

GLOBALISATION OF SERVICES – CALLING INDIA

Globalisation of services

Globalisation is the process by which regional economies, societies, and cultures have become integrated through a worldwide network of communication and exchange. In relation to industry it is also the move to a globalised economic system dominated by supranational corporate trade and banking institutions operating beyond national governments.

The current wave of economic globalisation started in the 1980s, following on from the earlier relocation overseas of manufacturing industries to gain access to raw materials and cheaper labour costs. The globalisation of services is also in part due to labour costs but also the global mobility of factors of production, capital and advances in infrastructure, transport and communications technologies. These developments have coincided with the opening up of the less economically developed countries (LEDCs) to direct foreign investment and international trade.

Why and how is it happening?

Service industry or tertiary industry: an industry comprised of companies that primarily earn revenue through providing intangible products and services.

Factors of industrial location

- Labour/human capital
- Capital
- Government policy
- Transport/accessibility
- Raw materials
- Site

'Footloose' service industries have no need of heavy raw materials nor large sites. What they require is an educated workforce, with IT skills, access to communications systems, offices or business parks and government policy in favour of foreign investment and development of their country's infrastructure. Since these location factors are all readily available around the world there is no restriction on business in choosing a location, and so the key determining factor for industry is the cost of production.

Developing countries, newly industrialised countries (NICs) and periphery countries in developed regions are endowed with the well-qualified workforces that the service industry requires, but pay levels are relatively low. This gives them a 'comparative advantage' in terms of labour costs.

Clustering/cumulative causation

Clustering of similar industries due to cumulative causation is also part of the explanation. According to Dicken these specialised clusters reflect the tendency for firms in the same or closely related, industries to locate in the same place. They grow through a process of cumulative self-reinforcing development (Dicken, 2007).

This means as industries become successful, they will:

- attract linked activities
- stimulate entrepreneurship and innovation
- deepen and widen the local labour market
- cause economic diversification
- stimulate development of the physical infrastructure.

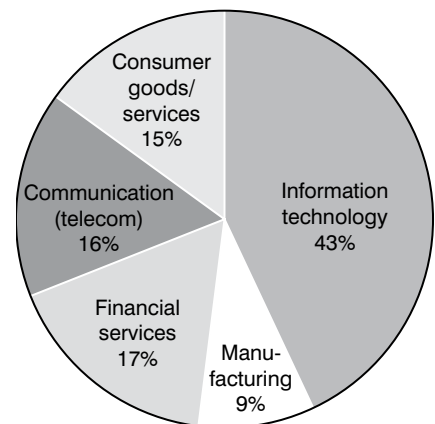
This ongoing process makes established overseas sites even more attractive.

Outsourcing and offshoring

In making decisions on the provision of IT or accountancy services, companies can choose between having the work done in-house (internalisation) or subcontracting/outsourcing (externalisation). Outsourcing used to be limited geographically to companies in their home nation, but with innovations in communications these services can now be provided anywhere in the world. This is referred to as offshoring.

Initially, offshoring catered for simple 'back room' office functions, such as payroll, and IT services. These remain a major element of the industry and are collectively referred to as business process offshoring (BPO) and information technology enabled services (ITES). Figure 1

Figure 1: Global BPO market by industry



Source: Price Waterhouse Cooper (www.pwc.com/en_IN/in/assets/pdfs/evolution-of-bpo-in-india.pdf)

shows the services provided in the global BPO market

Innovation has allowed the BPO market to expand to include database marketing, transcription, billing services, web design, sales/marketing, accounting, tax processing, telesales/telemarketing, human resources, market research, legal processes, biotech research and special effects for Hollywood. On a smaller scale, one company in India is offering outsourced personal assistants.

Knowledge process outsourcing of core innovation activities (product development, engineering, R&D) is also increasingly being offshored. e.g. US aircraft manufacturers Boeing (US) and Airbus (Europe) have design centres in Russia.

