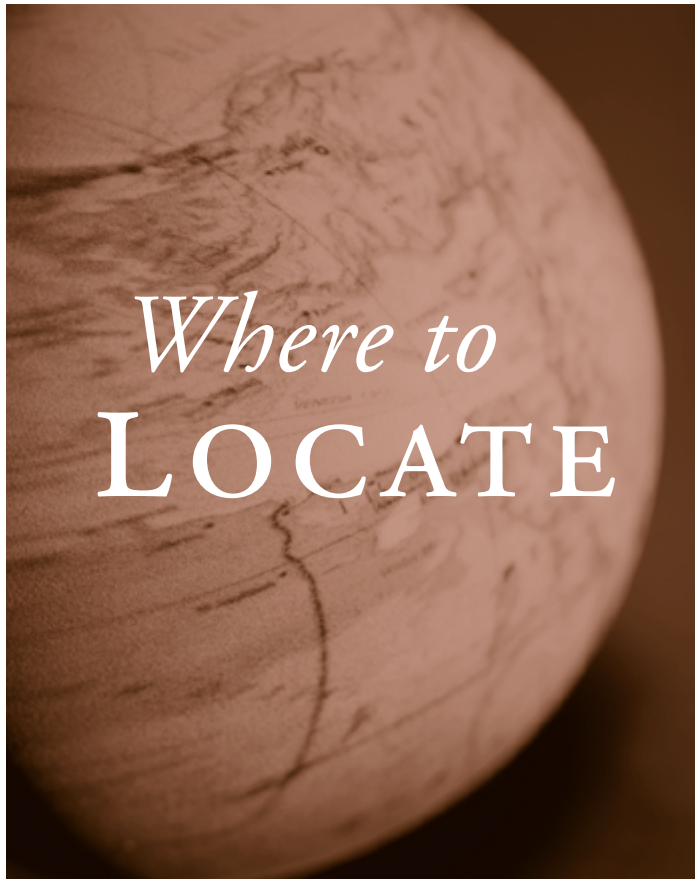


*Selecting a Country
For Offshore Business Processing*



Introduction

Through the suburbs of Delhi, an offshore business processing vendor drove a van full of executives from a major North American multinational corporation and consultants to his location. We stopped outside a factory building, the only vehicle in the parking lot. The vendor led us up two flights of stairs and opened a door onto a huge empty space, just floor, columns and windows. “Not long ago, we made shoes here,” he said. “Then it got too expensive and the manufacturing moved to China. Now we can put your call center here.”

As one manufacturer moves in search of labor arbitrage, other firms scout the former premises. They arrive at different answers to one of the most difficult strategic questions faced by companies exploring their offshore options: Where to locate?

At a time when international tensions are high, the offshore movement continues unabated. Last year, nearly half of all CIOs used offshore providers to avoid high labor costs in the United States and Europe, and two-thirds say they plan to send work overseas this year, according to Forrester Research. And the work being sent offshore is not only in software development, which is a long-established trend. More companies are migrating their business-specific, back-office processes to low-cost countries as well.

Yet while offshore business processing is among today’s hottest topics, few CEOs have had an objective, rigorous or comprehensive basis for comparing host countries.

Until now.

A.T. Kearney has developed a quantitative evaluation tool to support companies’ offshore location strategies (*see sidebar: The Offshore Evaluation Tool*). This proprietary tool rates countries according to three factors: cost, environment and people (*see figure 1 on page 2*). Each factor is assigned a weight, thus establishing its importance and relative ability to meet a company’s unique needs.

In this paper, we discuss the offshore prospects of 11 countries, all of which are finalists in our evaluation. We explore the various attributes and characteristics of the countries, and examine what makes them good or not-so-good candidates for offshore business processing. Finally, we trace the progress of the Alpha Company, a fictional firm, as it systematically works through its own offshore decision-making process.

WHO IS ON TOP AND WHY?

Most people think of India when they hear the word offshore—and for good reason. It leads in most polls, including the composite scoring in the A.T. Kearney evaluation (*see figure 2*). But India is not the only answer when it comes to offshore business processing. Just as not all companies are alike, neither are all countries.

