



Can China's IT Services market live up to the hype?

March 2011

Since 2006, China's market for the outsourcing of technology services has experienced rapid growth and has been heralded as a challenger to India's market dominance. According to China's Ministry of Commerce, the total contract value of executed outsourcing contracts in 2010 with Chinese-based service providers was approximately \$19.8 Billion, a 43.1 per cent increase from the prior year.

Since 2006, China's market for the outsourcing of technology services has experienced rapid growth and has been heralded as a challenger to India's market dominance. According to China's Ministry of Commerce, the total contract value of executed outsourcing contracts in 2010 with Chinese-based service providers was approximately \$19.8 Billion, a 43.1 per cent increase from the prior year.

Nonetheless, this rapid growth represents a mere fraction of the global IT services market and hardly 26 per cent of India's market volume.



So how can China rise to compete globally in IT Services?

Focus on market share, not on "beating India"

Focus on unique markets

The sharp increase in offshore business is closely tied to China's unique linguistic and demographic advantages in supporting South East Asia. Vast differences in economic development, culture and labor skill-sets have provided Chinese cities and local providers with their own specialized competencies. Below is an independent analysis conducted by Avasant that illustrates the strengths and weaknesses of the key outsourcing cities in China.

Key China Outsourcing Destinations	Key Industry Park	Key ITES/BPO Advantage					
		Unique language capabilities	Large Service Provider Presence	Low infrastructure & salary costs	Close to Hub Cities	Large Talent Base	Mature Business Environment
Beijing	Zhongguancun National Demonstration Zone	●	●	●	●	●	●
Shenzhen	Shenzhen Software Park	●	●	●	●	●	●
Guangzhou	Tianhe Software Park	●	●	●	●	●	●
Shanghai	Caohejing Hi Tech Park	●	●	●	●	●	●
Wuxi	Wuxi National Software Park	●	●	●	●	●	●
Nanjin	Nanjin New Technology Development Zone	●	●	●	●	●	●
Suzhou	Qunshan Hua Qiao Economic Development Zone	●	●	●	●	●	●
Dalian	Dalian Software Park	●	●	●	●	●	●
Tianjing	Tianjin Economic Development Zone	●	●	●	●	●	●
Hefei	Hi Technomogy Park	●	●	●	●	●	●
Changsha	HiTech Development Zone	●	●	●	●	●	●
Xi'an	Xian Software Park	●	●	●	●	●	●
Hangzhou	Hangzhou Economic Development Zone	●	●	●	●	●	●
Wuhan	Donghu New Technology Development Zone	●	●	●	●	●	●
Chongqing	Jinyunshan Software Park	●	●	●	●	●	●
Jinan	Qinu Software Park	●	●	●	●	●	●
Chengdu	Chengdu Hitech Park	●	●	●	●	●	●
Nanchang	New Technology Development Zone	●	●	●	●	●	●

Ratings: ● Poor ● Average ● Excellent

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Additionally, the large potential for growth of the domestic market in China (including MNC subsidiaries in China) has only recently been unleashed. These unique markets should continue to be the focal point of entry for all Chinese service providers.

This is about building businesses, not global politics

The outsourcing services industry has received significant attention from China's leading policymakers. However, despite the Chinese government's attention, the industry's development has to be market-driven and not constrained by a political agenda.

The IT outsourcing services industry in China should not be focusing on "beating" or even "catching up" with India, but rather on where Chinese businesses can thrive and compete effectively with larger global players. For example, local Chinese service providers have unparalleled advantages over other global players with respect to supporting China's growing domestic market for IT services, as well as regional advantages to support near shore markets like Korea, Japan and other East Asian and South East Asian countries. This has already been demonstrated by the success of Dalian and other regional cities as specialized sourcing centers of excellence.

