

Offshore Insights

Market Report Series

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RESEARCH SUMMARY:

Global City Competitiveness

In June 2004, we released our first Offshore City Competitiveness Report, which ranked 27 Indian cities based on their attractiveness for offshoring. The services globalization landscape has seen a major change since then. Companies have moved beyond India to explore a multitude of other cities.

Offshoring today is not limited to the top cities in India, Philippines, China, Poland, Hungary, Mexico or Malaysia. It is also making inroads into the lesser-known, smaller cities in these countries. Fuelling this trend are two factors: overheating of established locations, and evolving client needs (such as achieving a global footprint). Each city has its own set of advantages and shortfalls. This report analyzes the best possible cities across the globe to set up offshore units, both in terms of their current and future attractiveness.

Key Topics Covered

- Which are the most attractive cities for offshoring of services?
- Which are the ones most suited for a certain work profile and/or source country?
- How can organizations use the Offshore City Competitiveness framework in their location assessment decisions?
- How is the attractiveness of current hot-spots expected to change over time?

Which are the most attractive Services Globalization locations?
What factors should organizations consider when selecting Services Globalization locations?



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Key Insights

- On the basis of Generic Factors (Human Capital, Costs, Infrastructure, Business & Living Environment, and Risk Factors), the Delhi NCR (National Capital Region) is the most suitable offshore location, closely followed by the Indian cities of Mumbai and Bangalore.
- Smaller locations within India, though relatively inexpensive, are yet to achieve the scale to invite companies setting up their first offshore center.
- Global leaders like India and Philippines score only on English capabilities, but companies looking for other language skills will need to look towards Eastern European nations for European language skills and towards China for Japanese and Korean language skills.

Mature locations are developing a truly distinctive industry-specific capability.

Introduction

Six years ago, offshoring was synonymous with a just a few countries all over the world. The Asia Pacific region had India and Philippines to offer, while the other countries that served as near shore locations, mainly for the United States, were Canada and Ireland.

The offshoring landscape looks markedly different now. Taking a cue from India and Philippines, several countries have positioned themselves to take a slice of the offshoring pie, riding mainly on low labor costs. China has emerged as a player keen to topple India's dominance in the services globalization arena. Asia Pacific now has many more location choices for a company looking at offshoring. Malaysia, Vietnam, Thailand, Sri Lanka and now Pakistan as well are gearing up to gain their place under the globalization sun. The Central and Eastern European region has emerged as a powerful and hard-to-ignore choice as a near shore location for the Western

European companies. The Americas too are not lagging behind, with Mexico already having established itself as a Spanish voice center. Jamaica, Cost Rica and Brazil are in the arena as well.

The transformation is not limited to the number of countries providing offshoring services. Companies that are exploring destinations for offshoring are not looking at just one location to serve their needs. They are looking for a portfolio of services, and that means that one location is not likely to suit their requirements. They are looking for a set of optimal destinations for the range of services they want to take offshore. Now, the trend is no more about a country being a great offshore location. The move is now towards identifying centers of excellence—this could be a city in India, or a province in China, or a region in CEE—which can deliver the kind of service levels expected by companies. For instance, Budapest is known for European

language voice services, and Bangalore is emerging as a retail offshore hotspot.

In short, the services globalization spectrum is breached, both from the demand as well as the supply side. With an increase in offshore location choices and an increased range of processes being offshored, a “one size-fits all” approach is not relevant today. The optimal choice is as dependent on the source country and specific process characteristics, as it is on the remote location. The challenge for enterprises now is to find the location which is most optimal for a specific segment of the portfolio.

Take the case of a global company looking at offshoring some of its corporate back-office functions such as F&A, HR and customer support services. Today, a probable choice

would be to offshore its Continental Europe payroll operations to Prague, its European F&A to a service provider in Warsaw, and North American F&A and customer support to a number of vendors spread across Mumbai and Bangalore.

A company looking for offshore locations has a tougher task at hand to identify the best fit for its services and business requirements. In June 2004, we released the Offshore City Competitiveness Report¹, which ranked 27 Indian cities based on their attractiveness for offshoring. With the shift in the globalization landscape, our study now focuses on 24 global cities. This report analyzes the cities in terms of their current and future attractiveness for services globalization. This is meant to serve as a handy tool for companies to determine the optimal locations for their portfolio.

