Offshoring Opportunities Amid Economic Turbulence

The A.T. Kearney Global Services Location Index™, 2011

The current global services landscape is marked by countervailing trends. On one hand, firms are responding to intensifying cost-cutting imperatives by moving operations offshore. On the other, politicians are using global services offshoring as an easy scapegoat for current economic woes and high unemployment levels in their home countries, stoking resentment against globalized firms and their foreign host countries. Although signs of a slowdown in the growth of global services are evident in this environment, don't expect offshoring to end. In fact, the global services industry's full potential is ready to be tapped.

As we publish the 2011 A.T. Kearney Global Services Location Index™, we find that the world of services offshoring has changed dramatically since we published the first report in 2003.[1] What was then an emerging phenomenon that seemed to have great potential is now a natural element of corporate services supply chains. The industry has grown significantly and in many cases exceeded expectations from the early days. The part of the value chain that can be performed offshore has increased in value-add and complexity as we continue to see new types of services being handled remotely and across borders. At the same time, the geography of offshore delivery has expanded to include a large number of countries specializing in different parts of the service-production ecosystem.

In terms of the industry's broader macroeconomic environment, the world in 2003 was similar to today's, emerging from an economic slowdown that had begun two years earlier. At the time, the economy soon returned to health. Likewise, the hope today is for renewed growth, but the situation is still fragile. The International Monetary Fund (IMF) projects gross domestic product (GDP) growth of 2.3 percent in the United States in 2011—hardly the kind of dynamism that would propel the global economy. The IMF's latest projections for global economic growth—an estimated 4.8 percent in 2010 and 4.2 percent in 2011—come with the warning that "global recovery remains fragile, because strong policies to foster internal rebalancing of demand from public to private sources and external

[1] *The first report was named the A.T. Kearney Offshore Location Attractiveness Index.*

Figure 1

The A.T. Kearney Global Services Location Index™, 2011

Rank	Country	Financial attractiveness	People skills and availability	Business environment	Total score
1	India	3.11	2.76	1.14	7.01
2	China	2.62	2.55	1.31	6.49
3	Malaysia	2.78	1.38	1.83	5.99
4	Egypt	3.10	1.36	1.35	5.81
5	Indonesia	3.24	1.53	1.01	5.78
6	Mexico	2.68	1.60	1.44	5.72
7	Thailand	3.05	1.38	1.29	5.72
8	Vietnam	3.27	1.19	1.24	5.69
9	Philippines	3.18	1.31	1.16	5.65
10	Chile	2.44	1.27	1.82	5.52
11	Estonia	2.31	0.95	2.24	5.51
12	Brazil	2.02	2.07	1.38	5.48
13	Latvia	2.56	0.93	1.96	5.46
14	Lithuania	2.48	0.93	2.02	5.43
15	United Arab Emirates	2.41	0.94	2.05	5.41
16	United Kingdom	0.91	2.26	2.23	5.41
17	Bulgaria	2.82	0.88	1.67	5.37
18	United States	0.45	2.88	2.01	5.35
19	Costa Rica	2.84	0.94	1.56	5.34
20	Russia	2.48	1.79	1.07	5.34
21	Sri Lanka	3.20	0.95	1.11	5.26
22	Jordan	2.97	0.77	1.49	5.23
23	Tunisia	3.05	0.81	1.37	5.23
24	Poland	2.14	1.27	1.81	5.23
25	Romania	2.54	1.03	1.65	5.21
26	Germany	0.76	2.17	2.27	5.20
27	Ghana	3.21	0.69	1.28	5.18
28	Pakistan	3.23	1.16	0.76	5.15
29	Senegal	3.23	0.78	1.11	5.12
30	Argentina	2.45	1.58	1.09	5.12
31	Hungary	2.05	1.24	1.82	5.11
32	Singapore	1.00	1.66	2.40	5.06
33	Jamaica	2.81	0.86	1.34	5.01
34	Panama	2.77	0.72	1.49	4.98
35	Czech Republic	1.81	1.14	2.03	4.98
36	Mauritius	2.41	0.87	1.70	4.98
37	Morocco	2.83	0.87	1.26	4.96
38	Ukraine	2.86	1.07	1.02	4.95
39	Canada	0.56	2.14	2.25	4.95
40	Slovakia	2.33	0.93	1.65	4.91
41	Uruguay	2.42	0.91	1.42	4.75
42	Spain	0.81	2.06	1.88	4.75
43	Colombia	2.34	1.20	1.18	4.72
44	France	0.38	2.12	2.11	4.61
45	South Africa	2.27	0.93	1.37	4.57
46	Australia	0.51	1.80	2.13	4.44
47	Israel	1.45	1.35	1.64	4.44
48	Turkey	1.87	1.29	1.17	4.33
49	Ireland	0.42	1.74	2.08	4.24
50	Portugal	1.21	1.09	1.85	4.15

Note: The weight distribution for the three categories is 40:30:30. Financial attractiveness is rated on a scale of 0 to 4, and the categories for people skills and availability, and business environment are on a scale of 0 to 3.

Source: A.T. Kearney Global Services Location Index™, 2011

rebalancing from deficit to surplus economies are not yet in place."[2] The IMF's recent Global Financial Stability Report offers a similar caveat: "The global financial system is still in a period of significant uncertainty and remains the Achilles' heel of the economic recovery."[3]

Within this shifting macroeconomic environment, the Index continues to track the contours of the global outsourcing landscape in 50 countries and their potential across three major categories: financial attractiveness, people skills and availability, and business environment. We consider 39 metrics to identify the top countries for delivering information technology (IT), business process outsourcing (BPO) and voice services *(see appendix: About the Study on page 19)*.

This paper presents an overview of the 2011 findings of the Index *(see figure 1)*. We examine the results for each region and offer guidance for choosing the right locations around the globe to perform services. In the final analysis, maximizing the benefits of offshoring is vital for success—regardless of economic conditions.

Industry in Transition

After the 2008 financial crisis hit, we predicted an immediate and significant impact for global services outsourcing, considering that financial services firms were the biggest customers of services outsourcing and the United States was the world's economic center of gravity. Today, we look back at an industry that has certainly endured two lean years.

The reality is that the global business environment has been in profound flux for a variety of reasons: contrasting—and conflicting—recovery and post-recovery strategies (especially among advanced economies); asymmetrical rates of recovery between developed and developing worlds; uncertainty about the capacity of the United States to engineer a strong economic recovery; persistent questions in Europe about its fiscal maneuverability (highlighted by the recurrent sovereign debt and banking crises); concerns about persistent economic obstacles in Japan; and reservations about the capacity of the G20 countries to formulate unified responses to their various economic challenges. It is no surprise, therefore, that the IMF finds that "downside risks remain elevated" *(see sidebar: A World of Risks on page 4)*.[4]

As the economic environment shifts, the picture in the global services industry is growing more complex. Political backlash against offshoring and talk of "reshoring"—bringing functions and jobs back to home countries—are commonplace, and the economic crisis and high unemployment rates have made such reshoring in tier-2 and tier-3 locations in developed countries more attractive. Still, huge potential remains for globalized services delivery, as new technologies such as cloud computing help it continue to evolve rapidly.[5] How, then, will the traditional outsourcing business model change in the future?

