

# The Visegrad countries in the business services GVCs

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# Outline

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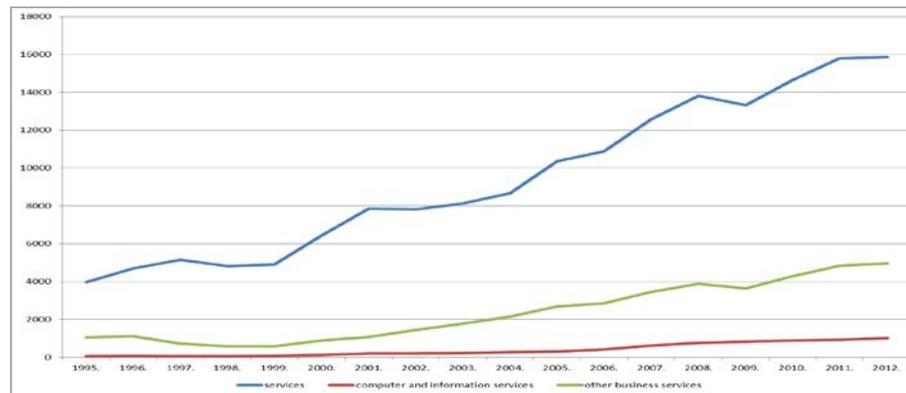
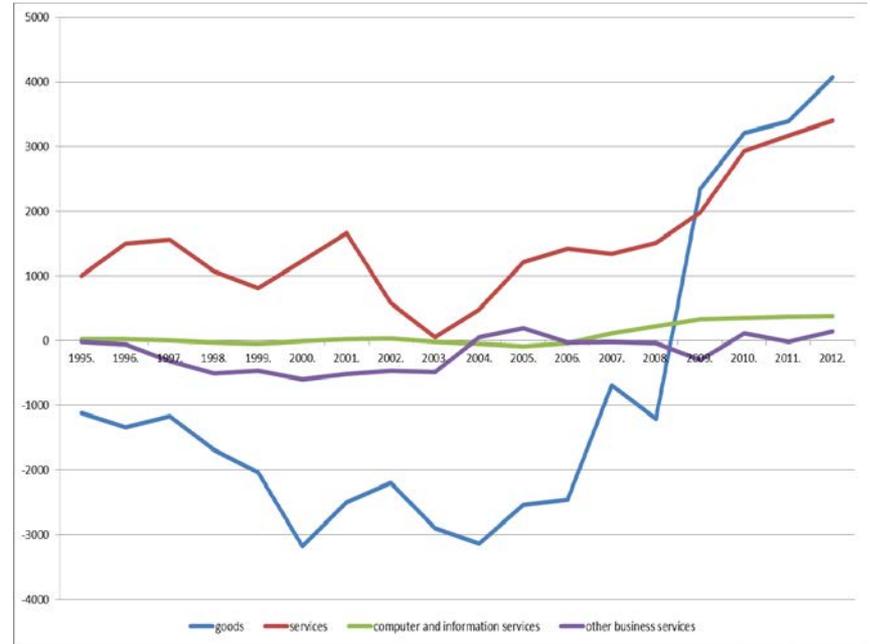
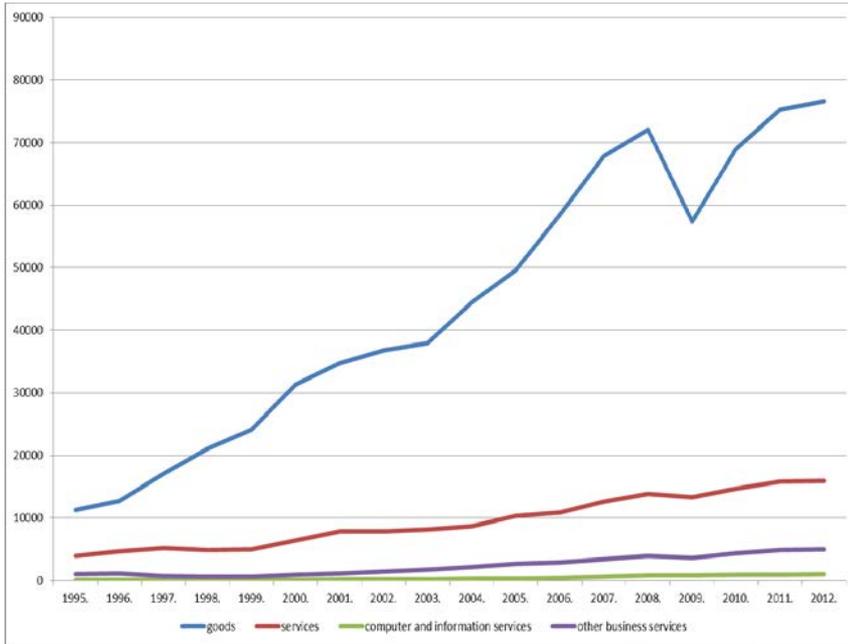