Figure 1: Indicative Options for Services Globalization, as They Exist Today



¹ Available at http://www.neoit.com/gen/knowledgecenter/whitepapers_arch_04.html

Our Approach

Based on client interactions, we have found that the key determinants of location choice can be split into two categories:

- Generic (or basic) factors
- Enterprise-specific factors

Generic factors are those which are independent of the country from which the work is offshored, and the industry of the offshoring enterprise. The factors that fall into this category are: Human capital, Costs, Infrastructure, Environment and Risks. Any enterprise looking at globalizing its services would typically look in detail at each of these factors to create a shortlist of options. These options can then be examined thoroughly to come up with the most optimal fit.

Specific factors are those which are dependent on the source country, industry of the enterprise, or the specific processes being offshored. These include language compatibility, physical proximity, socio-economic affinity and sector-specific expertise availability. There are two trends which highlight the need for paying importance to these "Specific factors"

- With companies now offshoring core and value-added processes, the suitability of a location for more vertical-specific operations is gaining importance
- Continental European nations such as Germany, Switzerland and France are seeing services globalization activity, which brings to fore the need for language capabilities and business/economic/cultural fit

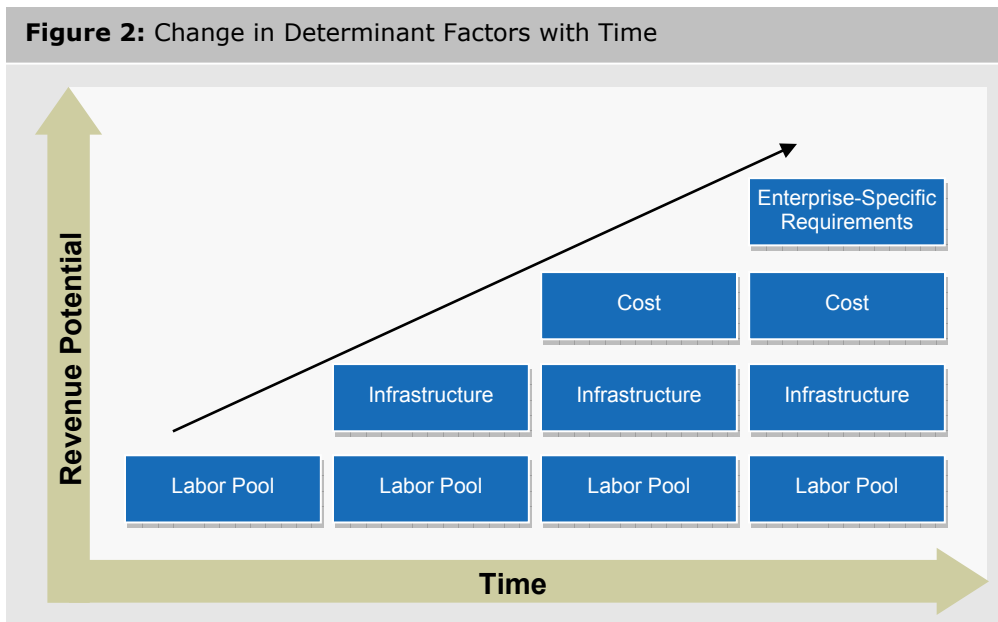


Table 1: Generic Factors Affecting Location Choice

Generic Factor	Sub-factors	Importance
Human capital	Access to labor pool, attrition levels, Overheating	Very High
Costs	Compensation, Real Estate, Telecom and Power costs, Wage inflation	High
Infrastructure	Telecom, Power, Office space, Airline connectivity and road infrastructure	Medium - High
Business & Living Environment	Government support, Social environment, Attractiveness to expats	High
Risk factors	Crime rates, Political instability, Natural disasters	Very High

Table 2: Enterprise-Specific Factors Affecting Location Choice

Generic Factor	Sub-factors	Importance
Language fluency	Fluency in German, French, Spanish	High – Very High
Physical proximity	Air travel time to reach remote center	Medium
Economic/ business system affinity	Awareness and compatibility with source country economic system	Medium - High
Industry-specific suitability	Existence of BPOs catering to a specific industry sector	High
Enterprise specific suitability	Enterprise Globalization Maturity, Enterprise Globalization Drivers, Enterprise Culture	Medium - High

Human Capital: This is perhaps the most important factor in the services globalization

space. The existence of a fairly large and qualified pool of workers is imperative to the success of a city as an offshore services hub. Apart from a supply of fresh graduates and sub-factors in the city, other sub-factors include availability of middle managers, and the attrition levels in the region.