Offshoring will overcome negative perceptions. Economic turmoil renewed the negative perception of offshoring and its perceived impact on domestic labor markets in developed countries. In the 2009 Index, however, we pointed to evidence suggesting the contrary—that the sectors with the fastest employment growth in developed countries were actually tradable (or "offshoreable") services.[6] In other words, despite growing concerns about job losses, these services still grew in developed countries as economies globalized.

[2] *IMF,* World Economic Outlook: Recovery, Risk, and Rebalancing, *Washington, D.C.: October 2010.*
[3] *IMF,* Global Financial Stability Report: Sovereigns, Funding, and Systemic Liquidity, *Washington, D.C.: October 2010.*
[4] *IMF,* World Economic Outlook: Recovery, Risk, and Rebalancing, *Washington, D.C.: October 2010.*
[5] *See "Software Demand Management" at www.atkearney.com.*
[6] *For more information about the 2009 Index, see "The Shifting Geography of Offshoring" at www.atkearney.com.*

A World of Risks

With a global business environment in flux and economies continually shifting, the picture in the global services industry is growing more complex. The following trends have significant implications for the industry:

Countries are pursuing different fiscal strategies. The differences in how countries are adjusting following the Great Recession could not be more pronounced. Consider, for example, the stark contrast between the hard-line fiscal austerity program pursued in the United Kingdom and the quantitative easing under way in the United States. The polar-opposite policies underline substantial differences in how to strike a balance between continued stimulus and belt-tightening to avoid large deficits and longer-term debts. The choices these two countries make have a major impact on the global services market, as these countries are the largest demand centers for services outsourcing.

Production and consumption are shifting. Among other things, the Great Recession has accelerated the shift of global economic production and consumption from developed to developing worlds. The IMF predicts that in 2011, developing countries will grow at an average rate of 6.4 percent, compared to 2.2 percent for developed countries.[†] In short, because they have been more resilient in the face of the recession, emerging economies are catching up more quickly. A sector shift is also under way, as developing economies ramp up their service sectors in addition to their manufacturing base. China, in particular, appears set to expand its services sector in the coming decade.

Political uncertainty in the United States. In the aftermath of the November 2010 mid-term elections, the outlook in the United States for an enduring political con-

In a political climate of high unemployment, however, these concerns are still intensifying as politicians respond to the growing frustrations of their constituents. While reducing global services trade through legislation and regulation is nearly impossible—especially when dealing with multinational companies—many firms have elected to keep at least a temporarily low profile on their offshoring to avoid risking their reputations. In the long run, however, the cost and talent arbitrage benefits for overseas locations are still great and the underlying business case for offshoring remains intact. As manufacturing supply chains have permanently left the shores of developed economies, the same is happening to services supply chains, and a forced move to reshore them would result in significant costs for businesses.

Traditional outsourcing is under threat. While the business case for offshoring is still strong, traditional IT outsourcing services are under threat. These include multi-year contracts based on developing and maintaining custom code and requiring legions of programmers and on-site systems-integration workers. In the new model, outsourcers provide standardized software solutions on a per-use basis. Such services require that outsourcers combine BPO services with cloud-based technology, enabling customers to outsource entire business processes and only pay for the information they access or use.[7]

In the past two years, a variety of outsourcers have worked on acquiring the complete stack of capabilities required to survive the shift and create a new business model for the outsourcing industry. These capabilities include: hardware and connectivity for hosting and network capabilities; standardized software that can be deployed on shared hardware platforms or through cloud

[7] *See "Building Flexibility into Software Licensing" at www.atkearney.com.*

sensus to address the nation's economic challenges seems as remote as ever. Nevertheless, the seriousness of the country's fiscal worries was underlined recently by the austere recommendations of a bipartisan commission on reducing the national debt. For firms with global operations, the political climate is particularly sensitive. A bill introduced in the Senate this year sought to bar companies from receiving tax credits or deductions if they closed a U.S.-based facility in favor of one overseas. Though defeated, the bill's title—Creating American Jobs and Ending Offshoring Act—is a testament to the unpopularity of offshoring and its link in the public consciousness to economic hardship in the United States.

Europe's precarious fiscal situation. The Greek debt debacle last spring highlighted the precariousness of Europe's economic outlook, and the ensuing debate on fiscal policies demonstrates the wide array of opinions across the eurozone. The Organisation for Economic Co-operation and Development (OECD) predicts an uneven recovery in the eurozone, with growth curtailed because of deficit-reduction plans and credit-market tensions related to the persistent sovereign-debt concerns in Greece, Ireland and elsewhere.[††] Demand centers in Western Europe will consequently face a challenging road ahead. Companies that have restructured may emerge stronger and leaner, with a favorable attitude toward offshoring.

Debates about international exchange-rate policy. The growing international debate over exchange-rate policy—and the threat of currency wars—reflects the lack of a strong, institutionalized, international organizational architecture that can address the dynamic nature of the world's problems.

[†] *IMF, World Economic Outlook.*
[††] *OECD Economic Outlook, Paris: 18 November 2010.*

computing; new service capabilities; and commercial strength to move from a long-term contract model to a flexible, "pay-as-you-go" approach. These are the preliminary steps toward what will end up being a revolution in the BPO and ITO marketplace.[8]

Globalization of services has tremendous untapped potential. Regardless of changes in the outsourcing industry business model and other temporary setbacks, we believe the era of globalization of services production has only just begun. The untapped potential is enormous. IT and BPO offshoring are early manifestations of a larger trend that, in the long run, means that more functions can and will be located outside the countries where end-customers reside.

We have already witnessed a shift in the footprint of manufacturing across the globe to the point at which emerging markets have become manufacturing powerhouses—and we can expect to see a similar development in services. As with offshoring of manufacturing, the move of services jobs will grow less controversial with the passage of time. Much as the United States and EU countries exchange a wide range of services, trading of services will also grow between developed and developing countries. In the medium to long term, demographics will reinforce this trend. As the developed world ages, it faces a choice between allowing more liberal immigration policies and importing manufactured goods and services. Countries such as India and Egypt, with large, young populations, are well-positioned to take on a greater role in delivering services to countries with shrinking labor pools.

In the future, therefore, we will see a dramatic shift in the relative balance of service production among developed and emerging markets.

