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OFFSHORING from Business Perspectives
Challenges and Opportunities for Companies

University of Trier, July 7-10, 2014
Definition of Global Sourcing of business services

- Process of sourcing and coordinating tasks and business functions, across national borders, normally to low cost countries
- Encompasses activities internal and external to the firm for purposes of serving home country or global markets rather than local operations (Manning, Massini & Lewin, AMP 2008; Kenney, Massini & Murtha, JIBS 2009)
- Offshoring an activity to a firm’s own affiliates located outside its home country constitutes internal or captive offshoring
- Offshoring to third part providers constitutes offshore outsourcing
- Focus on Administrative and Technical work (e.g., business services) not Manufacturing
Co-evolutionary Dynamics of Offshoring

INDUSTRY AND TECHNOLOGICAL ENVIRONMENT

Industry competitive pressures
• Isomorphic pressures
• Increasing global competition

Advances in ICT and Web-based technologies

Competition between providers
• Commoditization
• New services offerings
• Service providers better able to work with Western companies
• Service providers constantly upgrading their capabilities

TASK CHARACTERISTICS

• Interdependence
• Physical presence
• Specific knowledge
• Increased standardization

FIRM’S SPECIFIC FACTORS

• Bottom-up offshoring champions
• Top-down intentionality and strategy to direct attention and legitimize offshoring
• Absorptive Capacity and Experience
• Offshoring companies increasingly capable of sourcing talent globally
• Globalization mindset

DECISION TO OFFSHORE

NATIONAL AND INSTITUTIONAL ENVIRONMENT

Western Economies Factors
• Structural Changes in Labor Market
• Fewer young adults select careers in Science and Engineering
• Ageing of population & retirement of baby boomers
• Country immigration policies

Emerging Economies National aspirations
• Building human capital
• Education policies
• Incentives for nationals with advanced degrees to return home
• Driving maturity level of domestic outsourcing industry services

Massini and Lewin (2012) chapter in *West meets East*
1. Macroeconomic aspects
   1.1. Global capital flows.
   1.2. FDI trends, structure and location factors in global economy.
   1.3. Understanding the essence of offshoring.
   1.4. Attractiveness for offshoring investments.

2. Microeconomic aspects
   2.1. Recognizing determinants of successful offshoring.
   2.2. Key factors driving offshoring.
   2.3. Understanding the challenges and opportunities of production relocation, BPO and KPO.

3. CASE STUDY
   3.1. Building the basic abilities to plan and manage offshoring project.
   3.2. Risks and Mitigation Strategies.
Two Dimensions of Globalization

- Firm home sale vs. intra-regional GDP distribution
  - UK constitutes 17% of EU GDP
  - A fully intra-regionalized UK firm should derive 83% of its revenues from sales outside UK.

- Firm foreign sales outside home region relative to global distribution of GDP
  - UK GDP equals 5% of world GDP and 68% of UK sales are outside of EU.
  - A fully inter-regionalized UK firm should derive 14 times as much revenue from rest of the world relative to its revenue from within the UK.
Internationalization Paths

- **Liability of Foreignness**
  - Host region oriented
  - Balanced → Global
  - Home region oriented

- **Firm Global Revenue** $T = H + E + W$

Source: Christian Geisler Asmumssen, 2009. “Local, Regional, or Global? Qualifying MNE Geographic Scope“, JIBS, 40, 1192-1205
Key Integration Mechanisms of Global Sourcing Activity

Strategic integration mechanism
- Corporate-wide strategy (TMT directing attention)

Structural integration mechanisms
- TMT oversight (Hierarchical distance)
- Global sourcing center of excellence

Functional integration mechanisms
- Clear, measurable objectives
- Defined process for implementing service delivery structure
- Formal vendor management program
  * Operating Level Agreements (OLA's) with strategic providers
- Utilization of process improvement methods
- Cost accounting
- Formal process for allocating savings
Seven Dimensions of Global Sourcing Operational Effectiveness

n=115
Offshoring Strategy

Cumulative percent of companies adopting corporate wide and function strategy for offshoring

Adoption of New Management Practice
(number of companies/yr  n=500)

Is there any chance to keep business home?

- to churn out **knowledge workers** - able to produce **idea-based goods and services** competitive world-wide
  - *no limit to the number of idea-generated jobs in the world*

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Tom Friedman, “The World is Flat” 2005
<table>
<thead>
<tr>
<th><strong>Comparison of the local, national and international business</strong></th>
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<tr>
<td><strong>International business</strong></td>
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<tr>
<td>• Organization based in a home country with foreign country</td>
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<td>and regional links</td>
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<tr>
<td>• Domestic and foreign customers</td>
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<tr>
<td>• Sourcing of products across national borders</td>
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<tr>
<td>• Use of global media to manage international marketing and</td>
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<tr>
<td>reach customers</td>
</tr>
<tr>
<td><strong>National business</strong></td>
</tr>
<tr>
<td>• Country wide organization with regional and local units</td>
</tr>
<tr>
<td>• Diverse customers within national environment</td>
</tr>
<tr>
<td>• Products and distribution more complex</td>
</tr>
<tr>
<td>• Use of national media to reach customers</td>
</tr>
<tr>
<td><strong>Local business</strong></td>
</tr>
<tr>
<td>• Small local firm</td>
</tr>
<tr>
<td>• Local customers</td>
</tr>
<tr>
<td>• Semi-products sourced through local suppliers</td>
</tr>
<tr>
<td>• Importance of personal relations for operations and</td>
</tr>
<tr>
<td>reaching customers</td>
</tr>
</tbody>
</table>
Comparing
local, national and international business:

Think of a business enterprise in each of these categories, with which you are familiar. Compare them in terms of:

• organization
• customers
• products
Why Do Companies Internationalize?

- Decision by Cisco to globalize innovation

1. What are the strategic and organizational challenges facing companies in the near and long term as they consider whether to globalize their operations?