Costs: Labor costs account for a huge chunk of the total cost of offshoring. As the market matures, popular locations are seeing sharp increases in wages at all levels. Apart from the present wages, it is also important to consider the expected trends at each location. A location which may be relatively low-cost today may turn out to be rather expensive in the long run.

Other costs include real estate rentals, telecommunication costs and other miscellaneous costs.

Infrastructure: A good telecommunication services infrastructure is a prime requirement. We have seen that with advances in technology, more or less all locations have access to the threshold required for smooth operations.

Apart from telecom, availability of Grade-A office space, good air connectivity and presence of a good public transport network are important factors to consider while selecting an optimum location.

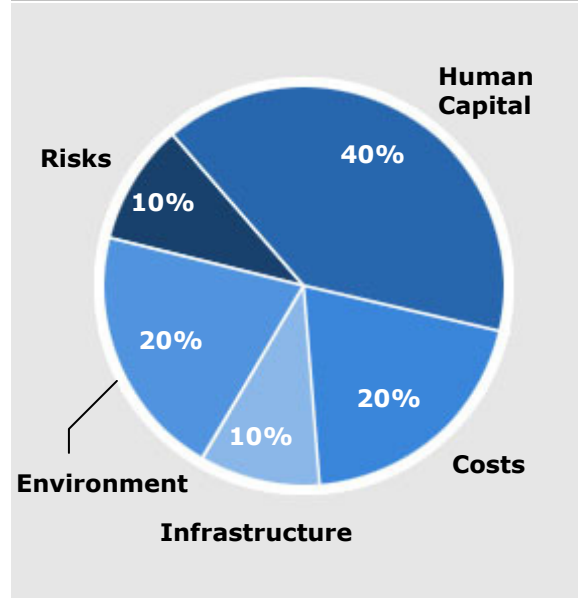
Business & Living Environment: The ease of doing business in a city depends on the government support, the response to foreign investment and the quality of life there. Companies have had varied experiences of dealing with the authorities in various cities.

Risk Factors: As in any project, it is essential to take into account the risk factors associated with it. In terms of city selection, it is imperative to examine closely risks like political instability, personal safety and natural disasters.

Generic City Competitiveness

We evaluated the various locations for their generic competitiveness, and arrived at a composite score based on the following weightages:

Figure 3: Distribution of Weights for Parameters

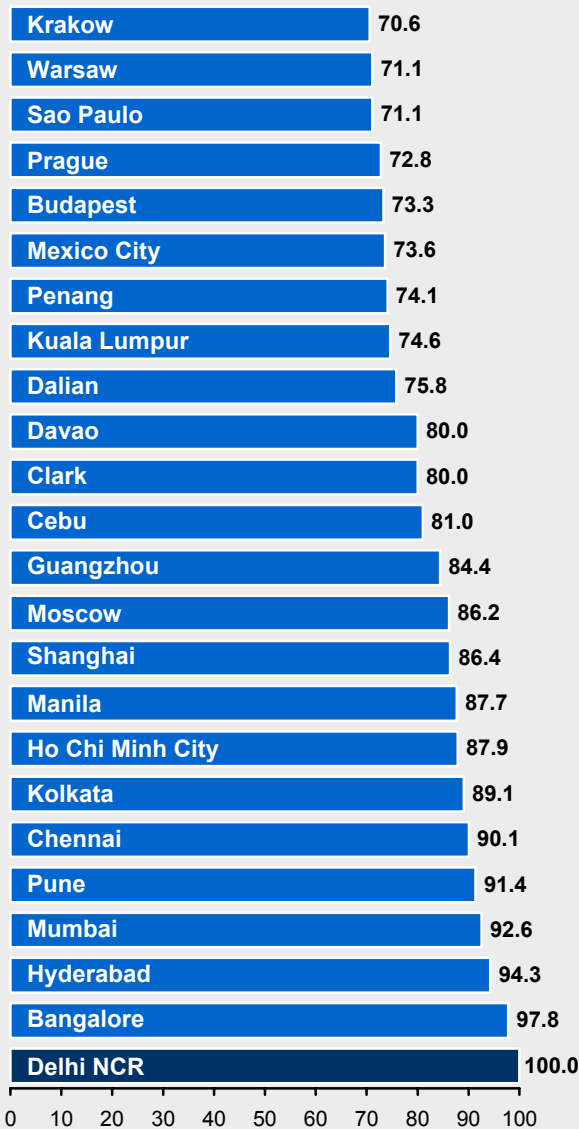


Source: neoIT

Our analysis (please refer to Figure 4) shows that the Delhi NCR is the most suitable location, closely followed by the Indian cities of Mumbai and Bangalore. These three highly mature centers of offshore service delivery even today rank among the best locations to set up offshore units.

Though a lot has been said and written about India's eroding cost advantage and supply constraints, the fact remains that in terms of talent supply and cost arbitrage, India is still the leader. Even within India, the most mature cities such as Delhi NCR, Mumbai and Bangalore are the ones attracting the largest BPO investments.

One of the main reasons for the attractiveness of these mature destinations is the high availability of middle and senior-level management to provide operational and strategic direction. Smaller locations within India, though relatively inexpensive are yet to achieve the scale to invite companies setting up their first offshore center. This is the reason why only established players like Genpact and Dell have ventured into the smaller Indian cities.

Figure 4: Generic City Competitiveness Index

Source: neoIT

City Competitiveness – Enterprise Level Factors

The generic competitiveness alone does not decide where a company would set up an offshore unit. In fact, much of the decision

rests on factors specific to the enterprise. Typically, the specific factors include:

Language fluency requirements: With the growing acceptance of services globalization in Continental Europe, the standard “Abundant English-speaking workforce” does not suffice. Many corporations, especially those looking to globalize their business processes have a core requirement of fluency in a particular language.

Physical proximity requirements: At times, the activities to be globalized require to be supervised continually by onshore staff, which requires the delivery location to be within quick and easy reach of the home country. This is an important factor driving many decisions around location of the offshore unit.

Industry-specific BPO capability: With each passing year, we observe enterprises offshoring higher-value, core processes and applications. This engenders the need for the offshore staff to have a view of the industry sector which the enterprise operates in.

Enterprise offshoring maturity: The choice of location also depends on the offshoring maturity of the organization itself. A case in point is a company which is just embarking on its services globalization initiative. The choices at that point would be limited to mostly Tier 1 cities, due to the relatively mature business conditions in those cities.

As global offshoring becomes commonplace, the generic factors are becoming more “hygiene” in nature whereas the enterprise-level factors are becoming the true decision drivers. This is especially true for European companies. They have been slow to adopt services globalization but are now entering the fray to realize the benefits being reaped by their US and UK counterparts.

Individual City Snapshots – 3 Sample Cities

Delhi NCR

Country: India
 Area: 1483 km²
 Population: 15 million
 Literacy: 81%

Well-suited for financial services industry. Also ideal for services involving voice and back-office activities in English.

Generic Factors		Industry		Activity		Proximity		Language	
Human capital	5	Financial services	5	Voice	5	New York	1	German	1
Costs	5	Retail	2	Back-office	5	Frankfurt	3	French	1
Infrastructure	3	Healthcare	3	IT (Apps)	4	Paris	3	Spanish	1
Environment	3	High Tech	4	IT (Infra)	4	Tokyo	3	Japanese	1
Risk	3							English	5

- 5 - Among the best in peer group
- 4 - Strong positioning in the peer group
- 3 - Moderately placed in peer group
- 2 - Not a competitive advantage in peer group
- 1 - Lagging in the peer group

Source: neoIT

The Delhi NCR (National Capital Region) in India, which comprises Delhi and satellite cities of Gurgaon, Noida and Faridabad, is uniquely geared up to be highly attractive as an offshore location. It is home to many of the country's best institutions such as Delhi University colleges and IIT Delhi. More than 150,000 students graduate each year from its colleges and universities. Apart from these, the city also attracts talent from the neighboring states of Rajasthan, Punjab, Haryana and Uttar Pradesh to work in offshore units.