[8] *See "Outsourcing (But Not as We Know It)" in Executive Agenda, Vol. XIII, No. 2, 2010, at www.atkearney.com.*

Highlights of the 2011 Index

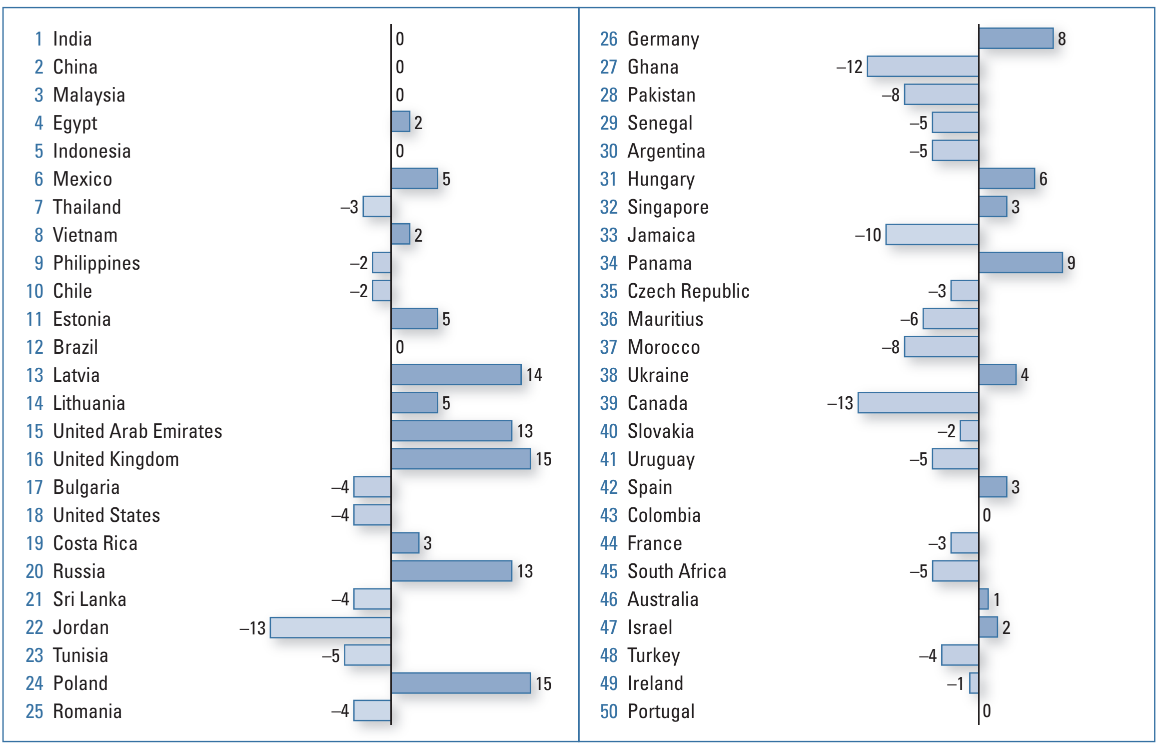
The top three countries in the 2011 Index have demonstrated remarkable staying power. Thanks to their deep talent pools and cost advantages, India, China and Malaysia have been first, second and third, respectively, since the inception of the Index. Wage changes and currency shifts from the financial crisis, however, have led to major changes in other rankings within the Index *(see sidebar: Currency Woes on page 7)*.

Formerly lower ranked states with highly qualified labor once again became viable options amid currency devaluation *(see figure 2)*. The Baltic states are a dramatic example—Estonia moves into 11th place and Latvia 13th amid ongoing austerity programs. The United Kingdom advances from 31st to 16th place due to the pound's fall in value coupled with slowing wage increases. Mexico reaches 6th place and is now Latin America's top location in the Index, thanks to currency depreciation and increased nearshoring sentiment in the United States. In the Middle East, improving fundamentals allowed Egypt to inch forward to 4th, while the United Arab Emirates (UAE), acting as a regional services hub, moved from 29th to 15th position, because its

Figure 2

Fallout from the financial crisis shook up the rankings, as once-expensive countries moved up

Change in rankings (2009 to 2011)



Source: A.T. Kearney Global Services Location Index™, 2011

service sector became more competitive as the financial crisis tempered the breakneck speed of its growth.[9]

The following offers a breakdown of the Index results by region:

North America. The United States is the top customer market for outsourcing services and will remain so for the foreseeable future. In 2010, the United States accounted for 63 percent of global IT offshore outsource spending, down somewhat from pre-crisis levels of approximately 67 percent.[10] At the same time, the United States presents an interesting supply possibility, as its tier-2 locations rank 18th in the Index, thanks to its top position in people skills and availability *(see figure 3 on page 8)*.

Currency Woes

Fluctuating currencies cause volatility for corporate planners, and currency concerns will likely remain a central feature of international business and policy into the future. China is currently under attack for its undervalued currency, which has been propped up by $2.5 trillion in reserves. Meanwhile, the United States has angered some countries because of its quantitative easing.

Government interventions throughout the world are prompting worries about destructive "currency wars." A full-scale currency war would indeed put the brakes on the world's economic growth prospects and would injure the global offshoring industry. In such a scenario, economic relations between countries could devolve into tit-for-tat duels about currencies—one country erecting tariffs to counter the effects of another's devaluation. Economic uncertainty would reign and companies would find global service supply chains costly and difficult to maintain.

This doomsday scenario will hopefully be averted as central banks and international institutions come together to broker solutions among major players such as the United States and China. Kati Suominen of the German Marshall Fund sees two other more palatable options going forward: *détente* and "containment."† In *détente*, countries would look to the IMF to settle disputes and provide solutions for international currency troubles. This would be a neat solution to current problems, but highly unlikely given that policymakers in many emerging markets still do not trust the IMF. In containment, countries would not cooperate at the level described above, instead holding out the threat of tariffs and currency devaluations. The interconnectedness of their economies and a fear of "mutually assured destruction," however, would lead to a certain level of good behavior. This system could be stable for global firms to navigate—albeit cautiously. The dollar would likely decline in this era while the renminbi and other emerging market currencies would appreciate. Offshoring companies will see a decline in labor arbitrage opportunities in certain countries as this process unfolds.

The challenge for corporate planners is to look beyond the month-to-month or even year-to-year currency swings so they can stay attuned to the long-term trends. A typical planning horizon for establishing offshore centers is three to five years—often longer. Some of the exchange-rate fluctuations we have seen in the past few years may be merely blips, such as the dramatic dip of the British pound. Other currencies are significantly more likely to experience longer-term changes. As developing countries (for example, China and India) experience dramatic export-led growth, their currencies will come under long-term pressure to appreciate, which has the potential to alter the economic calculations of corporate planners.