Indeed, our evaluation shows that leading companies are increasingly following multi-country strategies to ensure business continuity. For example, in the event of a natural disaster in Delhi, a comparable workforce in Manila

could perform the same business process without interruption. By the same token, companies find it useful to identify subcategories of countries that are most apt to meet their specific needs. For example, top U.S. companies often begin their offshore decision-making by narrowing the field to all nations with specific language capabilities before settling on a final offshore locale.

Based on our evaluation and findings, as well as data from industry analysts and subject matter experts, we offer the following country-by-country analysis of the major offshore locations,

Figure 1: Criteria and weights in country analysis*

CATEGORY (Percent of total)	COUNTRY CHARACTERISTICS	METRICS USED
Cost (40%)	<ul style="list-style-type: none"> • Cost of labor • Cost of management and infrastructure • Tax and treasury impact 	<ul style="list-style-type: none"> • Blended BPO and IT labor cost • Average cost of infrastructure (occupancy, utilities, telecom, management) • Corporate tax rates, profit realization and exchange rates
Environment (30%)	<ul style="list-style-type: none"> • Risk (economic, political) • Country infrastructure • Cultural compatibility • Geographic proximity • Security of intellectual property (IP) 	<ul style="list-style-type: none"> • Gauge political and business risk, degree of government support • Relative strength of infrastructure and investments • Cultural differences or compatibility compared to United States • Relative distance (in bands) from United States • Relative security of intellectual property
People (30%)	<ul style="list-style-type: none"> • BPO and IT process experience • Size of labor market • Education level of work force • Language barriers and literacy rates • Employee retention 	<ul style="list-style-type: none"> • COPC and CMM SEI and quality ratings, business process expertise and offshore market share* • Available total labor market • Expected per capita education level • Percent fluency in English (overall and select companies), country literacy rates • Select company retention and turnover rates

*Customer operations performance center (COPC) defines performance standards for call centers worldwide; capability maturity model (CMM) was developed by the Carnegie Mellon Software Engineering Institute (SEI)

Source: A.T. Kearney

including reasons why more companies choose these countries over others to meet their unique offshore needs.