In terms of costs, it is less expensive than Mumbai and Bangalore, on account of lower living costs. The region also has very good air travel connectivity, telecom infrastructure and roads.

Manila

Country: Philippines
 Area: 38 km²
 Population: 1.7 million
 Literacy: 97%

Ideal for English voice-based activities. Also great for back office processing activities such as payroll and accounting

Generic Factors		Industry		Activity		Proximity		Language	
Human capital	3	Financial services	3	Voice	3	New York	1	German	1
Costs	5	Retail	2	Back-office	3	Frankfurt	3	French	1
Infrastructure	2	Healthcare	2	IT (Apps)	3	Paris	3	Spanish	1
Environment	3	High Tech	2	IT (Infra)	2	Tokyo	3	Japanese	1
Risk	3							English	5

- 5 - Among the best in peer group
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Source: neoIT

Manila is a very popular offshore location, especially for voice (customer care) BPOs serving North American clients. Because of a predominantly English-based educational system, the English speaking skills are great in the city. Manila also happens to be a shared services hub for many global corporations.

The city has a good talent supply, thanks to a large number of universities in the region.

In terms of costs, it is slightly more expensive as compared to Indian cities. However, the city has good infrastructure and air travel connectivity with the rest of the world.

Warsaw

Country: Poland
 Area: 516 km²
 Population: 1.7 million
 Literacy: 99%

Ideal for financial services, voice and back-office activities. Highly competent in German language capabilities and very good with English as well.

Generic Factors		Industry		Activity		Proximity		Language	
Human capital	3	Financial services	4	Voice	4	New York	3	German	4
Costs	2	Retail	3	Back-office	4	Frankfurt	5	French	2
Infrastructure	4	Healthcare	2	IT (Apps)	3	Paris	5	Spanish	1
Environment	3	High Tech	3	IT (Infra)	3	Tokyo	2	Japanese	1
Risk	4							English	3

- 5 - Among the best in peer group
- 4 - Strong positioning in the peer group
- 3 - Moderately placed in peer group
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Source: neoIT

Warsaw is an important near-shore destination, primarily due to its large, multilingual workforce and proximity to Western Europe. It is home to four major universities and 62 other schools of higher education. In terms of infrastructure, too, it compares favorably with large Western European cities such as Frankfurt and London.

Although it is more expensive than Prague and Budapest, a lot of companies have set up their delivery centers here. Notable examples include Citigroup, AVON, ABN Amro and HP.

Note: The snapshot of all other cities mentioned in the report is available in the full version of this report. To request for the full version of the report please visit <http://neoit.com/gen/knowledgecenter/whitepapers.html>

How Companies Can Use the Generic and Enterprise-Specific Factors

The choice for the optimal location will be based on both the generic and enterprise-level factors. Our experience suggests that the generic factors are used to shortlist locations based on different weights or criteria adopted by the company. For instance, if a company has higher sensitivity to its Intellectual

Property, countries such as China and Vietnam would not likely be considered.

Typically, companies start with an initial shortlist of cities, and then apply both generic and enterprise-specific criteria to arrive at a final set of 3-4 cities. The decision after this point, more often than not hinges on a subjective deep dive into the characteristics of the location. The management uses its discretion to arrive at the "one" location which has the perfect fit with the objectives.