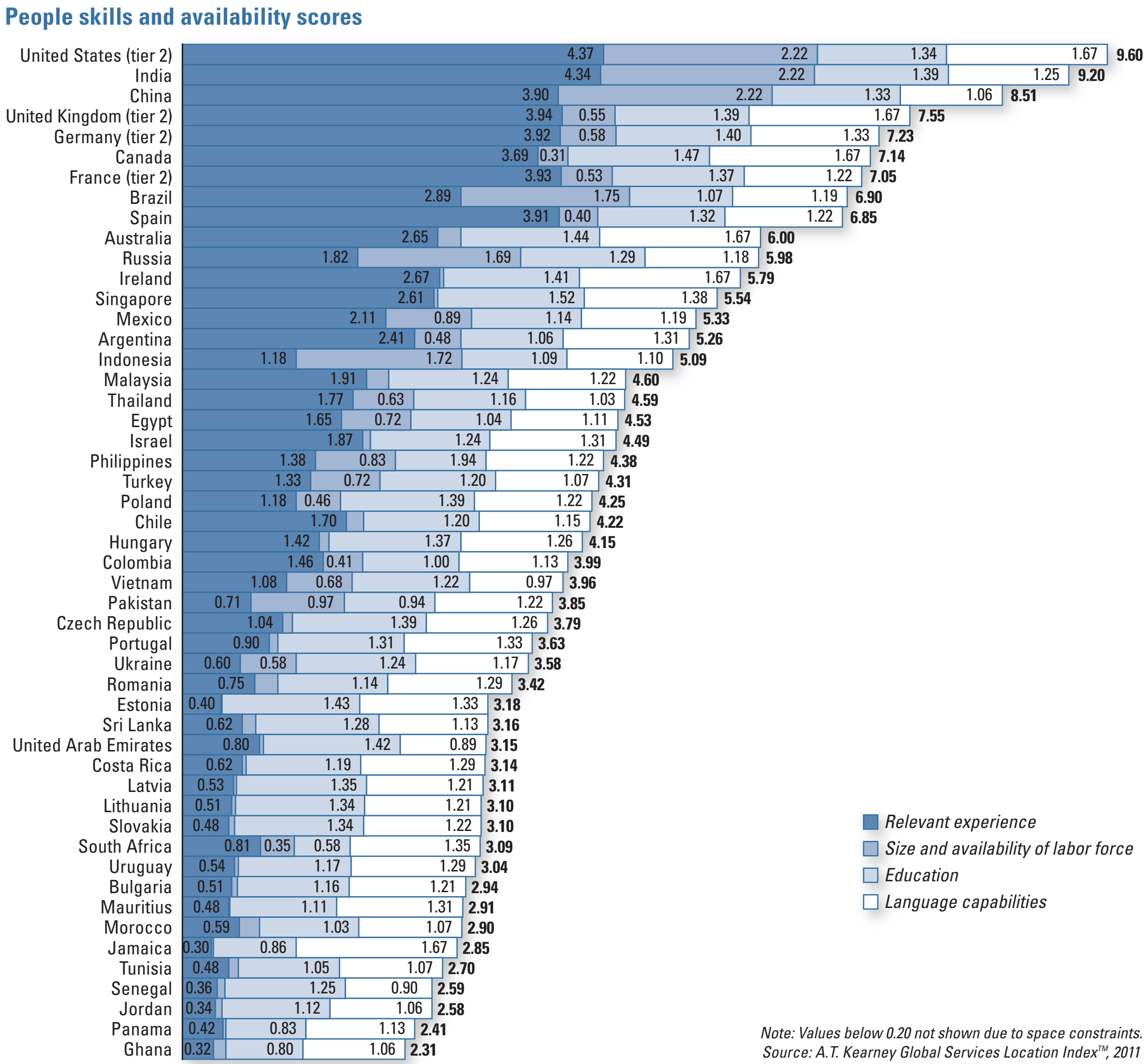
† *Kati Suominen,* Globalization at Risk: Challenges to Finance and Trade, *Yale University Press, New Haven, Conn.: October 2010.*

[9] *The rankings were made before the recent political unrest in Egypt and Tunisia began. As a result, the political uncertainty and country risk associated with both countries have dramatically increased. The situations need to be monitored closely to gauge whether the long-term risk profiles will change.*

[10] *International Data Corporation,* Worldwide and U.S. Offshore IT Services 2010-2014 Forecast, *May 2010.*

Figure 3

The United States leads in people skills and availability



Some cause for concern exists, however: U.S. anti-outsourcing sentiment is re-emerging, particularly given the country's stubbornly high unemployment rates and rancorous political discourse. While we believe that some companies will likely respond to such a hostile environment in the short term by postponing offshoring decisions or choosing local options, historical trends suggest that once the economy rebounds, globalization will resume.

Still, companies are not automatically assuming that overseas locations are the answer to their service transformation questions. U.S. tier-2 and tier-3 cities with strong talent pools and low operating costs are becoming attractive alternatives, in light of lower domestic wages and greater availability of human resources during the recession.

Canada (39th) falls in the Index this year. It is no longer primarily an offshore destination to the United States, as its relative cost-competiveness has eroded. Instead of strong growth in contact centers serving its southern neighbor, Canada is today equally important as an integrated part of the North American IT supply chain, much as the two countries' automotive industries have become intertwined over the years with multiple supplier relationships and assembly plants on both sides of the border.

Latin America. Latin America's proximity to the U.S. consumer market serves it well as a services hub. With a growing Spanish-speaking population in the United States and English proficiency continuing to grow in Latin America, customer service activities will naturally increase. Latin America, similar to other regions, presents a kaleidoscope of skill sets. Brazil excels in IT and is a strong platform location for software developers and systems integrators. Mexico is becoming a more prominent BPO location, as it supports the United States with both Spanish and English. Meanwhile, Chile has emerged as a niche destination for R&D and analytics, while Costa Rica and Argentina continue to grow their offshore services presence despite facing some decline in cost-competitiveness.

Mexico (6th) is the highest-ranked Latin American country. Its average wages decreased 18 percent in dollar terms last year, as it was buffeted by economic headwinds from the United States. The country now stands to benefit from increasing nearshoring sentiment, even with the difficult times related to escalating drug violence in its northern states. The country boasts one of the highest numbers of Capability Maturity Model Integration (CMMI) certified centers worldwide.[11] Additionally, as its management schools improve in quality, Mexico could carve out an important space in the service sector *(see sidebar: Mexico: City by City on page 10).*

Mexico stands to benefit from increasing nearshoring sentiment, even with the difficult times related to escalating drug violence in its northern states.

Chile dropped to 10th place from 8th, largely because its economic contraction was less severe than elsewhere, meaning its wages have remained relatively stable. The country's infrastructure score also received a slight downgrade because of the vulnerabilities exposed during the February 2010 earthquake; although by all accounts, Chilean authorities' response to the disaster was commendable. The recent success in rescuing trapped miners has helped fortify the country's brand.

Brazil ranks 12th for the second straight year. The country's standing in global services has been challenged in recent years by a strengthening currency. While this demonstrates strong economic prospects in a bleak global landscape, it hinders

[11] *CMMI is a process-improvement program created by the Software Engineering Institute of Carnegie Mellon University.*

export growth. The triumph of President Luiz Inácio Lula da Silva (whose term in office ended on the first day of 2011) in bringing Brazil to the global stage will hopefully linger as his successor, Dilma Rousseff, the country's first elected female president, defines the new political trajectory.