2. Think of examples of companies for whom globalization should not become a strategic imperative.

3. What is the strategic reasoning behind the Cisco initiative to globalize innovation?

4. What are the organizational challenges facing Cisco in implementing the strategy?

5. Considering the strategic importance of CISCO East strategy, how successful has the strategy been to date?
Why Do Companies Internationalize?

• **What are firm level strategic drivers to internationalize?**
  – Exploit economies of scale/scope
  – Exploit national differences
  – Declining growth in home country
  – Managerial intentionality

• Why do some firms become regional MNEs and others global MNEs?

• What differentiates global MNEs from regional MNEs?

• What metrics could define global MNEs and regional MNEs?
Theoretical Background

Resource-based view of the firm:
Corporate capability to grow through international expansion is limited by financial, technological and production resources and by managerial and organizational capabilities to deploy those resources (Penrose, 1959; Barney, 1991; Kor & Mahoney, 2004) Managerial intentionality (Hutzschenreuter T, Pedersen T, Volberda HW. 2007).
Serendipity?

Internalization theory:
Multinational firms grow internationally by deploying their Firm Specific Assets in host countries Buckley & Casson, 1976; Rugman, 1981; Hennart, 1982

Stage theory of internationalization argues that firms must acquire international experience which builds managerial capacity for expansion into host countries. Emphasis is on sequences of stages. Johanson & Vahlne, 1977; Johanson & Wiedersheim-Paul, 1975
Firm Specific Assets (FSA)

• Multinational firms face a “Liability of Foreignness” (Hymer, 1976; Zaheer, 1995; Mezias, 2002)
  – Discrimination
  – Uncertainty
  – Complexity

• FSAs are required for overcoming liability of foreignness (Caves, 1971)

• Liability of foreignness determined by cultural distance, degree of institutional similarity, between home and host countries (Zaheer, 1995, Lewin and Kim, 2002)

• What are FSAs?
Rugman & Verbeke definitions

- Utilizing a three-region or “triad” perspective of global business activity, encompassing North America, Europe and Asia, R & V seek to classify the world’s largest firms as home-regional, host-regional, bi-regional or global. The classification employs the following cut-off parameters:

  - **home-regional firms** have greater than 50 percent of sales in the home region;
  - **bi-regional firms** have less than 50 percent of sales in the home region and greater than 20 percent in another region of the triad;
  - **host-regional firms**, a special form of bi-regional firm, have greater than 50 percent of sales in a triad region other than the home region;
  - **global firms** have less than 50 percent of sales in the home region and greater than 20 percent in each of the other two triad regions.
1: Technology
Mobile phones
Internet
Customer Relationship Mngt (CRM)
Portable computing

Remote provision of services: Financial,
Customer care,
Accounting,
Administrative

2: Business innovations
Just-in-time inventory management
Supply chain integration
Customer-supplier partnerships

Allow outsourcing to offshore operational units
or purchasing from foreign third-party suppliers.

3. Skilled Workforce Availability
Young, unemployed, multilingual, skilled

4. Free-trade Agreements
WTO -> GATT, GATS, TRIPS, trademark, patent, and (IPR) protection.
Businesses and Governments face a sourcing decision.

Should we:
- Produce our services internally?
- Source them domestically (outsourcing)?
- Source them offshore (subsidiary or captive offshoring)?

**What is Offshoring? - simplification**

**Offshore Sourcing (Offshoring)**—includes BOTH:
1. services supplied by a company’s overseas operations (“in-house” or “affiliated”), and
2. services supplied by a third party (“outsourced”)

<table>
<thead>
<tr>
<th>Domestic in-house production</th>
<th>Offshore in-house sourcing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Example: Company produces its products domestically without any outside contracts</td>
<td>Example: Company uses services supplied by its own foreign-based affiliate (subsidiary)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Domestic outsourcing</th>
<th>Offshore outsourcing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Example: Company uses services supplied by another domestically-based company</td>
<td>Example: Company uses services supplied by an unaffiliated foreign-based company</td>
</tr>
</tbody>
</table>
## Picture. Strategy of offshoring advantages and disadvantages

<table>
<thead>
<tr>
<th></th>
<th>Captive</th>
<th>Virtual captives</th>
<th>Offshore outsourcing</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Operational risk</strong></td>
<td>Client (service buyer) gets the risk of entire process and is responsible for failure</td>
<td>Risk is shared among buyer and vendor</td>
<td>Vendor (service provider) intercepts the risk of transaction and process delivery</td>
</tr>
<tr>
<td><strong>Cost/price</strong></td>
<td>Costs fixed, revealed at the beginning</td>
<td>Costs fixed, revealed at the beginning</td>
<td>Prices negotiable</td>
</tr>
<tr>
<td><strong>Solicitation of human resources</strong></td>
<td>Client is responsible for number and cost of human resources</td>
<td>Vendor recruits, with client’s requirement and control</td>
<td>Vendor is completely responsible for HR policy and cost of recruitment/employment</td>
</tr>
<tr>
<td><strong>Management</strong></td>
<td>Client is responsible for operating management</td>
<td>Client is partly responsible for operating management and manage the process on the level of service/production</td>
<td>Client manage the process on the level of service/production</td>
</tr>
<tr>
<td><strong>Elasticity of project – introduce changes</strong></td>
<td>Possible changes, related to add costs</td>
<td>Costs of changes are splitted into partners</td>
<td>Changes are hardly possible</td>
</tr>
</tbody>
</table>

Country selection criteria for offshore outsourcing

- Cost of labor
- Language skills
- Country infrastructure
- Relevant skill sets
- IP protection
- Cultural fit
- Proximity to the BUYER
- Security/business continuity

\[ OSS_i = \sum_j \left[ \frac{Ps_{j,i,t}}{NEI_{i,t}} \right] \times \left[ \frac{Is_{j,t}}{P_{j,t} + I_{j,t} - E_{j,t}} \right] \]

*Input-Output: OECD data source*
Offshoring Benefits/ Costs

- Reduced Production Costs
  - Inputs
  - Labor
  - Taxes
- Access to Skills
- Labor Market Flexibility
- Access to New Markets
- Business Strategy