Increase education focus

Each year, China churns out millions of educated workers with a diverse and potentially complementary set of skills. However, these educated resources have not been converted effectively into a quality labor force for the outsourcing services industry. For example, few major universities in China have dedicated academic majors in outsourcing related fields, and students coming out of colleges generally lack training in specific outsourcing service areas (e.g. call centers, BPO centers, etc). In addition, a large number of local training institutions exist but the quality and effectiveness of the programs vary too much for global MNCs to evaluate skill sets. In short, increased attention is required to establish an education system that focuses on producing students that are easily hired into the outsourcing services industry.

Slow down infrastructure build until cities can be filled. Empty buildings still have to be maintained.

Infrastructure development has been one of the highlights of China's recent economic development. A number of technology parks in China have established top-tier IT infrastructure to support the planned demand from overseas investors. Nonetheless, Avasant has observed a number of cases across China where high-quality infrastructure has not been fully utilized. Consequently, local technology park operators are facing a tremendous amount of pressure to bring in tenants from overseas.

Moreover, all of the newly built - and somewhat underutilized - infrastructure will require a significant amount of investment for ongoing maintenance. If infrastructure investments are not managed properly, it will create an adverse effect to the local or even national economy. In essence, rather than focusing on future infrastructure projects, China needs to slow down any future build until existing infrastructure assets are fully utilized and can create positive value for the overall economy.

Continue to improve IP protection

The overall IP protection regime in China has improved tremendously in recent years, which is a testament to the Chinese government's ability and willingness to address a long-running complaint of foreign companies and governments. China should continue to improve its enforcement of IP laws in order to further alleviate the on-going concerns of global companies that desire to set up shared services or delivery centres in China.

Focus on English plus focus on communications and cultural understanding

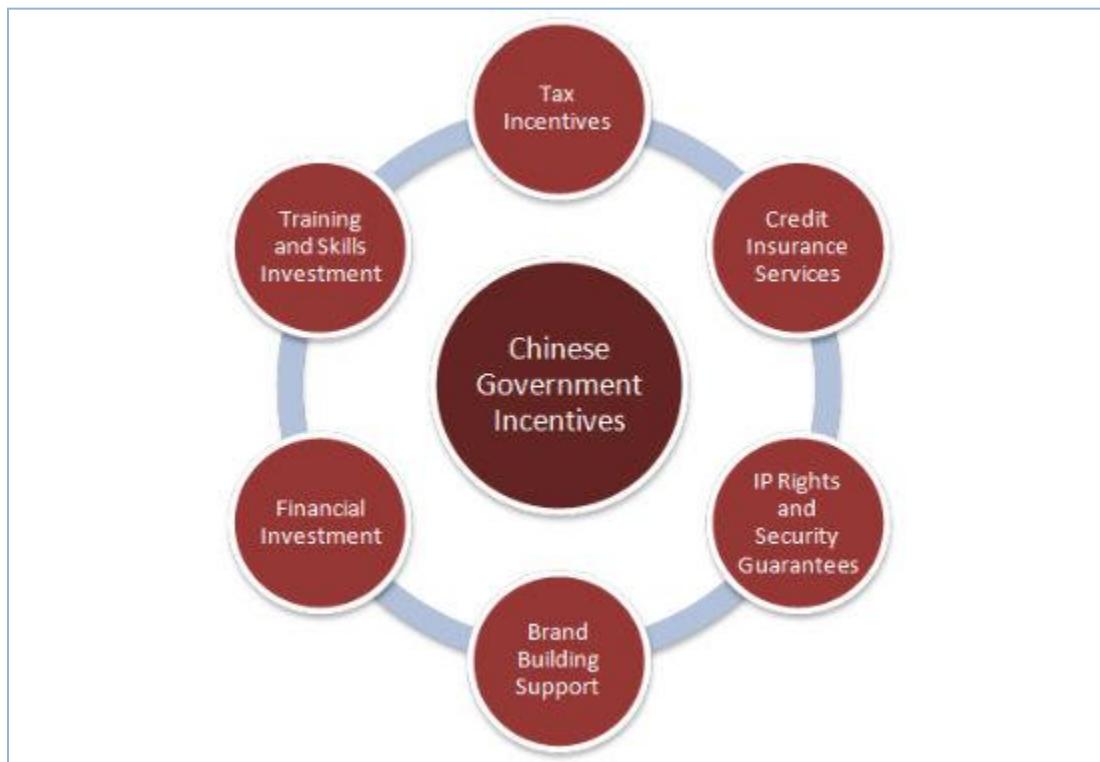
One of the challenges for Chinese providers to compete globally is to address the market's concerns over the Chinese workforce's capacity to deliver services in English.