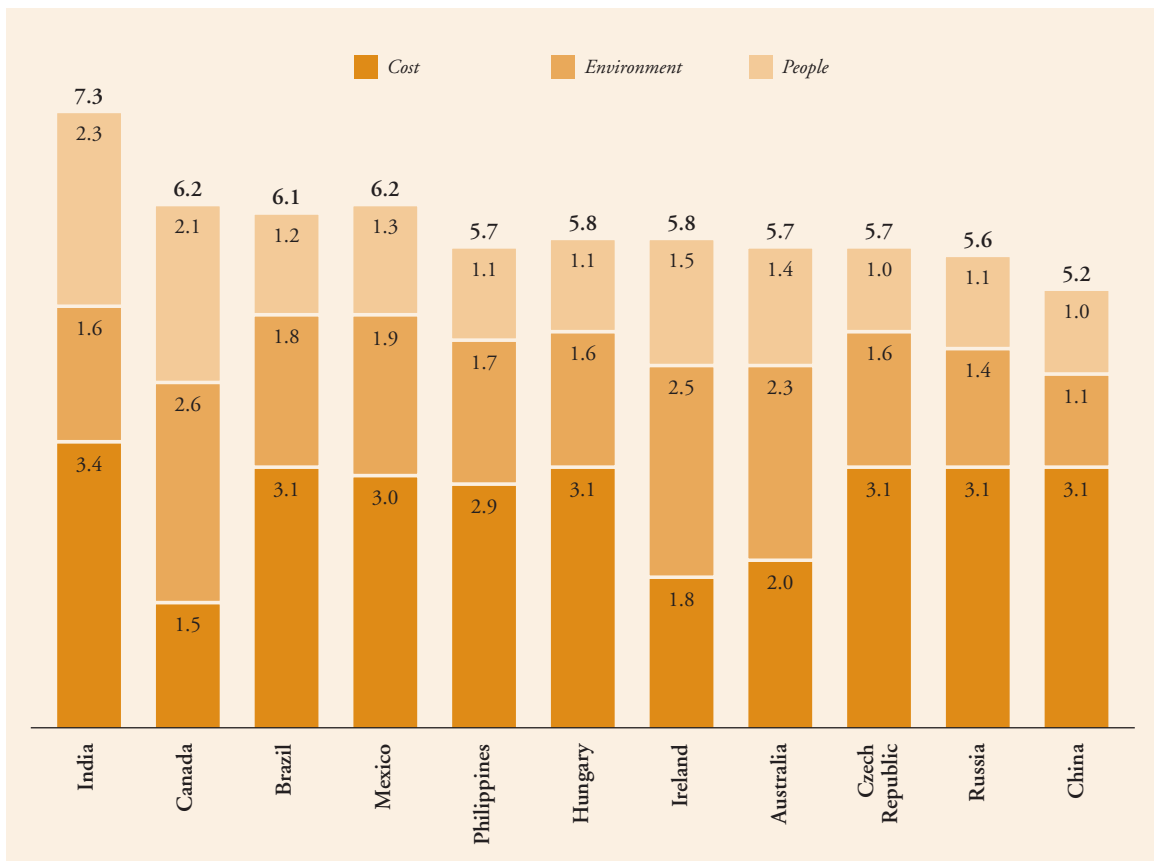
India

India is the top rated country in two of the three major categories, cost and people. It boasts the most highly skilled, lowest cost labor force (see figure 3 on page 4). This is a powerful combination, particularly when its experience in

offshore business processing is factored into the mix. GE Capital, American Express, Citibank, Conesco, British Airways and Dell Computer are among the many companies taking advantage of India's capabilities.

In the financial services industry, Citigroup lists India among its top offshore choices. In 1999, Citigroup formed e-Serve International, an offshore business processing company in India. The business has grown from 1,200

Figure 2: Composite scores by country*



*Scoring methodology reviewed and confirmed by leading industry analysts

Sources: A.T. Kearney, Bank of America, Economist, Gartner, Giga, IDC, International Country Risk Guide, World Bank, World Markets Research Center and UNESCO

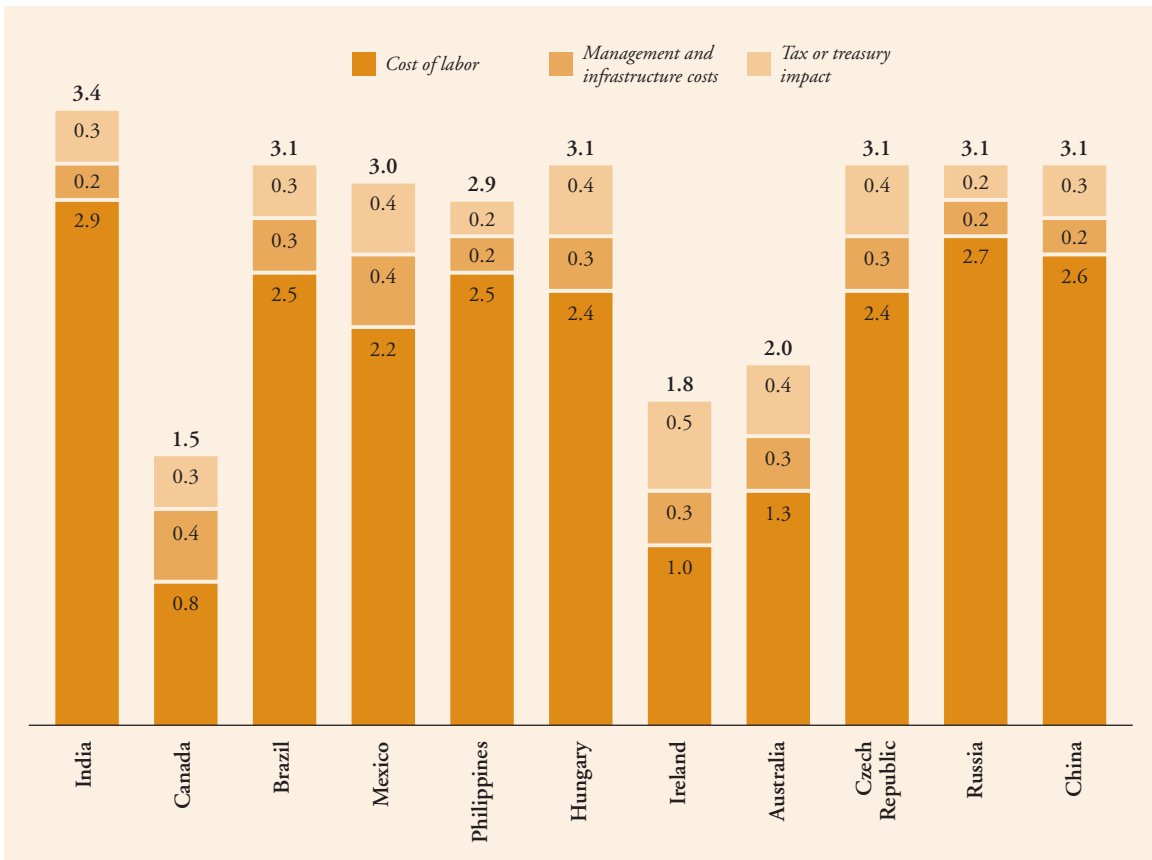
employees in 1999 to more than 3,200 in 2003, and performs 100 million transactions per year.