# 1. Introduction

- Offshoring and offshore outsourcing (trends: from offshoring to outsourcing, dynamism – crisis; various shaping factors) - captive (offshoring) and independent service providers (offshore outsourcing)
- Wide definition: 3 main segments (Fernandez-Stark, Gereffi, 2010) 1. BPO: business process outsourcing and offshoring; 2. ITO: information technology outsourcing and offshoring; 3. KPO: knowledge process outsourcing and offshoring
- Activities involved: constantly changing (increasing)
- Hungary and V3 (+Czech Republic and Slovakia) – host country perspectives (Poland different: bigger size, more centers (close to 400, while in Hu/Cz around 70-75; altogether around 850 in CEE) – more dispersed geographically) – growing dynamically after 2003
- Current size and share of V3/4???: different estimations/segments (BPO, ITO, KPO or offshoring/outsourcing) , methodological approaches (and bias) ; share of global market around 4-5% (WEu: 20-25%) in 2011 (based on McKinsey, Gartner...); top 100 outsourcing destinations (Tholons, 2013): 5 WEu, 7 V4, 10 CEE+! - fr sure: growing, but still smaller than traditional WEu locations
- Traces (?): BOP services trade – illustration: Hungary; other 2/3 countries similar developments with a time lag (Slovakia) according to data up till 2009

# Illustration – Hungary: 1 export of goods and services

## 2 balance of goods and services FT; 3 export of services (million euros)





## 2. Data and methodological problems

- Lack of clear definition, esp. with reference to existing statistical categories
- Inconsequent use of categories in the literature (offshoring, offshore outsourcing etc.)
- Problems of separation/identification of the sector/activity, and separation of the GVC-related part
- High level of aggregation of available data
- Data unreliability and inaccuracy (higher than for manufacturing, confirmed by the company interviews and interview with the Central Statistical Office)
- In detail: for services trade in general: Francois, Hoekman, 2009; for services offshoring and outsourcing: Kirkegaard, 2005; Sturgeon et al., 2006; specifically for V4 services offshoring-outsourcing: Sass and Fifekiva, 2011
- Recommendations of the above papers: to combine statistical/econometric analysis with case studies, analysis of company surveys etc.
- (New possibility: new set of data: measuring trade in value added (WTO-OECD) may offer new insights into services GVCs)

# 3. The GVC framework and research questions

- The GVC framework used for the analysis: a global(ly organised) activity with a value chain sliced and distributed between various countries
- GVC: identifies/measures values at each stage of production of a service and thus can show how it is distributed between participants/geographically
- Basis: analysis at the firm level to determine in which stages of production the activities carried out belong – company cases
- Questions to analyse:
  1. Which activities are offshored to the given location?
  2. Which are the locational factors to attract these activities?
  3. Is there any change in the activity content either in the already present companies or through newcomers setting up new companies – is there upgrading, i.e. an increase in the local added value?
  4. Is this upgrading translated into higher local „gains” (wages/profits etc.), i.e. value capture?
  5. What are the local impacts (on economic and non-economic actors) of these subsidiaries? (GVC versus GPN)

# 4. Methodology and Data

- Company case studies, based on semi-structured interviews with leading managers of foreign-owned companies
- Advantages (rich in details, attention to differences/specificities, qualitative analysis) and disadvantages (problems of generalisation, selection bias) of this approach
- Additional interviews: Hungarian Outsourcing Association, ITDH
- 2008-9: 30 in the Czech Republic, Hungary and Slovakia (8+1 in Hungary), ITO and BPO
- December 2012-January-February 2013: 5 organisationally separate KPOs (+ 15 non-separate - in the GRINCOH project)
- Update + interviews: August-September 2013: 3 (1 ITO, 1 BPO and 1 KPO; 1 captive (I), 2 independent)
- the methodological approach is justified by the problems with available data and by the use of the GVC (in the published article: GPN) framework
- Relatively good coverage in Hungary (and in V3 in 2008-9) altogether 40-50 SSC + independent service provider (ITO and BPO) and around 20 (organisationally separate) KPO (with some „mixed” cases)
- Overall: a qualitative analysis with very few numbers....

# Results of the research 1

## Which activities?

Activities carried out in the companies interviewed in Hungary

Back office	Customer contact	Common corporate functions	Knowledge services and decision analysis	Research and development
▶▶▶ Increasingly complex transactions ▶▶▶				
Transaction processing Document management Data entry Data processing	Call centres Telemarketing Contact centres	HR management Accounting Administrative services Financial services IT call centres Other IT services Quality management Cost planning Service delivery (after sales) Supply chain management Procurement management Payroll and benefit administration	Program and project management Financial program management Integration engineering Analytical accounting services Business performance analysis Cost analysis Mobile application support Software application support	(Original) software development Application development and integration Mathematical modelling Manufacturing development and research

Basis: McKinsey

Wide range of activities, mainly in the higher mid-range

Moving towards more complex in time (speed differs)

KPO (R&D) differing content

Language as a prerequisite: some highly standardised activities could be (were) carried out by employees with secondary education