Company structure

The move to BPO in its many forms is for many organisations just one aspect of their operation as a multinational company (MNC), utilising their experience of working in different countries. They also outsource backroom operations to large service MNCs. The success of companies competing for business in offshore locations has allowed them to develop into MNCs, including establishing offices back in the originating more economically developed countries (MEDCs).

Government policy

The move to offshoring has also required LEDCs to create appropriate economic development policies, to liberalise policy to allow foreign direct investment (FDI), and to support investment in infrastructure and specialised education.

Locations for offshoring

Who generates the demand?

Figure 2 shows the source of the demand for offshoring. North America generates the greatest demand and is responsible for 70% of spending on offshore outsourcing. This demand was originally met by captive subsidiary companies; more recently this has shifted to buying from providers: e.g. Citibank sold its captive subsidiary to Tata Consultancy Services in October 2008.

Figure 2: Global BPO market by volume

USA	59%
Europe	27%
Asia-Pacific (inc Japan)	9%
Rest of World	5%

Source Price Waterhouse Cooper (www.pwc.com/en_IN/in/assets/pdfs/evolution-of-bpo-in-india.pdf)

Who provides the service?

The primary factors in deciding on an offshore location include:

- Cost competitiveness:
 - cost of labour
 - infrastructure costs
 - exchange rates.
- Labour competitiveness:
 - size of the available labour force
 - level of education
 - fluency in the English language
 - cultural compatibility to western markets.
- Other factors:
 - existing business and political risks
 - geographic location (time difference)
 - tax regime
 - regulatory considerations such as data security and intellectual property rights issues.

The top three countries in the 2009 Kearney Global Services Location Index were India, China and Malaysia. India leads the way in all business functions but now faces competition from an ever-increasing

Figure 3: Worldwide offshoring locations

Argentina	Web & software programming, game development, IT support, network solutions
Bangladesh	Web & software programming, game development, IT support, network solutions, offshore outsourcing service
Belarus	Programming, R&D
Brazil	Web & software programming, game development, IT support, network solutions
Bulgaria	Programming and R&D
China	Programming, data entry, customer support, F&A
Egypt	Customer support and programming
Indonesia	Programming, data entry, customer support
Malaysia	Customer support and R&D
Mauritius	BPO (for France)
Nepal	Programming, customer support
Pakistan	Programming, customer support
Panama	Programming, customer support
Philippines	Customer support, IT support, programming, animation, transcription
Romania	Programming and IT
Russia	Programming and R&D
Ukraine	Programming and R&D

Source: A T Kearney (www.atkearney.com/index.php/Publications/global-services-location-index-gsli-2009-report.html)

list of countries. Central Europe had emerged as one of the key centres for offshoring, primarily for Western European clients. However, during 2009 Poland, the Czech Republic and Hungary were hit by increasing costs, eroding their competitiveness. The most recent destinations for companies include Guatemala, El Salvador, Dominican Republic, Barbados, Bangladesh, Kenya and the Himalayan Kingdom of Bhutan. Others are listed in Figure 3.

Case Study: India

The major concentrations of the IT and ITES industry are located in Bangalore, Mumbai, Chennai, Hyderabad, Pune, Chandigarh and close to New Delhi at Noida, Gurgaon and Faridabad. Ahmedabad is the fastest growing centre for offshore IT outsourcing.

In March 2009, annual revenues from outsourcing operations in India amounted to US\$60 billion and this is expected to increase to US\$225 billion by 2020. This is remarkable in a country considered as an LEDC with a rural population of 71%, where GDP per capita is \$2,800 (2008), compared to the UK figure of \$36,600 (2008). Its GDP has been growing at over 7% for the last decade and even in the current difficult economic times growth is

Figure 4: Major centres of India's offshore IT outsourcing industry



estimated at 6%. The service sector's contribution to India's GDP has increased from 15% in 1950 to over 50% (Figure 5).