Today, e-Serve supports Citigroup in 25 countries from its global contact center in Mumbai, four call centers and two global processing sites. This support includes internet-enabled customer-care solutions, and transaction and technology services. Although e-Serve remains exclusive to Citigroup, it could eventually break the bonds of the captive model to

become a business processing provider.

Citigroup was one of several multinational pioneers, along with GE, British Airways and American Express, that first committed to India as a key location for back-office support. Citi's foray began in 1992 through Citicorp Securities and Investments Limited. Low costs may have attracted these pioneers initially—and they have achieved savings of 50 percent—but service quality has kept them there

Figure 3: Cost scores by country*



*Scoring methodology reviewed and confirmed by leading industry analysts

Sources: A.T. Kearney, Bank of America, Economist, Gartner, Giga, IDC, International Country Risk Guide, World Bank, World Markets Research Center and UNESCO

and is spurring ongoing growth. Citigroup continues to set trends in offshore business operations, opening regional processing centers in Ireland and Singapore to complement its global scope.

GE Capital International Services (GECIS) is a prominent India success story. Originating as a joint venture in 1997, GECIS offered basic financial transaction work and contact-center services. From 2001 to 2002, the company's offerings expanded to finance and accounting, complex transaction processing such as mortgage loans and insurance claims, and call-center services including outbound calls. GECIS plans to increase its workforce to 20,000 by the end of 2003. Offices in Mexico, China and Hungary will report to GECIS-India as GE's Center of Excellence for outsourcing. Also, its service offerings have become increasingly complex, analytical and knowledge-based. Now GECIS-India conducts actuarial analysis, risk modeling, data mining and statutory financial reporting. All totaled, GECIS-India executes nearly 500 processes, of which many are mission critical.

Although India is expected to retain its leadership position for the foreseeable future,

its strong ratings may be tempered by gradually rising labor costs (so far offset by reductions in telecom rates) and geopolitical concerns. In the long run, India is likely to become the location of choice for high-value analytical tasks, while more generic, commodity processes will eventually move to lower cost environments, such as China.

Canada, Australia and Ireland

English-speaking countries score well in two of the three main categories—people and environment (*see figure 4 on page 6*). Beyond the immediately obvious cultural and language similarities to the United States, these countries feature a number of other advantages. Canada, Australia and Ireland have markedly better infrastructures and lower economic and political risk than other countries. However, all three demand the highest labor costs and, as a result, fare poorly in the financial ratings.

Canada is distinguished by superior employee retention rates, business process experience and proximity to the United States compared to Ireland and Australia. Due to its high labor costs, Canada is well suited for

The Offshore Evaluation Tool

A joint team from A.T. Kearney and a Fortune 100 multinational corporation assembled the offshore evaluation tool over a 10-week period. The team first narrowed the universe of countries using the following criteria:

- Presence of multinational corporations

- Degree of information technology and business process maturity
 - Availability of skilled labor
 - Expected future development
 - Scalability of operations
- Eleven countries made the final cut. The team then evaluated these countries against more than 30 mea-*

surements comprising three major categories: cost, environment and people. Team members quantified the attributes and assigned weights using detailed industry and proprietary data, cross-referencing their findings with data from industry analysts and subject matter experts.