Costa Rica (19th) moves up three spots, thanks to infrastructure modernization, increased international bandwidth and improvements in electricity infrastructure. Argentina (30th) falls five slots as inflation and rising demands among labor leaders for increased wages challenged its competitive position.

Colombia (43rd) enters the Index after performing particularly well in the people skills and availability category. Colombian Spanish is a neutral accent that allows call centers in Colombia to serve people throughout the Spanish-speaking

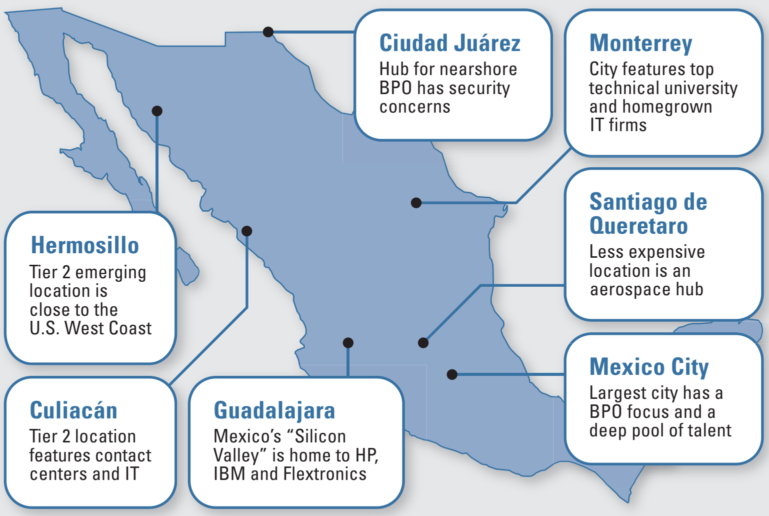
Mexico: City by City

The Global Services Location Index looks at IT/BPO potential at the country level, but in our client work we are asked to develop a more detailed view of each country in order to match client needs to specific locations. We therefore work with clients to customize the Index methodology according to their specific preferences. Once a shortlist of countries is determined using this methodology, we perform deep dives for each location to understand the internal market dynamics. This research requires a thorough assessment of such aspects as city-level talent availability, government incentives and infrastructure. Here we provide a brief outline of a city assessment for Mexico. We selected this country instead of several others in the Index because not only is it a top performer with a large industry, it also presents a range of capabilities across the country.

Guadalajara and Monterrey are the top locations in Mexico in terms of talent availability and infrastructure for IT services. Mexico City also offers a vast range of services and Queretaro is a smaller alternative location that has capitalized on its aerospace industry to grow *(see figure)*. Across all regions, Mexico has prioritized the development of the IT/BPO industry through several initiatives. *Mexico First* aims to certify 60,000 specialized workers in both technical and soft skills by 2013. *Mexico IT* promotes Mexico as a nearshore outsourcing location for U.S. companies. *ProSoft* offers subsidies and tax incentives for companies investing in the IT sector. The following offers a description of some of Mexico's top destinations:

Guadalajara is often referred to as "Mexico's Silicon Valley," reflect-

Figure: Key IT/BPO locations in Mexico



Note: BPO is business process outsourcing

Source: A.T. Kearney Global Services Location Index™, 2011

world with relative ease. A major hurdle, however, is the level of English among professionals. As Colombia's currency appreciates, the government will have to adjust to the fact that it will not be able to compete as a low-cost destination and will have to look higher on the value chain for advanced services such as architectural rendering and finance. To achieve this shift, several English-improvement programs have opened in the past few years, and now all Colombian school children receive English training. In Bogota, the "Talk to the World" campaign provides funding for companies to upgrade their employees' English capabilities.

Europe. The financial crisis pummeled many economies in Europe, and fiscal woes in Greece, Ireland and elsewhere have raised the specter that the euro could fail. In the process, countries outside the eurozone that were once too expensive or

ing its history as a major electronics center specializing in software design, semiconductor design, embedded software and multimedia. General Electric, IBM, Intel, Hitachi, Hewlett-Packard, Siemens, Flextronics and Solectron have national headquarters or major development centers in the city. The region contains 16 ITO and BPO service centers, 150 software companies and 35 design houses, but competition is fierce for the limited talent that speaks English.

Monterrey is an IT and BPO center, housing both international and domestic firms and home to Mexico's most successful homegrown firms Softtek and Neoris. Softtek was started by engineers from petrochemical company Alfa, while Neoris was a spin-off of the IT operations of Mexican multinational cement giant CEMEX. Firms in Monterrey have access to some of the country's top technical talent through the Monterrey Technical Institute. However, Monterrey is experiencing an upsurge in drug war violence connected to the northern states. Though foreign firms have not yet been directly targeted, a general sense of unease is stifling investment or expansion of operations in the area.

Mexico City hosts numerous large and small IT firms, domestic and foreign, offering voice, BPO and KPO services. The growth of this sector in Mexico City is a natural byproduct of the city's economic weight and the synergies among the broad range of businesses operating there. The city has shown increased focus in recent years on BPO development. The city and its environs contain 72 universities with IT programs.

Queretaro provides an alternative location to the country's established hubs and has gained prominence as an aerospace hub and manufacturing site for Canadian aerospace and defense company Bombardier. The Queretaro site offers call-center and BPO capabilities; the knowledge base of the local population is high and compensation costs are also less, in part because of the location's relative obscurity. The region's labor pool, however, is shallower than the others listed above.

Ciudad Juárez has long been a hub for nearshore BPO services, capitalizing on its proximity to El Paso, Texas, just across the Rio Grande, to turn large volumes of physical documents into data. It is one of the Mexican cities hit worst by drug-related violence, however, with more than 3,000 homicides in 2010 alone.

Hermosillo and the surrounding area is a tier-2 option just across the border from the United States that in the past has been primarily oriented toward manufacturing operations, but which is emerging as an IT destination in close proximity to clients on the U.S. West Coast.

Culiacán is another tier-2 location. Its main focus is IT and contact centers. Many of the IT companies in Culiacán are working in state-supported IT technology clusters.

Other states, such as Aguascalientes, Zacatecas and Baja California, are also starting to develop strategies to promote the IT/BPO sector, mainly through technological parks and human capital initiatives.

had experienced long stretches of growth once again became viable offshoring options.

Estonia (11th), Latvia (13th) and Lithuania (14th) are examples of countries that have climbed in the rankings as a direct consequence of the economic crisis. Strong people skills have allowed these countries to develop small but strong BPO and voice markets. The global financial crisis hit all three (Latvia in particular) harder than most countries, propelling them into a dire situation with rapidly expanding current account deficits. Instead of devaluing their currencies, Latvia, Lithuania and Estonia pursued what they called "internal devaluation." Their governments and private sectors cut wages by an average of 35 percent and slashed expenditures. As a result of these painful adjustments, cost levels became more competitive. Increased cost-competitiveness has propelled these countries to the higher echelons of the Index and has already yielded new investments in the IT/BPO sector. U.K.-based Barclays opened an IT center in Vilnius in 2009, and U.S. financial services company Western Union has also announced plans to establish a regional service center in Lithuania. Significant growth is still needed, however, to get the Baltic states on the same turf as the more traditional European outsourcing locations.