Elements of the service sector in India are so well established they are part of

Figure 5: Comparison of India's and the UK's economies

Percentage of GDP by sector (estimate 2008)	India	UK
Agriculture	17	1
Industry	29	23
Services	54	76

Figure 6: What India offers – competitive advantages

1	Low cost, high quality
2	2nd largest English-speaking manpower resource in the world
3	Investment friendly & supportive government policies
4	Adaptability to new technologies
5	Geographical advantage
6	Legal protection for intellectual property rights
7	World class infrastructure in line with the developed countries for power, transport and data communication
8	World's 3rd largest brain bank – availability of around 2.5 million technical professionals
9	Stable democratic environment in over 50 years of independence
10	Large market size with a middle class population of 250-350 million with increasing purchasing power reflected by remarkable increase in purchase of consumer durables in recent years
11	Access to regional international markets through membership of regional integration frameworks such as South Asian Association for Regional Cooperation (SAARC)
12	Large and diversified infrastructure spread across the country
13	Thrust on technology, innovation and knowledge base
14	Large manufacturing capability, spanning almost all area of manufacturing activities
15	Well developed R&D infrastructure and technical and marketing services
16	Large resources of untapped natural wealth

Source: adapted from Ministry of External affairs <http://meaindia.nic.in>

our domestic lives, be it the day-to-day management of phone and broadband provision, or in our entertainment, with call centres featuring in the film *Slumdog Millionaire* and on the TV in Mumbai Calling. Yet the service sector in India is so much more than this; India is dominant across all business functions, in particular in Information Technology Enabled Service (ITES). This form of outsourcing includes all processes that can be enabled with information technology and covers diverse areas like finance, human resources, administration, health care and telecommunications. In 2009, seven Indian firms, including Tata Consultancy Services, Wipro Technologies and Infosys Technologies, were listed among the top 15 technology outsourcing companies in the world. Source: <http://outsourcingprofessional.org/content/23/196/1861/>

India's success has developed over 30 years. Initially overseas MNCs including American express, General Electric, British Airways, Citibank and AOL set up wholly owned captive companies to carry out their back office operations. This was followed by experienced professionals setting up start-up operations in India, often funded by venture capital. Infosys was established in 1981 and is now one of the world's top-performing companies in the software and services sector, with 50 offices and development centres in India, China, Australia, the Czech Republic, Poland, the UK, Canada and Japan, employing over 100,000 staff.

As skills and infrastructure have developed, many large IT services companies have ventured into providing ITES. More recently, captive companies have been partly or completely sold off, allowing them to seek third party business and become MNCs in their own right. British Airways Operations became WNS Global services in 2002, and General Electric Operations became Genpact in 2005. The latter now has 31 operations centres in 10 countries. In 2008-09 Genpact was India's top BPO company, enjoying growth of 54% with their clients, including Nissan. The year also saw Genpact opening new centres in Guatemala, Poland and Morocco. Indian companies are also expanding across the world e.g. Tata Consultancy services has delivery centres in Argentina, Brazil, China, Hungary, Mexico, Singapore, USA

and Uruguay, plus numerous centres in India.

Why the success?

The Indian perspective on India's advantages can be seen in Figure 6.

Labour

India is capitalising on its large, well-educated workforce skilled in the English language. It produces over a million graduates each year, including 350,000 engineers. It has a history of excellence in mathematical and software problem-solving; its world ranked educational institutions include 15 Institutes of Technology. The Indian School of Business MBA was ranked 15th in the world, ahead of Cambridge. Source: <http://rankings.ft.com/businessschoolrankings/global-mba-rankings>.

Cost

The cost advantages of offshoring to India are significant. The costs of hiring in the IT sector in India are between 15 and 40% of the cost in the USA. A bright science graduate can expect a starting salary of approximately £3,400 as a software engineer, and within two years they will be earning far more than their university lecturers.

Geographic location

India is 10.5 to 13.5 hours ahead of mainland USA. Problem-solving or processing of jobs sent during the evening from the US can be completed in India during the day to be sent back to the US.