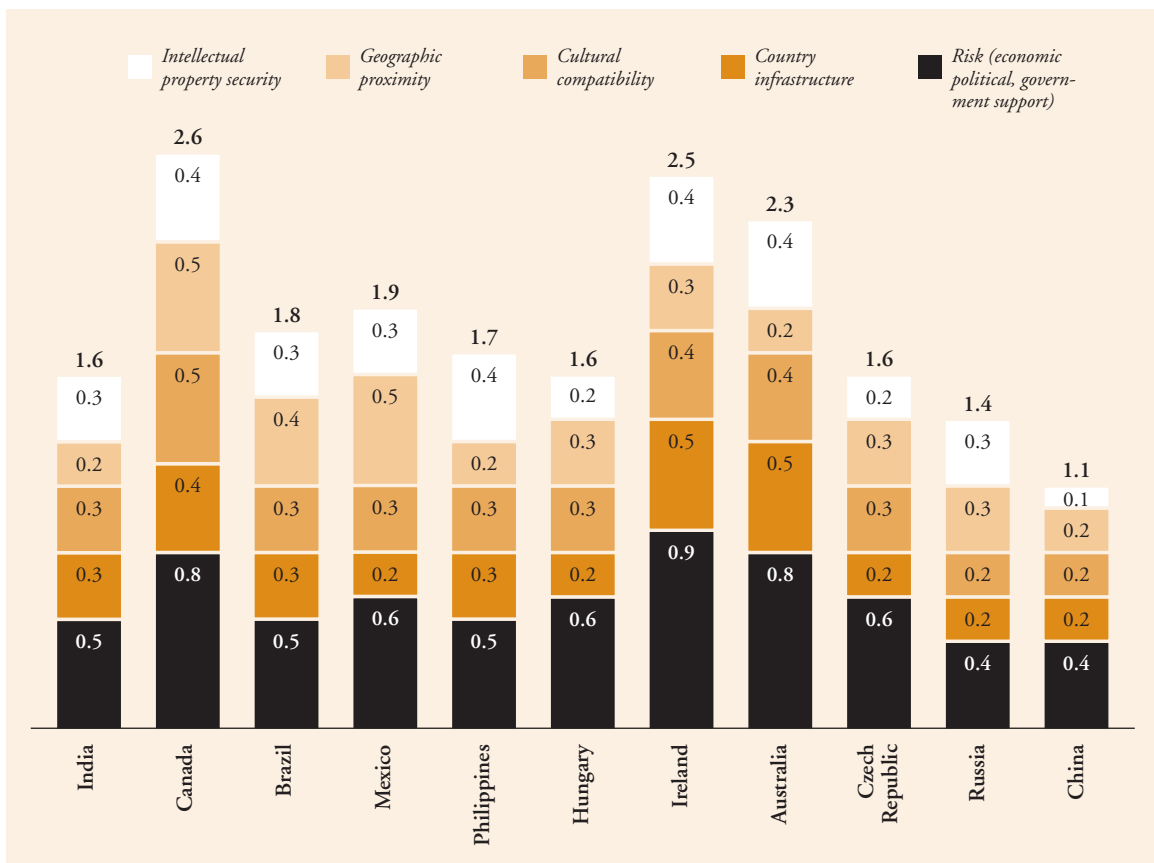
complex business processes that require close proximity to home office operations. Its greatest advantage is political stability. Accordingly, a number of firms including BP Amoco, Allmerica, Siemens and Compaq have chosen Canada as an offshore location. In fact, Compaq has realized up to 15 percent cost savings by locating five call centers throughout Canada. In Canada, call center agents employ specialized workforce management technology, used by

less than 12 percent of the call centers in the United States, which can automate scheduling and help drive sales. Quality improves as fewer calls are abandoned.