Risks for offshoring firm:
- Reduced control of production, quality
- Change in cost structure
- Change in commercial image
- Political/ business climate risk

Risks for recipient country:
- Reliance on foreign economic performance
- Dependence on foreign firm’s business cycle
The Major Risks In Offshoring

- Contract
- Privacy and Security
- Diminishing Technical Returns
- Increased/ Hidden Costs
- Loss of Expertise (Mainly IT)
  - Impact On Your Employees
- Impact on Your Customers
- Failure of Outsource Provider
Additional Offshoring Risks

- Economic Risks
- Culture Risks
- Demographic Risks
- Political Stability Risks
70 : 70 : 70 RULE

- 70% of all business processes will be bought in the future
- 70% of outsourcing will be bought from abroad
- 70% of those outsourcing services will come from India (J. Welch, GE)

India: « back office of the world »
WHAT IS OFFSHORING DETERMINED BY?
Exogenous Factors

Factors, that define the characteristics of the country, beyond influence of organization:

- government support
- educational system
- geographical environment,
- infrastructure

Catalyst Factors

Factors that drive offshore service delivery in a country. Some of these factors could be exogenous as well:

- physical and time zone displacement,
- cultural compatibility
- labor pool
- language proficiency

Business Environment

Relates to the direct advantages, competencies of suppliers, and supportive business issues:

- cost advantage (direct, indirect),
- process maturity,
- competitiveness of a supplier
- supportive people factors
- security, IP protection
<table>
<thead>
<tr>
<th>Country</th>
<th>Salary Range</th>
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<tbody>
<tr>
<td>US</td>
<td>63,000</td>
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<tr>
<td>Canada</td>
<td>57,000</td>
</tr>
<tr>
<td>Japan</td>
<td>44,000</td>
</tr>
<tr>
<td>Singapore</td>
<td>43,000</td>
</tr>
<tr>
<td>Brazil</td>
<td>20,000</td>
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<tr>
<td>Mexico</td>
<td>7,000</td>
</tr>
<tr>
<td>India</td>
<td>8,000-9,000</td>
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<tr>
<td>Russia</td>
<td>5,000-18,000</td>
</tr>
<tr>
<td>China</td>
<td>3,000-14,000</td>
</tr>
<tr>
<td>Vietnam</td>
<td>1,400-6,000</td>
</tr>
</tbody>
</table>

All salaries US$/year

What do IT professionals cost?
What about housing, medical insurance, transportation, loans, 13\textsuperscript{th} month bonus, etc. ... 

The full costs of an Indian programmer are 30-40K, compared to 120K in the US.

Chinese programmers (3-4 years experience) cost US$12.50/hour – about 20\% of the US rate.
HOT SPOTS in the world

India – Software engineering and support; call centers for all types of computer and telekom services; medical analysis and consultative services; Indian companies such as Tata, Infosys and Wipro are already global leaders in IT design, implementation and support

China – chemical, mechanical and petroleum engineering services; business and production development centers for companies

Russia – Engineering Design, technical skills

Mexico – automotive engineering and electronic-sector services

Eastern Europe – call centers and business support in Hungary, Poland, Czech Rep; Romanian and Bulgarian centers for German-speaking IT customers in Europe
India SWOT analysis

**Strengths**
- High quality technical skills
- Reference clients - measurable results
- English language
- Business Intelligence
- Non-disruptive approach to existing processes

**Weaknesses**
- Link between IT and business capabilities
- Change management capabilities
- Lack of global footprint
- UK-centric approach
- Underutilized infrastructure

**Threats**
- Increase in attrition
- Social resistance in client countries
- Competition from other English-speaking locations

**Opportunities**
- Leverage existing infrastructure
- Global strategy
- Indirect channels
- Attract US and European service providers
- Develop new HR strategies
- Focus on communication as a core competency
Offshoring: division of labour – practical example

Source: VLG
China SWOT analysis

Strengths

Weaknesses

Threats

Opportunities
India
- Liberalisation process: 1986 import licensing policy for software; 1990s full financial liberalisation
- 1980s Higher Education policy increased supply of S&T graduates
- 1990s creation of Software Technology Parks of India to develop telecommunication infrastructure and low cost internet
- Development of general infrastructure
- Customised degrees for foreign companies needs

China
- Relied on imported technology and FDI, but hi-tech exports (Office machinery & TV and radio communication equip.) in 30% of total export 2005
- Open door policy 1978; WTO member 2001
- Improved infrastructure
- Aggressive S&T strategic plan for 2020 (OECD 2007):
  - Goals: “Innovation oriented society”; one of world’s leading innovation economies; develop “indigenous” and “home grown” innovation
- 21 cities designated as Outsourcing Hubs (2009)
## Top Locations for Offshoring Innovation in India and China

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<td><strong>India</strong></td>
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<td><strong>China</strong></td>
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<td>Chengdu</td>
<td>Dalian</td>
<td>Guangzhou</td>
<td>Chengdu</td>
</tr>
</tbody>
</table>
• China, India & Russia
  ◦ Large population, number of qualified employees
  ◦ 1000+ software exporting firms
• But around 100 countries provide some offshoring services (RO, BR, PH, VN, PO, HU, MY, AR, FJ,...)
  ◦ The Indian firms in particular are now global firms in their own right
  ◦ TCS, the largest Indian firm, had 2003 revenues of US$1B. It has its own offshore sites in HU, CN, UY, AU, US, UK, JP
    • All are a great threat to US- and Europe- based firms
Global delivery footprint services various clients' operations and provides world languages and local expertise.