The United Kingdom rises substantially in the rankings, from 31st in 2009 to 16th in 2011, driven by steep drops in compensation costs (14 percent in dollar terms). First and foremost, however, the United Kingdom is a demand market for outsourcing. In what is now a rather regular refrain on both sides of the Atlantic, British politicians have decried outsourcing in the face of mounting unemployment. On a recent visit to India, however, British Prime Minister David Cameron tried to put to rest the notion that the United Kingdom would prevent IT outsourcing. However, he bundled his somewhat reassuring message with a plea to Indian firms that they find a way to invest in job growth in the United Kingdom. Trade relations between the two countries have indeed become quite symbiotic, with jobs in the United Kingdom being created by Indian firms and vice versa.

In addition to the United Kingdom, we also include two other main customer markets for IT/BPO services in Europe: Germany and France. We use tier-2 cities (cities in areas of the country that have a lower relative income level) in these countries as a benchmark to compare them to the offshore competition. For the United Kingdom, we use cities in Northeast England, Wales and Northern Ireland as benchmarks. For Germany, we use Saxony in the former East Germany, and for France, the region of Languedoc-Roussillon.

In Central and Eastern Europe, Poland is the top story, moving up 15 places to 24th after weathering the economic troubles and benefiting from improved investor sentiment. Hungary (31st) and the Czech Republic (35th) also fared slightly better this year because of decreasing wage levels. However, the nearshoring story in Europe still shows a shift to Bulgaria (17th), Romania (25th) and the Middle East.

Portugal (50th), Ireland (49th) and Spain (42nd) — which together with Greece (not included in the Index) have been grouped under the less-than-flattering acronym PIGS — are all countries in financial distress and have not seen improvement in the Index this year, as opposed to the Baltic states. While some time in coming, the crises have just started to appear in these countries. Although austerity measures are being put forward, they have not yet taken effect. They are also less likely to be as far-reaching as the extreme measures taken by other European governments (for example, the Latvian government). It should be noted that currency devaluation is not an option for these countries to increase competitiveness as they are members of the eurozone.

Middle East and Africa. The region of the Middle East and North Africa has emerged in recent years as an ideal offshoring location for European firms taking advantage of the region's proximity and vast pool of skilled talent. Indeed, North Africa has eclipsed several Eastern European locations, as demonstrated in this year's

Industry Activity in the Top 10 Locations

The Global Services Location Index™ ranks countries based on their attractiveness across IT, BPO and voice work, but all countries have specific niches in which they compete. For companies locating their shared services functions offshore, it is not just a matter of picking the top countries in the Index. Deciding on an offshore location is a complex decision that must consider each country's mix of capabilities and specific niche in global competition. To illustrate the different profiles, we assessed the Index's top 10 locations based on their capabilities in IT, BPO and voice, and the industry activity in each of these sectors *(see figure)*.

India alone has proven able to compete in all dimensions. It is the preeminent destination and leader in all fields of offshore services, excelling in IT thanks to its elite educational institutions, in BPO because of a large annual output of qualified graduates, and in voice because of the English capabilities of its population. The Philippines, an early entrant into the service sector, is also relatively well-rounded. It has had more than a decade to hone its capabilities and by now has moved into ITO from being primarily a contact-center hub.

For most countries, the outlook is more complex, and success is determined by identifying a niche. China is a good example: It ranks second in the Index based on its strong offshore fundamentals, but its capabilities are mixed in terms of industry activity. China is increasingly strong in the IT area and is rapidly improving in BPO work. On voice work in languages other than Chinese, however, it is almost non-existent, other than a cluster of Japanese-language contact centers in the country's Northeast.

As countries continue to specialize in offering services, it is imperative for buyers of services to understand these differences when evaluating locations.

Figure: Industry activity in the top 10 countries

Country	BPO	Voice	ITO
India	●	●	●
China	◑	○	◕
Malaysia	◔	◔	◑
Egypt	◑	◔	◑
Indonesia	◔	○	◔
Mexico	◕	◕	◑
Thailand	○	○	◔
Vietnam	◑	◔	◑
Philippines	◕	●	◑
Chile	◔	◔	◔

● High industry activity ○ Limited industry activity

Note: BPO is business process outsourcing;
ITO is information technology outsourcing
Source: A.T. Kearney Global Services Location Index™, 2011

Index, which features Egypt 4th in the world and the leader in the Middle East. The country has scored consistently well over time because of its economical wage rates and large supply of talent. The Egyptian government has also actively promoted the sector abroad while aggressively pushing industry to bring its standards up to international levels. However, the recent political turmoil in the country could have long-term consequences for Egypt as a sourcing location.

India, with its first-mover advantage and deep skill base, still maintains the lion's share of the IT services market.

The UAE is second in the region—15th overall—thanks to more competitive compensation costs, a rise in the quality of its management schools and an improvement in literacy scores. The UAE leads in headquarters functions and services, which support many multinational corporations throughout the region. Cost pressures have also declined in the wake of the financial crisis. Jordan (22nd) and Tunisia (23rd) remain in the top 25.

Asia. The top three locations in the Index remain India, China and Malaysia. Asia also ranks highly throughout the rest of the top 10, which features Indonesia (5th), Thailand (7th), Vietnam (8th) and the Philippines (9th).