Years in formal education: not a good proxy for complexity

# Results of the research2

## What are the locational factors?

Main locational advantages for vertical business services FDI (BPO, ITO and KPO)

Motive	Elements
Cost reduction due to lower factor costs	Lower wages (ULC) of relevantly skilled labour (with specific language knowledge for BPO, certain ITO)
Reducing costs of disintegration of production	Transport costs (infrastructure, esp. telecom for BPO and ITO, geographical proximity in cases where regular personal contacts are required; presence of production in the case of production-related KPO) Trade costs (trade barriers, institutional openness, economic integration etc.)
Cost reduction: other costs	Costs connected to office space, to IP protection, to other elements of infrastructure Labour market regulations Cultural proximity Economies of scale (when concentration) Incentives
Cost reduction: due to the "smoother" functioning of the affiliate	Stability of the economic and political environment
Other motives (partly from confluence with horizontal FDI)	Together with factors affecting the "smoother" functioning of the affiliate, demand side factors (e.g. size and dynamism of local market)

Locational factors relative to the main competitors

Main competitors	Advantage	Disadvantage
(European) developed countries	cheaper; still a relatively larger supply of suitable employees	mother tongue and mother tongue+ skill combination less present
Asian developing countries (mainly India + China, Philippines etc.)	geographically, culturally closer to Europe; greater selection of languages; IPR protection	(slightly) more expensive; pool of suitable labour much smaller
Other countries in the CEE region (Romania, Bulgaria, Ukraine, Russia etc.)	geographically closer to Europe, better infrastructure, IPR protection, harmonised regulations in certain areas	(slightly) more expensive



# Results of the research3

## Is there any upgrading?

All company cases indicate at least one type of upgrading (though generalisation difficult):

Upgrading: four types (Humphrey and Schmitz, 2002), product, process, functional and intersectoral.

1. Product – increasing the complexity of the service offered: the majority of independent service providers (e.g. from call centre in one language towards call centre in multiple languages; from „password reset” ITO to mobile application support or software support), less present in captive SSCs;
2. Process – present in basically all cases, A. introducing new technology, specialised training of employees: continuous; 2. restructuring existing systems to increase efficiency: continuous; e.g. info from the parent, sharing best practices with other affiliates, area competencies distributed between affiliates/parent
3. Functional – production - related KPOs: all; IT (manuf.) companies towards IT services (one company); from ITO to KPO (two software companies); from BPO to ITO and KPO (one company); allocating captive HR and financial SSC to a Hungarian independent service provider affiliate in process
4. Inter-sectoral – cases: entry into a new vertical chain: from business services (incl. IT) to setting up a team of integrated system engineers for completing the informatics infrastructure of clients; intro of cloud computing; decision taken by the parent; SSC offering services to outside clients (overlap with product and functional upgrading – blurred dividing lines?)

Overall, captive seem to be less inclined to upgrading than independent (operates inside the firm, while independent operates on the market)

# Results of the research4

## Is upgrading translated into higher local „gains“? „Value-capture“

- Based on the interviews and company balance sheets (only the 16 companies involved)
- SSCs or KPOs/ITOs as part of a larger (manufacturing) affiliate: similarly to Szalavetz (2013), only little impact on „hard“ company indicators (e.g. per capita VA, profit) of the affiliate, a relatively larger share of white-collar employees; reason: - internal prices determined on the basis of costs+margin
- independent: continuous increase in employment; continuous increase in per capita wages (hypothesis: due more to high attrition rates and limited supply of suitable workers), however, similar pricing to captive: costs+margin
- Hard to trace (fully) through quantitative data
- „local gains“ more important in other forms: increase in importance (+allocated budget), strengthened or higher position inside the company network for the affiliate, more functions, higher degree of autonomy etc.

# Results of the research<sup>5</sup>

## What is the local impact of these activities?

Channels identified on the basis of the company interviews (but their impact not quantified):

1. Raising demand for skilled (foreign language-speaking university graduates ) labour
2. Training employees (continuous, activity-oriented; overview of the whole process/more segments only in a few cases, e.g. BPO: only 1)
3. Linkages: forward (minimal, but relatively significant for confluent BPO and ITO) and backward (minimal, some „spin-offs” in ITO (KPO), but mainly for the local market or to help fulfilling orders)
4. Mobility of trained employees (mainly between the FO centers, cases of former employees setting up own businesses: only in ITO)
5. Impact on local infrastructure and services through increased demand (telecom, office renting)
6. Impact on the business environment and on the local innovation system (KPO – universities; ITO/BPO – content varies; active in local chambers/associations - lobbying)
7. Competition impact (mainly on the labour market, for confluent also on product markets, but FO/DO operating mainly in different segments)
8. Regional impact (minimal in Hu/Cz/Sk; more significant in Poland – „threshold” level of population in countryside towns with tertiary education for BPO, ITO and stand-alone KPO; KPO – more dispersed because of production-related)

**THANK YOU FOR YOUR ATTENTION!**