Source: Infosys website
Corporate Client Analysis Examples: Delivery Model

Initial Delivery Model by Region (n=2472)

- **China**: Captive 66%, Outsourced 34%
- **Eastern Europe**: Captive 65%, Outsourced 35%
- **Latin America**: Captive 54%, Outsourced 46%
- **Western Europe**: Captive 66%, Outsourced 34%
- **Middle East**: Discrete 73%, Entire Process 27%
- **India**: Captive 43%, Outsourced 57%
- **Africa**: Captive 54%, Outsourced 46%
- **Asia/Australia**: Captive 56%, Outsourced 44%
- **USA**: Captive 55%, Outsourced 45%
- **Africa**: Captive 54%, Outsourced 46%
Number of cities where delivery centers are located in each time zones from New York City by function (2009-2010)

**Within 6-9 time zones**
- CC: 47 → 71 cities
- Inno: 127 → 149 cities
- F&A: 41 → 77 cities
- IT: 102 → 149 cities
- ADM: 99 → 140 cities

**Within 5 time zones**
- CC: 87 → 122 cities
- Inno: 48 → 83 cities
- F&A: 57 → 104 cities
- IT: 102 → 138 cities
- ADM: 65 → 94 cities

**More than 9 time zones**
- CC: 59 → 82 cities
- Inno: 69 → 127 cities
- F&A: 44 → 67 cities
- IT: 74 → 96 cities
- ADM: 56 → 72 cities

* CC = Contact Center | Inno = Innovation | F&A = Finance & Accounting | IT = IT Infrastructure | ADM = Application Development and Maintenance

Theme Line Analysis Examples: The Rise of Nearshore?
During the past few years, providers aggressively established delivery centers in locations within 5 time zones from their key clients on the Continent (e.g. London this slide).

Number of cities where delivery centers are located in each time zones from London by function (2009 → 2010):

- **Within 5 time zones**
  - CC: 69 → 101 cities
  - Innov: 131 → 200 cities
  - F&A: 50 → 95 cities
  - IT: 125 → 181 cities
  - ADM: 120 → 166 cities

- **Within 6-9 time zones**
  - CC: 117 → 164 cities
  - Innov: 87 → 144 cities
  - F&A: 89 → 148 cities
  - IT: 147 → 195 cities
  - ADM: 97 → 137 cities

- **More than 9 time zones**
  - CC: 7 → 10 cities
  - Innov: 1 → 2 cities
  - F&A: 3 → 5 cities
  - IT: 6 → 7 cities
  - ADM: 3 → 3 cities

* CC = Contact Center | Innov = Innovation | F&A = Finance & Accounting | IT = IT Infrastructure | ADM = Application Development and Maintenance
Location Factors for Offshoring
Innovation  India and China

- Low cost of labor
- Talent pool available
- High level of expertise
- Low costs (besides labor costs)
- Matches language requirements
- Location of the best service provider
- Quality of infrastructure
- Political stability in host country
- Collocating with existing BP facility offshore
- Collocating with existing manufacturing plant offshore
- Geographical proximity
- Access to local market
- Avoiding "hot spots"
- Supporting existing customers locally
- Cultural proximity
- Government incentives
- Other

China
India

0% 20% 40% 60% 80% 100%
Data Analysis Examples: Potential Growth Expected By Company Size From Considering Group

Percentage of Companies Considering Offshoring by Function by Size (2011)

- ADM
- CC
- Des
- Eng
- F&A
- HR
- IT
- Know
- Leg
- M&S
- Other
- Proc
- R&D

Source: ORN data
Figure 3
India and China dominate the region, but other countries are reinforcing their positions.

India  32  23  13
China  2.9  23  1.4
Malaysia  2.8  13  2.0
Thailand  32  12  1.6
Indonesia  3.3  1.5  1.1
Philippines  3.3  1.2  1.3
Singapore  1.7  1.5  2.5
Vietnam  3.3  1.0  1.2
Sri Lanka  3.2  1.0  1.2
Pakistan  3.2  1.0  1.1

(#) indicates overall Index ranking

Index ranking
- 1–10
- 11–20
- 21–30

Source: A.T. Kearney
Global Delivery – Nearshoring & Offshoring Combination

**European BPO Centers:**
- Near-shore Front-End
- Language Skills
- Cultural compatibility
- Same Timezone
- On-site support
- Local Management

**Indian BPO Centers:**
- Off-shore Back-End
- Domain Expertise
- Back-End Scalability
- Local Management
1. What does German economy offer to foreign investors?
   - FDI attractiveness
   - Are there any offshoring providers in Germany?
   - SWOT analyze

2. What will German investor (e.g. FMSG sector) be looking for in Central and Eastern European countries (vertical FDI)?
• Fewer than in the US, due to more conservative business culture, as well as stricter labor laws (redundancies)

• Language is an issue – few Indian programmers read French or Danish manuals, or can build interfaces in FR/DK

• The UK is an exception, with much work outsourced to IN, PK, BD, LA

• Germany – 80% of the large firms have yet to offshore – language, culture, ...

• 60% of German offshoring is to Eastern Europe (nearshoring)
IBM
- R&D in US, Israel, Switzerland + 16 devt centres

Microsoft
- most R&D in the US, but also India, China, Israel, UK.

Google
- R&D in India.

HSBC in 2003 had 1500 employees in China and 2000 in India for clerical work; +500 in Malaysia for data processing.

All the top 20 US tech firms do offshoring, but only about 10% of the Fortune 1000 devote more than 10% of their budget to offshored activities (!)
35 companies fully implemented their offshore programs
- saved 49 percent of their combined baseline costs
- experienced net improvement across all operational performance measures: organizational capacity, capability, flexibility, process maturity, revenue and service levels.

- 60 percent of these companies failed to meet their own operational performance targets, and
- 34 percent failed to meet their savings targets.

There was also significant variation across the offshore programs; cost savings ranged from 0 to 75 percent, and performance ranged from improvements in all six measures to a decline in five of the six.
FIGURE 1
The best performers and poorest performers fall into clear groups

Source: A.T. Kearney
FIGURE 2
Top companies focus more on operational performance than on cost savings

Want Savings? Don’t Focus on Savings
Figure
Business functions in the international context
How effective are centralized functions:
Looking at HRM, marketing and R&D, what are advantages of decentralization for the MNE with the operations in a number of different countries? What are the pitfalls?