Figure 6: Location Selection Process Flow



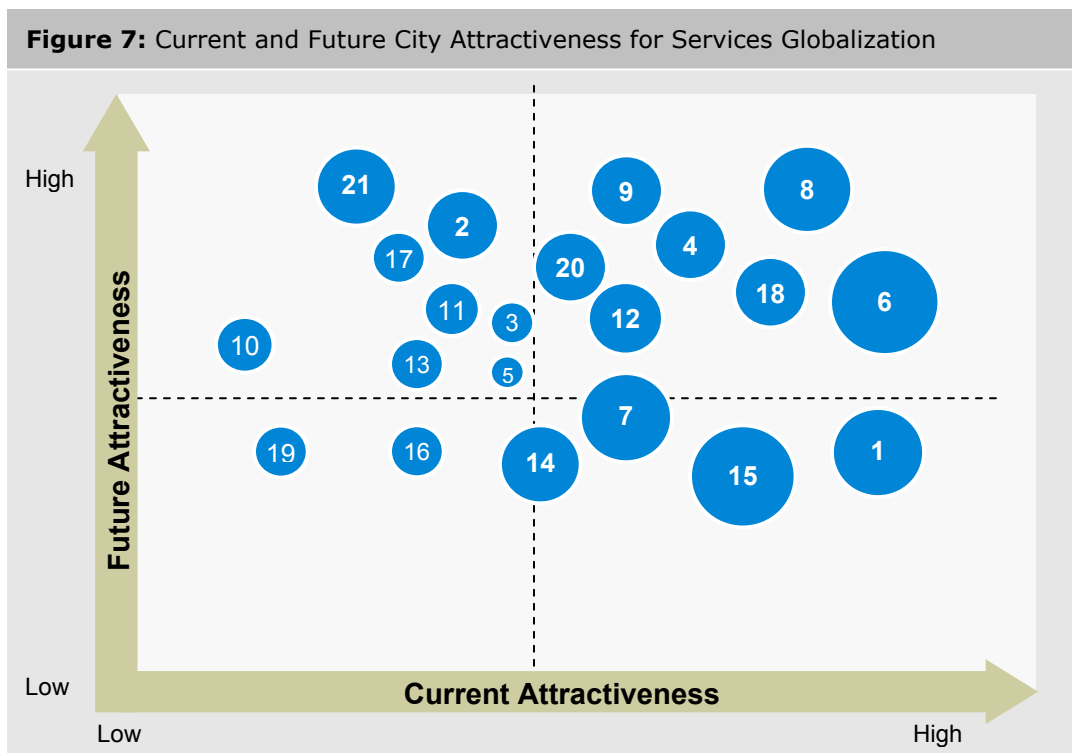
Future City Competitiveness

We also analyzed what the situation is likely to be 3-4 years from now. Indian cities like Bangalore and Delhi NCR are already showing signs of heating up. Thanks to innovative hiring by companies and willingness of people to migrate to these cities from smaller towns, things are manageable as of now.

However, considering the pace at which existing and new companies are ramping up operations in certain cities, a supply crunch is not too far. To take the example of Hyderabad, the STPI (Software Technology Parks of India)

in India expects the number of new company registrations in the city to exceed 200 this year. If each company aims to achieve employee strength of 200 by the end of the first year, the new demand alone would exceed 40,000 people. In addition to this, the expansion of existing players like Dell, Genpact, Satyam and Honeywell would again create a significant demand for talent.

Figure 5 showcases our perspective on the current and future attractiveness of these locations.



Source: neoIT

● Current size of talent pool

- | | | |
|--------------------|-----------------|--------------|
| 1 Bangalore | 8 Hyderabad | 15 Mumbai |
| 2 Budapest | 9 Kolkata | 16 Penang |
| 3 Cebu | 10 Krakow | 17 Prague |
| 4 Chennai | 11 Kuala Lumpur | 18 Pune |
| 5 Clark | 12 Manila | 19 Sao Paolo |
| 6 Delhi | 13 Mexico City | 20 Shanghai |
| 7 Ho Chi Minh City | 14 Moscow | 21 Warsaw |

Conclusion

The Global City Competitiveness (GCC) framework is developed as a reference tool to enable enterprises to arrive at the best places to offshore their services to. The GCC is meant to be of value to different sets of audience.

For enterprises looking at globalizing their services portfolio, the GCC model provides a perspective on the situation in various cities. This helps them make an informed decision as to which city (or cities) offers the optimum fit vis-à-vis their specific requirements.

Service providers who want to expand their delivery capability can use it to explore

untapped labor pools, and zero in on locations offering the best support infrastructure, low risks and maximum government support.

At the root of it, the overall attractiveness is contingent upon two kinds of parameters: the “extrinsics” such as infrastructure, business environment and government support and the “intrinsic” such as labor pool, inherent risk and costs of operation. The government agencies of various locations can use the GCC framework to work towards improving the “extrinsics” which can act as catalysts for the growth of the location as a destination of choice.

More information about the offshore outsourcing industry can be found within neoIT's research center at www.neoOffshore.com. For more details about neoIT's offshore advisory and management services, please contact:

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