Government policy

Economic development in India was held back until the 1990s by protectionist government policies and barriers to trade which supported state-run companies. However, in 1988 the government did establish the National Association of Software and Service Companies (NASSCOM). As the coordinating trade body for the ITES/BPO industry NASSCOM facilitates trade in software and services, and encourages research in software technology.

Following a balance of payments crisis in 1991, the government liberalised economic policy, removing barriers to trade and allowing foreign direct investment. The policy on FDI was extended in 2005 to allow 100% foreign ownership in most sectors of the economy.

This period brought deregulation of the telecoms industry, with the National Telecom Policy (NTP) opening up national, long distance and international connectivity to competition. In 1991 the Department of Communication & Information Technology, established the idea of Software Technology Parks of India (STPI). The objective of this policy was to encourage, promote and boost software exports from India.

Its role includes:

- establishing Software Technology Parks throughout the country
- establishing and managing the infrastructural resources in the parks such as communication facilities, core computers, buildings, amenities etc to provide services to the users
- undertaking export promotional activities
- organising specialised training in the field of software
- acting as an interface between industry and government.

The Software Technology Parks have been complemented by the Indian Government's announcement in April 2000 of the Special Economic Zones (SEZs) Policy, with a view to attracting larger foreign investments. By October 2009 they had approved 578 SEZs, of which 333 detail IT/ITES as part of their operations. The SEZs generate more than \$15 billion per year in exports and provide employment for more than half a million.

The SEZ Act 2005 included the development of infrastructure facilities among its objectives. Other incentives and facilities offered within them include:

- duty-free import/domestic procurement of goods
- 100% income tax exemption on export income for SEZ units for the first five years, and 50% for the next five years
- external commercial borrowing by SEZ units up to US\$500 million in a year
- Exemption from sales and service taxes.

Companies attracted to SEZs include:

- Nokia SEZ in Tamil Nadu (telecom equipment/R&D services)
- Motorola and DELL
- WIPRO Kolkatta (software development)
- Infosys Technologies SEZ Bangalore (IT/ITES).

Other government investment in infrastructure includes the 'Golden Quadrilateral', a highway network connecting Delhi, Mumbai, Kolkata and Chennai.

The future

India's role in the globalisation of services will continue to develop as the homegrown MNCs in the BPO and ITES sectors expand their operations around the world seeking to lower their labour costs. This search is also taking place within India, with smaller processing centres being set up in rural areas to undercut the salaries demanded in Indian cities.

The growth of India's middle class is also leading to interest from overseas MNCs in other sectors. Currently in the retail sector government policy prevents 100% foreign ownership. It seems likely that this will change and allow the big names, including Wal-mart and Tesco, full access to the Indian market. At present they are only allowed to provide support services to Indian companies, such as Tesco's 2008 exclusive franchise agreement with the retail arm of the Tata group. This will provide extensive retail and technical services to support the development of its hypermarket business, Star Bazaar.

Whilst India does appear to be riding out the current economic situation it is subject to the same threats as many MEDCs:

- terrorism
- competition from cheaper locations
- corporate scandals
- risk spreading by MNCs setting up operations in more than one country
- relocation back to domestic locations e.g. July 2009 BT announced the transfer at least 2,000 jobs from call centres in India back to Britain, and Dell offering a premium technical support subscription which guarantees US customers they can talk to a representative in the US rather than India.

Conclusion

The globalisation of services is well-established and will continue to spread across the world following improvements in communication infrastructure, especially access to broadband. In the summer of 2009 the coastline of East Africa became the final major inhabited coastline to be connected by undersea fibre-optic cable (Seacom) to networks in Europe and India. This means Kenya can promote itself as the new English-speaking base for call centres and other outsourcing. The broadband networks will spread inland from the East African coast, increasing the possibility for further globalisation.

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FOCUS QUESTIONS

1. Why has the provision of offshoring IT services been so successful in India?
2. Discuss the role of MNCs in the changing global economy.