- Financial
- Non-financial
2. Microeconomic aspects
   2.1. Recognizing determinants of successful offshoring.
   2.2. Key factors driving offshoring.
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General overview on global BPO

BUSINESS PROCESS OUTSOURCING

BPO – the relocation of a business process from internal structure of organization to external service providers; shifting work to domestic/foreign providers
Global BPO and IT Services Market 2013 ($Bn)

- Industry Specific, $185, 20%
- IT Infrastructure Mgmt, $143, 15%
- ADM, $70, 7%
- IT Prof Services, $309, 33%
- Other IT Services, $126, 13%
- F&A BPO, $25, 3%
- CRM BPO, $52, 5%
- HR BPO, $42, 4%

2013 Total Market Size: $952 Billion
IT Services: $648 bn
BPO: $304 bn

Source: HFS Research, 2013

Source: http://outsourcemagazine.co.uk/new-branding-tactics-for-outsourcing-companies-to-differentiate-and-accelerate-growth/
BPO is the act of transferring some of an organization's repeated non-core and/or core business processes to an outside provider to achieve cost reductions while improving service quality.

The main difference between BPO and more traditional IT outsourcing: BPO offers companies a way of achieving transformational outcomes much more quickly (3rd generation of offshoring).

In BPO, the outside provider not only takes on the responsibility to manage the function or business process, but also re-engineers the way the process has been traditionally done.
Best Case

- Initial position
- Severance and Offshore ramp-up

TIME

COST
**Best Case**

- **COST**
  - Initial position
  - Severance and Offshore ramp-up
  - Expense
  - Offshoring actualized

**TIME**
Best Case

COST

TIME

Severance and Offshore ramp-up

Initial position

Expense

Offshoring actualized

Savings

New steady state
**Pros**
→ need to be done “more with less”
→ competitors are doing it
→ improvement in quality
→ access to new technology without incurring capital expenses
→ *spill-over effect* inhouse

**Cons**
→ high initial costs
→ misunderstanding in the company’s unique processes
→ difficulties in *reinsourcing*
→ the quality of service will decrease over time

**Pros and cons of using BPO providers**
Source: Wipro
An alien from Mars, who is a regular reader of the Indian financial press, will conclude that:

- BPO is THE hottest game in town!
- It grows faster than IT – will get bigger one day.
- Size matters - bigger is better.
- Number of people is synonymous with how well you are doing.
- It doesn’t matter what you are doing, so long as you are growing.
- Revenue is more important than profits.
- If you get the accent right, rest will take care of itself.
- Native intelligence and inherent work ethic of Indians will automatically produce better quality.
- A multiplex cinema in a BPO company would not really be out of place – people just want to have fun.
- If you are not into BPO or IT, you must be a farmer.
And .... They do it everywhere:

- India
- Philippines
- Malaysia
- Singapore
- Taiwan
- Eastern Europe
- Ireland
- South Africa
- Mexico
- Brazil

...And:

- USA
- UK
- Europe
BPO market volume in USD bln

BPO market size in USD bln

GROWING COOPERATION

1. wave of dynamic specialization
   - company seeks the most effective specialization
   - at the same time, there is a fragmentation and delegation of the processes to specialized service providers
   - first wave characterizes in strong concentration of activities in outsourcing, but the choice of service provider is done by taking into account the best quality and reputation of the business partner
2. wave of integration due to the ability to links and coordination
- harmonization of operations, coordination and improvement of processes between cooperating companies;
- effective use of the external resources provided by business partner.

3. wave of supporting potential development
- company (coordinates and effectively uses resources) starts closely cooperate with other specialized service providers;

WORLD-WIDE BUSINESS NETWORK
Classification of Business Process Outsourcing (BPO):

According to the field of activity:

- **Contact Center** – the condition need to be satisfied is engagement of multi-language labor force (Gillette in Barcelona, Spain; Stream International – specialized in Customer Interaction Centers, offices in 16 countries, serve to 2000 companies, 11K employees)

- **Research and Development (KPO !!!)** – units employ high-skilled labor force with specific knowledge (in Poland: IBM, Avon, Delphi, GlaxoSmithKline, Oracle, Pliva)

- **Shared Services Center** – intercept business functions from multinationals and appear in countries, where labor costs are low concurrently to productivity and quality of service
Classification of Business Process Outsourcing (BPO)

(cont.): EX: Shared Service Center

• practice of multinationals
• reducing costs due to consolidation and standardization as well as invoicing, payrolls, IT services and help desk
• central management system and business process administration: HR, IT, Accounting, Finances provided and served for various departments (organization fraction)
• functions are decentralized and render services by separate divisions operating in the one field in each country
• consolidation and central system of quality management become an operating aim of the organization

(CEE, in Poland: KPMG, Philips, TNT Express, Thompson, GE Money, ArcelorMittal).
Classification of Business Process Outsourcing (BPO) (cont.):

According to a type of process:

- processes require direct contact to customer/client
- sale processes – negotiating and concluding a contract
- customer care support processes – technical support and call center
- internal processes with regards to supply chain – logistic and distribution
- internal processes with regards to organization function – HR, finance, IT, R&D, design
<table>
<thead>
<tr>
<th>SEGMENT</th>
<th>PROCESS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customer Relationship</td>
<td>Telemarketing</td>
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<tr>
<td>Management (CRM)</td>
<td>Collections</td>
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<tr>
<td></td>
<td>Customer Support</td>
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<td></td>
<td>(Voice, Email, Chat)</td>
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<tr>
<td>Finance and Accounting</td>
<td>Billing</td>
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<tr>
<td>(F&amp;A)</td>
<td>Receivables Management</td>
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<td>Creditors Management</td>
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<td>Financial Accounting</td>
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<td>Human Resources (HR)</td>
<td>Payroll Management</td>
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<td>Benefits Management</td>
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<td>Training</td>
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<td>Recruitment</td>
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<td></td>
<td>Records Management</td>
</tr>
</tbody>
</table>

