we develop a number of scenarios based around three core themes: (1) globalisation - which

is having a large impact on KIBS in terms of markets as well production. For some KIBS firms globalisation has enabled them to offshore production, while for others it represents new markets



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and opportunities for expansion and acquisition; (2) skills development in emerging nations – which refers to the fact that not only is the size of the international KIBS market expanding, but also improvements in the labour market and productive capability of developing countries. Increased skills and growing export levels mean that developing nations are no longer simply markets and locations for offshoring, but also competitors and potentially collaborator in their own right; and (3) technological progress – which is also impacting enormously on the development of KIBS. Improvements in information and communication technologies (ICT) mean it is becoming easier to share knowledge and information, with such improvements enabling businesses to penetrate international markets. Technological progress can also lead to increased automation in KIBS sectors, which can help to reduce costs, may also result in some lower value added employment becoming displaced. The paper concludes by highlighting some of the major public policy implications arising from the analysis.

## **Project Management Approach as a Key Factor of Successful Outsourcing Implementation: Theoretical Aspects and Empirical Evidence in the Czech Republic**

Kateřina Maršiková, Petra Rydvalová

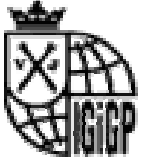
Outsourcing nowadays is a strategy that we can meet commonly in the most of organizations. Outsourcing involves the transfer of the management and/or day-to-day execution of an entire business function to an external service provider. It may or may not involve some degree of offshoring. Outsourcing is an activity for which the company uses external sources and the main reason is the perspective to decrease costs. Nevertheless there still exists a big amount of organizations that in the situation of outsourcing decision making of the certain inner activities, processes or resources do not have required knowledge and information to decide to outsource any activity or service. Offshoring describes the relocation of business processes from one country to another. This includes any business process such as production, manufacturing, or services, regardless of whether the work is outsourced or stays within the same company. Offshore outsourcing is than understood a combination of outsourcing and offshoring - hiring an external organization to perform some business functions in a country other than the one where the products or services are actually developed or manufactured.

The aim of the paper is to explore theoretical aspects of outsourcing, offshoring, offshore outsourcing and nearshoring as key factors of global markets and inform about current situation in Czech business environment from this point of view. The paper is divided in three main parts. The first part of the paper analysis a successful outsourcing implementation from the theoretical perspectives. There is pointed out a project management approach as a key factor to use outsourcing efficiently.

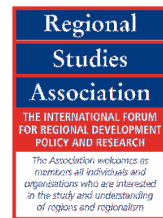
The second part brings empirical data from the Czech Republic on macro and micro level describing the situation of outsourcing and offshoring in the Czech Republic. As was notify in Economist Intelligence Unit study recently, the Czech Republic is the third among the most attractive offshore locations in the world due to a combination of relatively low labour costs, relatively well-educated workforce, an attractive regulatory environment, and close proximity to Western Europe, with which it also shares close cultural and historical ties. This aspect makes the Czech Republic attractive for world-class companies to establish there a part of their business activities. The Czech Republic has recorded a remarkable inflow of projects into the business support services sector over the past five years.

In the last chapter there is described situation on micro level, it means how Czech companies use outsourcing principles. The situation is illustrated on results of the survey done by the author, group

of respondents was more then 100 Czech companies questioned in 2007. The survey identifies some deficiencies in outsourcing application within the Czech environment.



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## Looking for the Core in Knowledge Globalization: The need for a new research agenda

Kathy Pain

In the context of the economic shift in the new wave of globalization to oil producing countries in the Middle East and Russia and the emergence of South East Asia, especially China, as a major service market and locus for production, the EU Lisbon process has formally recognised knowledge-based business services as essential for European competitiveness in the 21<sup>st</sup> century global economy.

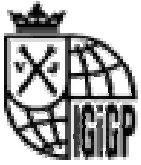
Until recently, theorization has focused on a core-periphery model of global economic development based on a world division of labour. Advanced financial, professional and creative business services have been associated with 'developed world' economies, in particular with 'world' or 'global' cities due to their paradoxical spatial relations in economic globalization. In order to provide knowledge-based services to transnational companies increasingly doing business on a world-wide scale, their operations have dispersed geographically but at the same time integrated globally, leading to agglomeration of core functions in key service nodes in advanced economies, London, New York, Tokyo, ... (Friedmann, Sassen etc.). Manufacturing production and more recently business (knowledge) process outsourcing (BPO/KPO) services, have been located in the developing world on the basis of lower labour costs and exploitation.