Brazil and Mexico

Latin American countries offer relatively low labor costs and similar time zones. These countries boast close proximity to the United States and score well in employee retention. Their

Figure 4: Environment scores by country*



*Scoring methodology reviewed and confirmed by leading industry analysts

Sources: A.T. Kearney, Bank of America, Economist, Gartner, Giga, IDC, International Country Risk Guide, World Bank, World Markets Research Center and UNESCO

position rests primarily on average performance, without significant weaknesses across the range of subcategories. Although both Brazil and Mexico score higher than India in environmental factors, they do not match India's workforce ranking.

Brazil's strengths include its hefty investments in IT and telecom infrastructure and a large, relatively low-cost labor pool. The main difference between Brazil and Mexico is Brazil's lower labor costs. Companies such as Xerox and Unisys have committed to Brazil.

Mexico has also made significant investments in the software industry and in IT and telecom infrastructures. However, its main attraction is its language—Spanish language skills are critical for many U.S. businesses. Companies can save from 25 to 40 percent by outsourcing Spanish-speaking call center services to Mexico. In March 2002, AOL Time Warner elected to serve its Spanish-speaking customers through a call center in Monterrey, Mexico, as part of a strategy to acquire and maintain this market.

The Philippines

The Philippines is a prime candidate for offshore business processing due to its cultural affinities with the United States, American-style English speakers, and the nature of its workforce. The Philippines is notable for low employee turnover rates and knowledge of U.S. standards of customer service. Compared to India, however, the Philippines has a smaller pool of skilled resources and somewhat higher labor costs.

Companies that have located in the Philippines include AIG, Procter & Gamble, American Express, Barnes and Noble, Caltex, Citibank and AOL Time Warner. Procter &

Gamble established accounting services in the Philippines more than three years ago, where today 650 employees complete P&G tax returns for its global operations. The Philippines is ideally suited for such processes given its oversupply of accountants who are trained in U.S. accounting standards.

Hungary and the Czech Republic

When viewed from the perspective of a multinational that operates in Europe, Central European countries offer cultural similarities, language skills, lower hurdles for adhering to European Union data privacy regulations, and high levels of engineering and other technical capabilities.

Hungary ranked higher than the Czech Republic by a small margin, primarily because it has more experience hosting business processes thanks to companies such as GE. Indeed, drawn by Hungary's educated population, GE has become one of its largest investors over the past 12 years and has migrated many business processes there. In October 2002, GE spent US\$4.6 million on a Budapest office that will employ 500 people in its customer service and back-office operations to support GE units across Western Europe.

Russia

Russia boasts a large pool of technical talent ranging from scientists and engineers to programmers (*see figure 5 on page 8*). The talent is offset by significant language barriers and retention problems, poor IT and telecommunications infrastructure, a history of political instability and corruption. For these reasons, the Russian offshore market, at least for some companies, is just getting off the ground.