Source: Pavan Vaish, Daksh eServices Private Limited
<table>
<thead>
<tr>
<th>SEGMENT</th>
<th>PROCESS</th>
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</thead>
</table>
| Content development/ Digitisation/ Transcription | Content Development  
Data Entry/ Data Conversion  
Transcription – Medical/ Legal/ Pre-press/ Pre-Media  
Geographic Information System (GIS) |
| Transaction Processing        | Tax Processing  
Claims Processing  
Check Processing  
Card Processing |
| Supply Chain                  | Transportation  
Materials Management  
Warehouse Management |
## Innovation Services

<table>
<thead>
<tr>
<th>Function</th>
<th>Examples of Tasks</th>
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<tbody>
<tr>
<td>Engineering Services</td>
<td>Design automation</td>
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<tr>
<td></td>
<td>Tool design</td>
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<tr>
<td></td>
<td>Simulating</td>
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<tr>
<td></td>
<td>Drafting &amp; modeling</td>
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<td></td>
<td>Engineering analysis (e.g. finite element analysis)</td>
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<td></td>
<td>Embedded systems development</td>
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<td></td>
<td>Re-engineering</td>
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<td></td>
<td>Technical publications</td>
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<tr>
<td>Research and Development</td>
<td>Research on new materials and processes</td>
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<tr>
<td></td>
<td>Code development</td>
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<tr>
<td></td>
<td>Research and development of new technologies</td>
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<tr>
<td>Product Design</td>
<td>Prototype design</td>
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<td>Systems design</td>
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<td>Application development</td>
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<tr>
<td>Software Design</td>
<td>Application development</td>
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<td>Software architecture &amp; design</td>
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<td></td>
<td>Database design</td>
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<td></td>
<td>Gaming and animation</td>
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</tbody>
</table>
BPO REVOLUTION

- Business Specialization
- Educational Achievements
- Broadband Internet
- Internet Security
- Abundant Data Storage
- Online Analytic Processing
In 2002, more than 20% students enrolled in U.S. higher education came from India and China.
60% Ph.D. graduates (2006) in electrical engineering in U.S. were foreign-born.

In the United States more students are getting degrees in recreation management than in electrical engineering.
In 2001, 46% of Chinese students graduated in engineering.
- U.S. – 5%.
Rapid growth in engineering and computer science graduates in China

U.S. firms have to rely on foreign high-skilled labor force. Anyway, many SKILLES providers come originally from US host institutions (universities, research institutes).

The quality of talent is high, and the cost is low. Concurrently – there is a warranty of skills.

Global achievements in education drives BPO innovators to develop their business despite regional placement (seeking skills not cost reduction).
2006: tremendous change was seen in South & East Asia, where the average downstream speed increased by over 130%.

**China Tietong** launched a new range of services with downstream speeds ranging from 512 Kbps to 4 Mbps.

**China Telecom** expanded its existing *Home ASDL Unlimited* range of services with downstream speeds ranging from 512 Kbps to 2 Mbps.
Abundant data storage

Computerization (punch card, magnetic tape, disk-based storage)

- paper replacement
- data = commodity
- data storage = commodity management
- limitless storage data – era of the storage overcapacity
- elimination of the barriers to data storage (no decision re: what to collect, what to keep or eliminate)

- new corporate culture – intranet on all over company operating worldwide
SOFTWARE

- major source of business competitiveness
- needs much concerns (!)
- SOFTWARE works *with* us
- SOFTWARE works *for* us

Data analysis software

Elimination in high-cost analyst labor – replaced by sophisticated analytical tools

NEW: job shifts in middle management – white-collar managers outsourced
**Internet security** refers to the ability to send information and data (incl. voice) over the internet without fear of leakage, espionage or outright loss.

Kerberos (MIT) – cryptographic environment

- Proxy servers
- Passwords
- Firewalls
- Certificates
- Extranet

**Law governing anxiety**

Organizations aware of security best practices and ensure that BPO vendor has **capability and processes in place** to meet and exceed security needs.
Adam Smith: specialization

Prahalad, C.K, Hamel, G.: core competency

business organization should operate as few non-revenue-producing units as possible

PEO – professional employment organization (2-3 millions Americans are co-employed)

- provides a specific service – on lower costs (overheads) and high quality

- operating in US, Germany, Sweden, UK, Russia
BPO: save money or fix your processes

• No clear-cut between BPO and outsourcing
• BPO as a buzz-word and apply it to relatively simple services
• entire process is outsourced, not merely one or two steps in a process

**NOTE:** contracting a freight company to deliver goods to your customers is outsourcing, but engaging a logistics company to handle warehousing, distribution, and/or delivery is BPO.
WHY BPO?

• tactical issues
• cost of advantages (not cost of process)
• speed up the reaction: from channel sale to via-web model (3rd GEN)
• *economies of scale* solve the business problem, that can not be solved internally
• risk transfer (*WHAT RISK DO U TRANSFER?*)
• knowledge gains (KPO)
Who's offering BPO? Vendor selection

- are all the multinationals: IBM Global Services, HP, Accenture, and Unisys, EDS, ACS (a pure BPO operation), and KAZ/Telstra
- BPO provider takes responsibility for the entire process

**NOTE:** Fuji Xerox sometimes partners with large outsourcing providers Fuji Xerox might provide all the document processing and engage with a partner to do the rest
Who's offering BPO? Vendor selection (cont.)