In spite of intensive use of the new information and communication technologies (ICTs) that have enabled contemporary globalization and dispersal to occur, it has become clear that certain knowledge production functions remain highly dependent on the personal and cultural relations associated with dense clustering in highly developed 'global cities'. Relationships that are essential for high complexity transactions, trust and tacit knowledge transfer, require proximity to transnational specialized, skilled labour that is highly concentrated in an elite group of world business capitals.

But recent research reveals a more complex emergent architecture of business service development that is emerging in the context of increasing cross-border competition in globalizing markets. New functional models and practices are producing operational and organizational structures that challenge a settled view of the geography of knowledge services with important implications for geo-functional relationships in the new era of knowledge globalization.

A variety of functional models for 'second sourcing' and 'multi-source' outsourcing and off-shoring of non-core services has arisen, but the need for firms to reduce cost has to be balanced with their need for market agility and to offset risk, cultural differences and management complexity that challenge global control, communication and co-ordination. Developed world in-sourcing (which involves post-communist European countries) has been an outcome and the reasons for outsourcing/off-shoring are changing. There are signs that traditional governance models which simply leveraged low pay conditions, for example in India and the Philippines, are changing to collaborative business models in emergent world globalization regions, for example in China.

Advanced primary and manufacturing production processes are increasingly reliant on knowledge functions and services - financing, advertising, marketing, supply chain and logistics management - that add value. The global location of 'back-office' service activity, core competencies and innovation is mobile. In this situation of fluid functional-spatial relationships, geo-political assumptions upon which traditional theorization has been based need to be reconsidered on the basis of new empirical evidence.



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## **Global trends in business service movements: the role of East Central Europe, with special emphasis on related methodological problems**

Magdolna Sass

With technological advancements, especially in the field of communication technologies, fragmentation in services has been made possible. This induced a process of relocation of certain services activities to locations where they can be carried out at lower costs and/or in better quality. The outsourcing of services activities, especially those of business services, is a relatively new though more and more widespread phenomenon in the world economy. Due to that process, and to the liberalisation of services trade, especially among member-countries of regional integrations, new countries have been increasingly appearing on the map of trade in services. Among others, countries of East Central Europe, especially the Czech Republic, Hungary and Poland are affected to a great extent. They have become hosts to various business services through relocations of these activities from other, higher cost locations, especially from the Western Europe as well as through the establishment of new capacities. After listing and discussing in detail various issues connected to the problems of the measurement of the process (both business outsourcing and relocation), the paper makes an attempt to estimate the extent to which the above mentioned region (and countries) are affected by the process, using mainly foreign trade data and already available estimates from other authors. Moreover, it is also discussed in the paper, what type of activities and from where are relocated or located to these countries, and what the main location advantages of these countries are in attracting this type of activities. The paper is based on detailed company case studies as well as on a database of relocated projects, collected for Hungary for the period 2003-2007, alongside the methodology used in Hunya, Sass (2005) and based on the definition of relocation given by Veugelers (2005).

### **From industrial city to BPO destination center. A fantasy or real trajectory? Case of Łódź (Poland)**

Mariusz E. Sokołowicz

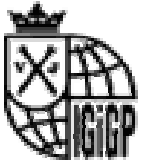
Internationalization of economic activity is one of the most important facets of globalization. It is possible due to lowering costs of communication (thanks to innovation in ICT), liberalization of international trade, and lowering level of investment risk of global-scale coordination of economic activities. Recently, also performing some of business services outside the country of the enterprise's origin, becomes more and more popular process. This process is called BPO – business process offshoring or business process outsourcing (in case when service sector activities are remote performed by a third-party company).

Although vast majority of BPO is localized in developed countries today, it is growing faster and faster in cities and regions in less developed states, offering lower labor costs. However, labor shortages experienced in the latter, as well as accession of Central and Eastern European (CEE) countries to European Union, together with their geographical, cultural and lingual proximity, opened wide prospects for this part of the world.

Analysis of recent data has revealed the growing role of many CEE metropolitan areas as BPO locations. What is important, due to spillover effects, BPO investment is not taking place in CEE

capitals only, but also in other regions as second-tier locations, so far known mainly as industrial regions.

The aim of this paper is the presentation of the case of Agglomeration of Łódź as one among other Polish cities and showing the conditions for future development of BPO in this region. Since the beginning of ninetieth century till now, Łódź has been known as a center of traditional industrial



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sector. Even today, described as a region attracting more and more foreign capital, mainly industrial FDI is being mentioned. However, being a second-rank city in settlement structure of Poland, with its number of universities, students and scientific potential, it is emerging as more and more important BPO location. In this context, an attempt to answer three following questions is taken: has Agglomeration of Łódź a chance to develop as one of main BPO location in CEE countries? Are BPO activities fostering economic development of the region more than industrial activities? Does foreign direct investment in BPO promote innovativeness of Łódź?