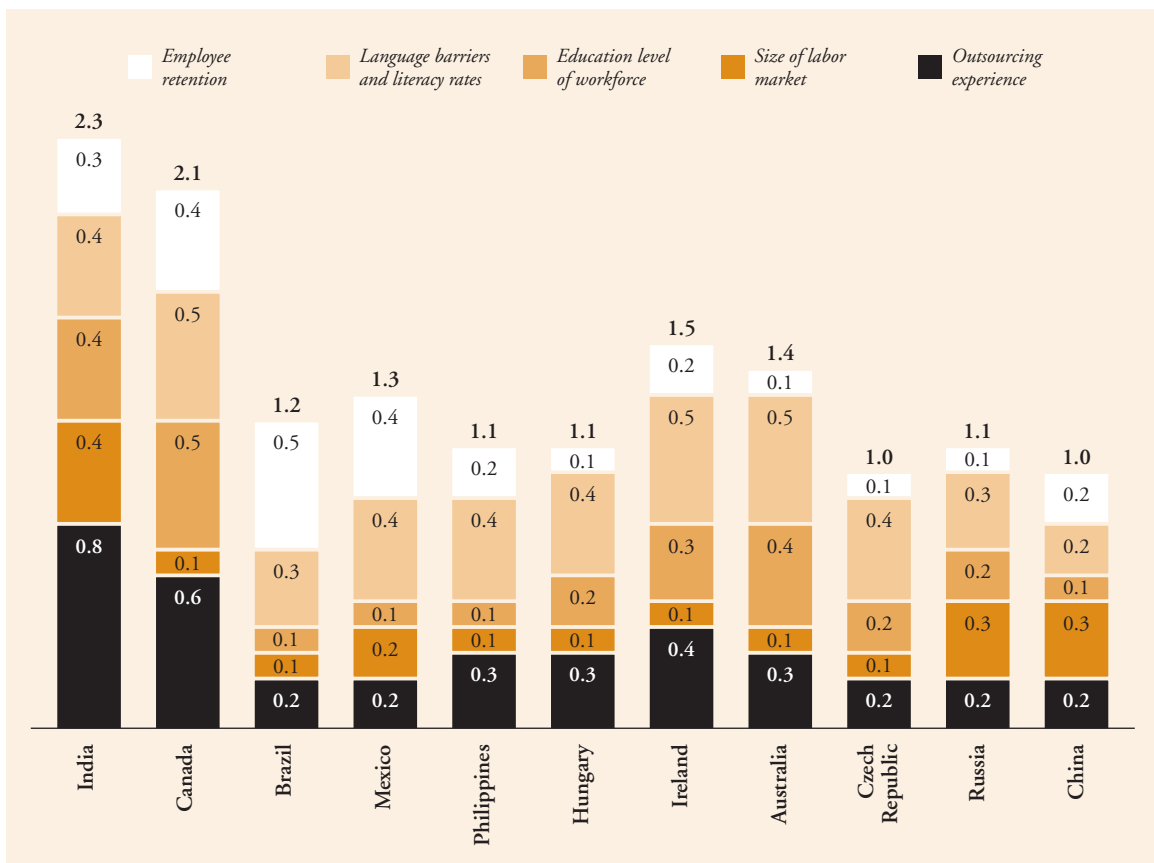
Boeing was among the first companies to go offshore to Russia. Following the collapse of the Soviet Union 12 years ago, Boeing began recruiting Russian aerospace engineers. Today, Russian aeronautics specialists in seven cities are designing parts including luggage bins and wing parts on 777 aircraft. Motorola and Intel have small R&D centers in Russia. Before long, however, Russia is expected to become a popular location for many levels of technical work and scientific research.

China

China’s greatest strength is its large, low-cost labor pool, which is attractive to companies with high volume, transaction-based business processes. Its biggest drawback is its relatively high economic and political risks.

China’s large and growing domestic economy and the government’s willingness to create more favorable business conditions have attracted companies such as Microsoft, HSBC and Motorola.

Figure 5: People scores by country*



*Scoring methodology reviewed and confirmed by leading industry analysts

Sources: A.T. Kearney, Bank of America, Economist, Gartner, Giga, IDC, International Country Risk Guide, World Bank, World Markets Research Center and UNESCO

All three companies, among others, recognize China's advantages over India in providing Asian language capabilities (including Japanese).

For example, Microsoft has invested more than US\$750 million in R&D and outsourcing over a three-year span. Its Beijing Research lab employs 180 programmers and has helped develop digital ink to display handwriting on tablet PCs.

HSBC maintains a strong commitment to business in China, opening a back-office processing center in China in 1995 to handle account maintenance for group subsidiaries in Hong Kong, the United Kingdom and Canada. In June 2002, it added a second facility in Shanghai, which employs 250 clerical workers and staff.

Motorola has been courting China since 1986, having invested some US\$3.4 billion in manufacturing and research and development facilities there.

The Asian language skills and the potentially vast, low-cost labor pool are likely to increase China's prominence as a top location to perform transaction-processing functions as well as for overall support of multinationals' Asia business operations.

THE ALPHA COMPANY

Gathering information on a country (or countries) regarding its potential as an offshore resource is only the beginning of the offshore decision-making process. A key question must still be answered, "How to apply this information to make the right decision to meet your unique needs?" To help answer this question, we can follow the Alpha Company as it works through its own decision-making process.