- lots of niche companies are challenging the big players, and specialist subcontractor providers are playing a part in the BPO system
- look at potential providers' track records and references

**NOTICE:** in emerging markets where nobody has substantial experience, examine the providers' capabilities and how that applies to what you'll need.
## Industry Structure

<table>
<thead>
<tr>
<th></th>
<th>1990-93</th>
<th>1994-99</th>
<th>2000-01</th>
<th>2002-</th>
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</thead>
<tbody>
<tr>
<td><strong>Captives</strong></td>
<td>• Citibank</td>
<td>• GE</td>
<td>• Dell</td>
<td>• Accenture</td>
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<td>• Amex</td>
<td>• Stanchart</td>
<td>• AOL</td>
<td>• IBM</td>
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<td>• HSBC</td>
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<td>• ADP</td>
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<td>• ACS</td>
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<tr>
<td><strong>Independents</strong></td>
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<td>• Spectramind</td>
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<td>• 24/7 etc.</td>
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<td><strong>IT Majors</strong></td>
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<td>• Progeon (Infosys)</td>
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<td>• Nipuna (Satyam)</td>
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<td>• Intellinet (TCS)</td>
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<td></td>
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<td>• Spectramind (WIPRO)</td>
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</table>
Delivery Model by Launch Year

- **Pre-2001**: 66% Captive, 34% Outsourced
- **2001-2003**: 66% Captive, 34% Outsourced
- **2004-2006**: 48% Captive, 52% Outsourced
- **2007-2009**: 37% Captive, 63% Outsourced
Captive centers sold out: ('08) CITI/BPO to TCS and IT center to Wipro, ('09) AXA group BPO center to Capita Group, Dell/El Salvador support center to Stream Global Services, Dell/Pasay consumer tech support center to Teleperformance; Amex India captive center to EXL, UBS to Cognizant, AIG/IT center to MphasiS (controlled by HP)

1970
- GE outsources software work to India; established GECIS ('72)
- IBM enters Indian market ('77)
- Nestlé R&D center in Singapore; TCS electronic trading system for SIS SegaInterSettle, Swiss ('79)
- TCS established first India's software R&D center; Wipro into technology business ('81)
- Wipro software products subsidiary ('83)
- Texas Instruments R&D facility in Bangalore ('85)
- Am Ex consolidated its JAPAC (Japan and Asia Pacific) back office in India ('87)
- Cannon R&D center in Philippines, Microsoft R&D center in Israel ('90)
- Motorola R&D centers in India and China ('90)
- TCS provides IT services to Citi ('92)

1975
- India: Software Export Scheme ('72)
- Bob Metcalfe announced the memo inventing “Ethernet” at Xerox Palo Alto Research Center ('73)
- India: liberalization import of software ('76)
- Successful commercial personal computers: Apple II, PET 2001 and TRS-80 ('77)

1980
- Successful commercial personal computers: Apple II, PET 2001 and TRS-80 ('77)
- India: “New computer policy” ('84)
- Macintosh personal computer and MAC system software ('84)
- Introduction of "broadband service" ('88)
- First www invented* ('89)

1985
- Am Ex consolidated its JAPAC (Japan and Asia Pacific) back office in India ('87)
- India: National Telecom Policy ('94)
- Software IP Encryption protocol swIPe ('93)

1990
- India: trade and FDI inflow liberalization, “Software Development Parks of India” ('91)
- US: Telecom Act - first time the Internet included in broadcasting and spectrum allotment ('96)

1995
- Canon R&D center in Philippines, Microsoft R&D center in Israel ('97)
- Intel set up China Research Center in Beijing ('98)
- Indian IT/BPO providers overseas: Spectramind, Efundus, vCustomer, Daksh, Wipro, Infosys ('00)
- GATS: 49 out of 136 WTO members’ schedules included commitments on R&D services ('05)

2000
- GATS : 49 out of 136 WTO members’ schedules included commitments on R&D services ('05)

2005
- Y2K

2010
- Indian IT-BPO sector revenue $100 bln, direct employment 2.8 mln people ('12)
CONTEMPORARY OFFSHORING

Knowledge Process Offshoring (KPO)
Why do Companies Offshore Innovation?

- **Asset exploiting R&D** (Dunning and Narula, 1995), **home-base exploiting R&D (HBE R&D)** (Kuemmerle, 1999), **competence exploiting** (Cantwell and Mudambi, 2005)
  - **Adapt products to local markets** (Hakanson and Nobel, 1993; Howells, 1990; Gammeltoft, 2006)
  - **Co-locate with manufacturing and marketing centers offshore** (Gammeltoft, 2006)

- **Asset augmenting R&D** (Dunning and Narula, 1995), **home-base augmenting R&D (HBA R&D)** (Kuemmerle, 1999), **or competence enhancing** (Cantwell and Mudambi, 2005)
  - **Augment a firm’s knowledge base** (Cantwell, 1991; Dunning 1998; Florida, 1997; Howells, 1990)
  - **Benefit from lower costs of engaging STEM talent** (Massini, Miozzo, 2012)
  - **Monitor foreign R&D environment and gain access to local IP** (Florida, 1997; Gammeltoft, 2006)
  - **Satisfy foreign governments that demand local R&D in return for market access** (Massini, Miozzo, 2012)

- **Home Based Replacement (HBR)** (Lewin, Peeters, Massini, 2009)
Companies Began Sourcing of Innovation At Same Time as IT

Source: 2, 3, 4, 5, 6
**Knowledge Process Offshoring**

services in rendering of which company needs experts’ knowledge, high-skilled labor force and: analytical research, market reports, legal advisory, engineering and design services, data collecting and working out statistical data.

KPO refers to: financial, *business & market intelligence*, legal services and research.

Value added is the basic aim of the processes get out of the home company into KPO.

KPO is the approach concentrated mainly on **experts** and relates to the tasks, what require technical abilities, analytical and decision driven activities.

The idea of KPO comes from lack of high-skilled labor force – skilled in specific field and industry - regionally and the most common aspect of offshoring/outsourcing – **COST REDUCTION is the objective but not the only one!!**

**KPO is taken by FDI investors:**
- offshored/outsourced process maintains under control
- less risk of commercial secret disclosure
- most common in multinationals – open cost
Knowledge Process Offshoring

is developed in the fields restricted and coordinated by state law regulations: medicine, law, accounting;

The sectors are restricted by official certificates, or state acknowledgement.