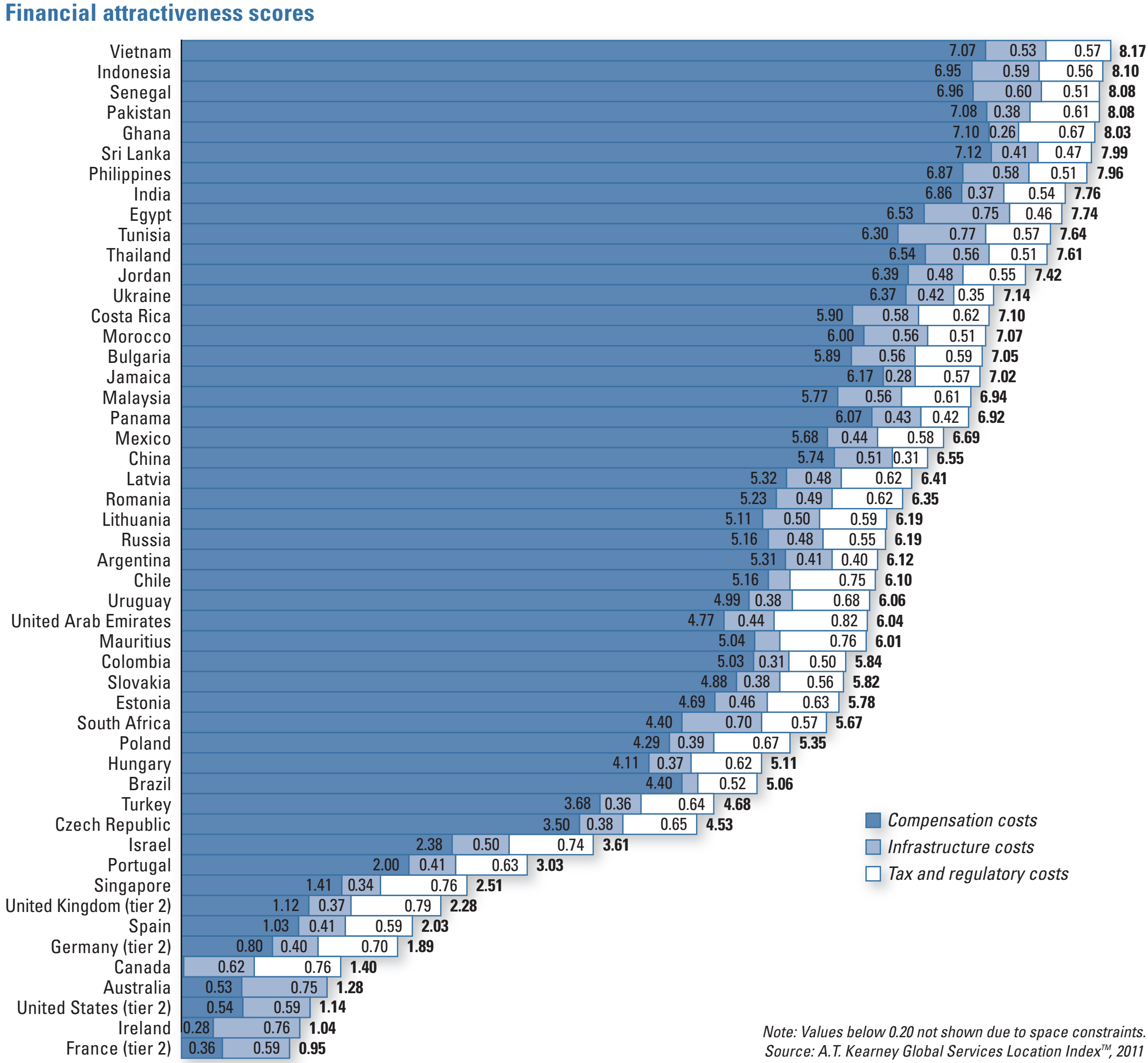
There is significant diversity in the ranks of these top Asian players. India is the all-around standout, able to provide manpower for any type of offshoring activity. The Philippines' long-established tradition of providing leading call-center support continues to be strong. China provides competitively priced high-end analytics and engineering, while Malaysia attracts IT services offshoring *(see sidebar: Industry Activity in the Top 10 Locations on page 13)*. The sectors in Indonesia, Vietnam and Thailand, however, are in their relative infancy. These countries have not yet devoted as much as they could to promoting information and communications technology, yet they score highly in the Index because of vast pools of talent and competitive wages *(see sidebar: What's Holding Back Thailand and Indonesia? on page 16)*. In particular, Vietnam ranks as the most financially attractive country for offshoring in the Index *(see figure 4)*.

India, with its first-mover advantage and deep skill base, remains the unquestioned leader in the Index—a half-point ahead of China and a full point in front of Malaysia—and still maintains the lion's share of the IT services market. On top of that, India's IT services stalwarts are moving up the value chain. Companies such as Infosys and Wipro are pursuing their own R&D capabilities and expanding well beyond their traditional vendor roles.

In the early years of offshoring, China was seen as a less-attractive option because of concerns about language capabilities and intellectual property security. The economy's strong manufacturing orientation has also meant that the service sector has remained largely undeveloped. Now, as the economy transitions to include more services, the government is supporting the

Figure 4

Vietnam leads in financial attractiveness



Note: Values below 0.20 not shown due to space constraints.
Source: A.T. Kearney Global Services Location Index™, 2011

BPO sector with unprecedented enthusiasm. Improved skills—from language ability to engineering—are turning China's BPO centers into viable options.

China has begun offering specialized skills not only in English, but also Korean, Japanese and Chinese. Call centers are unlikely to be where China makes its greatest impact, however; its most attractive areas are high-end analytics and advanced IT, where it is an alternative to Russia and Eastern Europe, and BPO, where it can be competitive with India. China is now developing R&D capabilities as a necessary adjunct to its manufacturing capabilities, which creates a strong

What's Holding Back Thailand and Indonesia?

The Global Services Location Index™ measures the underlying fundamentals that make a location an attractive destination for service delivery. However, in some top-ranked countries in the Index, there is no thriving industry—instead, there is great potential. Such is the case in Thailand and Indonesia, which are among the top 10 in the Index but are not household names in offshoring. These countries have the fundamentals in place to be successful service locations—they enjoy large workforces and competitive cost levels. Yet companies are not flocking to Bangkok or Jakarta to fill their needs—in fact, the opposite is happening. For example, Infosys announced in July 2010 that it was closing its BPO center in Bangkok, which it had acquired from Philips three years earlier. What is holding back these countries?

Language. Language is a major impediment. English has not been taught historically in Thai or Indonesian schools and is not used by these countries' administrations. By comparison, in the Philippines, English is widely spoken as a result of historic ties to the United States. While English instruction is part of curricula today in Thailand and Indonesia, the quality of instruction is often lacking.

Business environment. Indonesia suffers from a legacy of neglected infrastructure invest-ments, manifested in poor electricity supply and insufficient bandwidth. The government, however, has committed to ramping up investments in infrastructure in the future and we expect to see improvements soon. In Thailand, the unstable political situation—showcased last spring in front of the world's TV cameras when the army clashed with the opposition on the streets of Bangkok—is creating uncertainty among foreign investors. Hope remains, however, for improvements after the upcoming elections.

Government support. A lack of government support has hampered the outsourcing sector as governments spend their scarce resources on promoting different industries. With increased promotional efforts and removing crucial roadblocks, Indonesia and Thailand could repeat the Philippines' success.

foundation for knowledge process outsourcing, also called KPO services.