Consider company-specific requirements. Alpha's decision-making begins with scrutiniz-

ing its own organization—reviewing its footprint and customer needs. Alpha should select a country based on its existing geographic presence, its ability to leverage its current experience in the location, and the requirements of both its internal and external customers. For example, if Alpha wants to serve its Western European clients, it might select Central European countries such as Hungary and the Czech Republic. These countries have a distinct advantage due to their language capabilities and ability (lower hurdles) to adhere to European Union data privacy regulations.

Screen for skilled labor and service providers. Alpha must screen suitable countries for skilled workers that can perform the off-shore activities. For example, a simple data-entry process that does not require strong language or functional skills may be best situated in a country with a vast pool of low-cost resources, such as China. More complex, analytical work such as accounting or actuarial functions will require workers with higher education levels, so Alpha would want to look at Canada, Hungary and India as potential offshore options.

If Alpha decides to pursue an outsourcing model, contracting with a third-party provider, the offshore business processing market is immature in many countries. Alpha should evaluate potential third parties to ensure they have the capabilities, clients, management team and financial resources necessary to perform the activity.

Maintain operational and business continuity standards. Alpha should also look for countries with sufficiently robust infrastructures to ensure that it can maintain its operational and business continuity standards. For example,

the availability and cost of high-speed bandwidth and redundancy should be a key screening criterion. In addition, Alpha should be aware that although many countries have invested in IT and telecommunications capabilities for companies located in technology parks, comparable

services may not be offered across the country.

As a critical element of business continuity planning, Alpha will want to choose a multi-country strategy to ensure that one country's shortcomings—whether political, economic or infrastructure—do not impair its business. This

Figure 6: Location analysis rating framework (sample)

Scale: 1 to 5, with 5 the highest

LOCATION FACTORS	WEIGHT	LOCATION				
		A	B	C	D	E
Real estate <ul style="list-style-type: none"> • Availability • Facilities versus cost 	19%	3	2	2	3	2
IT infrastructure <ul style="list-style-type: none"> • Vendor presence • Bandwidth scalability • Last mile reliability and coverage • Cost of redundancy 	14%	3	2	2	3	2
Human resources <ul style="list-style-type: none"> • Labor availability • Costs • Soft issues (related to work performance and attitude) 	27%	4	4	5	5	4
Infrastructure <ul style="list-style-type: none"> • Power availability and reliability • Availability of water, gas and other utilities • Public and private transportation 	14%	2	2	2	3	2
Business environment <ul style="list-style-type: none"> • Political stability, rule of law • Receptiveness of state and local governments • Incentives and subsidies 	16%	2	1	1	2	2
Social and physical environment <ul style="list-style-type: none"> • Basic services • Cost of living • Social and physical risks 	10%	2	1	1	2	1
Total	100%	2.87	2.28	2.55	3.28	2.44
Preliminary ranking		2	5	3	1	4

Source: A.T. Kearney analysis

is a key way to mitigate risk. For an added measure of safety, or to capitalize on the resources of a large country, Alpha may choose to send a business process to multiple centers within the same borders. Citigroup, as previously described, has implemented such a strategy with great success.

In addition, establishing a global center of excellence, such as GE and HSBC have done, will ease coordination issues and improve the management of enterprisewide shared services.

Alpha's long-term success will depend on its ability to manage the effort as a multiyear, integrated corporate-led campaign. Establishing a global center of excellence, for example, will ease coordination issues and improve the man-

agement of enterprisewide shared services. In addition, Alpha should set cost targets that look beyond short-term concerns such as wage arbitrage to focus on long-term quality and productivity.

Choose a location and site. Although site selection within a country is not explicitly covered in the evaluation, it will become important as stakeholders pare down their list of offshore candidates. Alpha can use a rating framework, which is illustrated in figure 6, for each location and site on its short list of countries. Just as companies evaluate a country against their specific business needs, so too should they weigh site factors to meet their location needs.

Conclusion

Selecting an offshore country must stem from a rigorous assessment of objective criteria in the specific context of each company's business requirements. The model outlined in this paper can help companies compare factors across the range of countries and combine them to assess the tradeoffs. The process does not stop with committing to one location, however. Companies at the forefront of the offshore movement will continuously look for potential opportunities across the next border.