Administrative-law restrictions limit service in the economy

UNCTAD (2007): KPO proves 3rd generation offshoring
Picture. Evaluation of number of companies imposing Knowledge Process Offshoring

Evaluation of the high-skilled employees in Knowledge Process Offshoring

The BPO market is changing rapidly as customers demand higher value of offshore services.

**KPO DRIVERS**

**Buyer’s demand**

Buyer demands more specialized and higher value services and solutions – they want a provider that knows their business.

**Competitive pressures**

Competitive pressures on early market leaders like India from countries like Philippines, China, Sri Lanka or CEEs have forced players to offer higher value services in order to keep their market share.

**Industry consolidation**

Industry consolidation has driven the creation of niche KPO players who must differentiate in order to gain market share.
KPO brings tremendous advantages for customers, KPO providers, and employees of KPO firms alike

WHAT DO I KNOW ABOUT ...

...MY CLIENT
- strategic extension of the business
- access to a highly skilled workforce
- focus on quality and value-add
- knowledge rather than cost – no wage arbitrage

...MY STAFF
- definite career path – jobs are in specific industry, rather than in BPO
- more extensive training opportunities and more transferable skills
- higher earnings
- uniquely positioned to capitalize on local markets once they evolve

...MY BUSINESS
- deep relationship
- long-term contract
- low attrition rate
- increased profit margin
- better ability to compete with captive operations
As companies increase scale and scope of offshoring average cost savings declines

Business Process Outsourcing

1) Key players on BPO market:
   • MNC branch
   • **INTL BPO companies / IT companies**
   • Innovation providers
CONVERGYS is a global leader in relationship management. It delivers a broad range of customer and HR solutions, backed by technology, business analytics and consulting services.

Headquartered in Cincinnati, Ohio, Convergys employs nearly 75,000 employees who serve clients in over 70 countries, speaking more than 35 languages, from 85 contact centers and other facilities across the globe.
Provides fully integrated customer care and back office processing services

**Customer Care**
Repeat purchases, up-sell/cross-sell, billing information, issue resolution, account change, reservations, loyalty clubs, investor inquiries and warranty calls

**Technical Support**
Troubleshooting, hardware/software support, Internet support, PC/server support, corporate helpdesk, warranty and post warranty

**Risk Management**
Pre charge-off, post charge-off, early fraud, credit activation, property recovery, skip tracing, disaster prevention and recovery

**Back-Office Processing**
Order and payment processing, e-Commerce, catalog, continuity services and rebate processing activities
Sitel is a global Business Process Outsourcing (BPO) leader.

The company meets clients’ customer care and transaction processing needs through 60,000 associates in 27 countries. Sitel provides world-class solutions from on-shore, nearshore and offshore locations across 155+ facilities throughout North America, South America, EMEA and Asia Pacific.
Fidelity National Information Services (FIS), est. 2006 is the world's top-ranked technology provider to the banking industry. With more than **24,000 experts in 90 countries**, FIS delivers range of solutions for the broadest range of financial markets.
Business Process Outsourcing

1) Key players on BPO market:
   - MNC branch
   - INTL BPO companies / IT companies
   - Innovation providers
Emergence of Innovation Providers: Infotech value added innovation partnership

- Insourcing staffs
- Value added innovation partnerships
  - Dedicated and secure space for specific clients
- 7,000 staffs specializing in Engineering Services, Geographic Information System, and IT services
Emergence of Innovation Providers: Gen3’s Innovation on demand

- Organized Global Knowledge Network of over 8,000 Russian scientists and engineers
- Blue chip client list
- Offering open innovation services for clients to improve speed to market and impact of innovation efforts
- Unique problem solving design methodology
- Example: Teeth whitening strips
Some GEN3 Top Clients

ABB, Airgain, ALCOA, AlliedSignal, AVERY, BARD, Chiquita, CLOROX, DELPHI, Energizer, Fenwal, Gambro, GE, Gillette, Metso, Mitsubishi Research Institute, MOEN, Motorola, O-I, P&G, PPG, PURINA, Rich's, Siemens, Toshiba, Tyco Electronics, Unilever, Wrigley, Xerox
Business Process Outsourcing

1) Key players on BPO market:
   - MNC branch
   - INTL BPO companies / IT companies
   - Innovation providers
Key players

Online STEM Talent Markets
Online STEM Talent Markets

Research & Development platforms

Corporate Crowdsourcing

Marketing, Design & Idea platforms

Creative co-creation

Intermediary Services

Collective Intelligence & Prediction

HR & Freelance
Online STEM Talent Markets

**Freelancer**
est. 2004
Funding: $40Mln
Freelancers: 8 mln
Job posted: 4.4 mln
CEE*: $150Mln

**Elance**
est. 1998
Funding: $78Mln
Freelancers: 2 mln
Job posted: 2.9 mln
CEE: $739Mln

**qDesk**
est. 2003
Funding: $44Mln
Freelancers: 3.1 mln
Job posted: 3.6 mln
CEE: $739Mln

**99designs**
est. 2008
Funding: $35Mln
Freelancers: 0.2 mln
Job posted: 0.2 mln
CEE: $920Mln

* - cumulative estimated earnings
Work is Not a Place

How Employees Work Is Changing

- 63% of time is spent communicating and collaborating
- 47% of collaboration is with employees in different time zones

Technology Enables Mobile, Collaborative Work “Styles”

- 89% do some amount of their work from home
- 65-76% of work is done away from their office desk
- 38% work in a different location than their manager
- 32% are categorized as mobile workers though
- 54% work that way

Source: The 2010 Cisco Work Profile Survey
4. Case Studies

4.1. OFFSHORING OF AMERICA
TASK: Recognize the challenges of offshoring in selected regions: Mexico, China, India - SWOT analysis.

4.2. WILL YOU SURVIVE THE SERVICE REVOLUTION?
TASK: Design the strategy of offshoring for company taking into account the complexity of processes.

4.3. THE IMPACT OF TECHNOLOGY ON COST IN BUSINESS PROCESS OUTSOURCING
TASK: Identify and discuss the possibilities of reducing cost in manufacturing and/or service business on the basis of technology development.