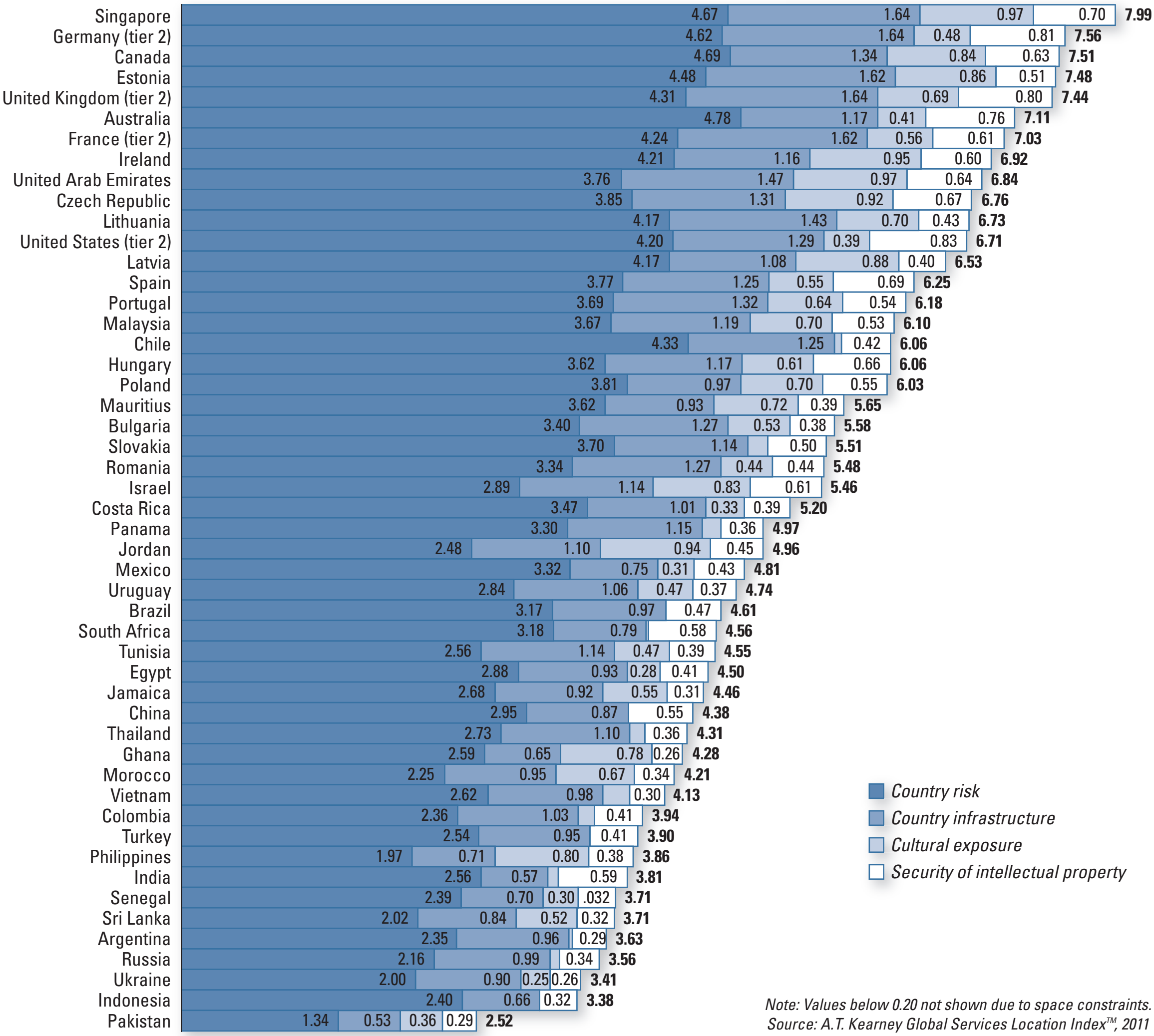
The top two countries have even begun linking up to expand their expertise. For example, Indian firms Tata Consulting Services (TCS), Infosys and Wipro have all established operations in Chengdu, China. Chengdu's mayor, who actively courted the Indian firms, told reporters that he dismisses language concerns: "As software development will be in English for [both] the domestic market and exports, language will not be a problem for companies and their professionals."[12]

The Philippines remains an offshoring behemoth, employing half a million people in the BPO sector and generating $7.2 billion in revenues in 2009. Call centers make up the majority of the country's operations, at $5 billion in revenues, but growing BPO niches such as services catering to the healthcare and pharmaceutical industries help fuel overall growth. Amid fierce competition from other regional players, the government has launched a plan to build a virtual BPO university and extend training in call-center skills to an additional 10,000 students to retain its competitive edge. Meanwhile, Singapore is 32nd, as it once again is the global number one in the business environment category—but a small labor force and high costs give it a relatively lower ranking *(see figure 5)*.

[12] *"Chengdu woos Indian firms to invest in China's IT hub,"* Nearshore Journal*, 1 March 2010.*

Figure 5

Singapore remains the leader in business environment



Note: Values below 0.20 not shown due to space constraints.
Source: A.T. Kearney Global Services Location Index™, 2011

Glimmers of Hope

The headlines about persistent economic volatility may be here for some time. For the global services industry, the short term will remain rocky as worries about sovereign debt, currencies and joblessness continue to roil the global economy. The long-term prospects, however, appear little changed from our first edition. An increasingly interconnected world and increasing demand mean that the global services industry remains on the rise.

Appendix: About the Study

The 50 countries included in this year's Global Services Location Index™ were selected on the basis of corporate input, current remote services activity and government initiatives to promote the sector. They were evaluated against 39 measurements across three major categories: financial attractiveness, people skills and availability, and business environment *(see figure)*.

The metrics used to evaluate location attractiveness were determined from responses to A.T. Kearney and other industry surveys, and knowledge obtained in client engagements over the past five years. The relative weights of each metric are based on their importance to the location decision, again derived from client experience and industry surveys. Because cost advantage is typically the primary driver behind location decisions, financial factors constitute 40 percent of the total weight in the Index. The two remaining categories—people skills and availability, and business environment—each constitute 30 percent of the total weight.

Index metrics

Category	Subcategories	Metrics
Financial attractiveness (40%)	Compensation costs	• Average wages • Median compensation costs for relevant positions (call-center representatives, BPO analysts, IT programmers and local operations managers)
	Infrastructure costs	• Rental costs • Commercial electricity rates • International telecom costs • Travel to major customer destinations (New York, London and Tokyo)
	Tax and regulatory costs	• Relative tax burden • Corruption perception • Currency appreciation or depreciation
People skills and availability (30%)	Remote services sector experience and quality ratings	• Size of existing IT and BPO sectors • Contact center and IT center quality certifications • Quality ratings of management schools and IT training
	Labor force availability	• Total workforce • University-educated workforce • Workforce flexibility
	Education and language	• Scores on standardized education and language tests
	Attrition risk	• Relative IT and BPO sector growth and unemployment rates
Business environment (30%)	Country environment	• Investor and analyst ratings of overall business and political environment • A.T. Kearney Foreign Direct Investment Confidence Index™ • Security risk • Regulatory burden and employment rigidity • Government support for the information and communications technology (ICT) sector
	Infrastructure	• Overall infrastructure quality • Quality of telecom, Internet and electricity infrastructure
	Cultural exposure	• Personal interaction score from A.T. Kearney Globalization Index™
	Security of intellectual property (IP)	• Investor ratings of IP protection and ICT laws • Software piracy rates • Information security certifications

Source: A.T. Kearney Global Services Location Index™, 2011