China has indeed made significant strides in its English education program at almost every level. However, the entire education system tends to focus more on writing rather than the ability to communicate, which is a vital quality that is required in the everyday service delivery.

On a deeper level, Chinese service providers lack a general understanding of the Western market and business practices. This is a larger challenge that Chinese providers are facing with respect to obtaining acceptance into the major Western outsourcing market. In sum, though China has markedly improved the English-language capabilities of its workforce, China will need a greater focus on communication skills and cultural awareness in order to meet the skill level of its global competitors.

Maintain strong government support

Since 2006, Chinese cities and provinces have provided various incentives and direct investment into attracting foreign direct investment and improvements in infrastructure. This support has largely facilitated the industry's growth and is expected to continue with strong central government investment. Below is a graphical summary of the support incentives that China has made available to aid the development of the IT outsourcing services industry.

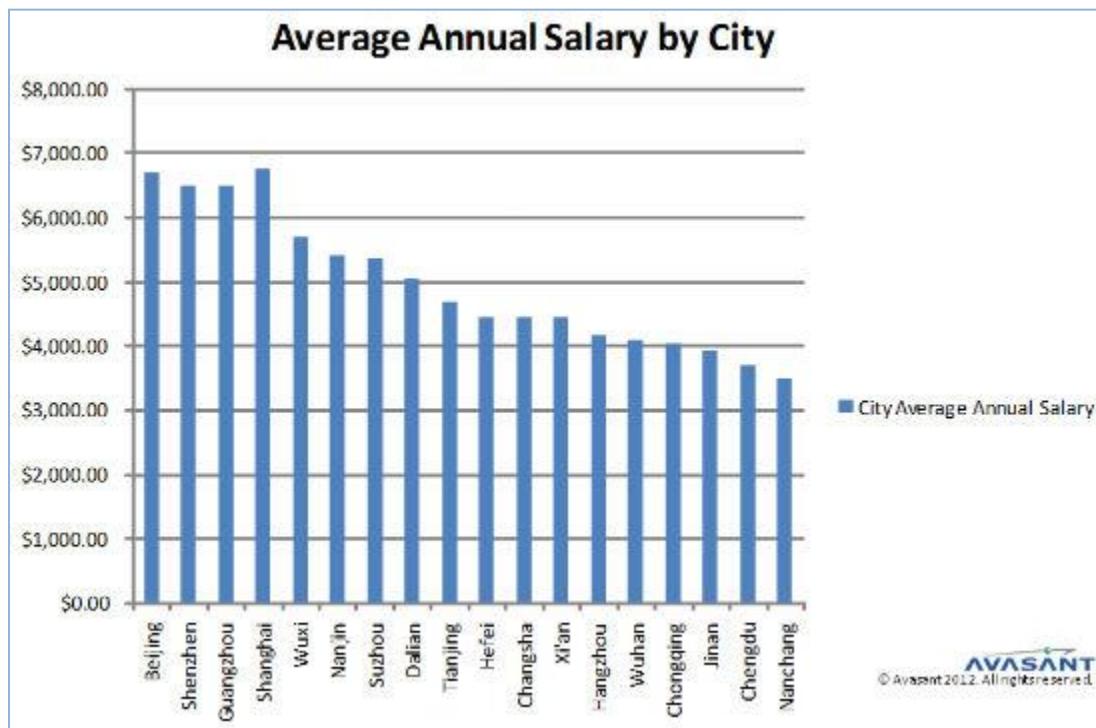


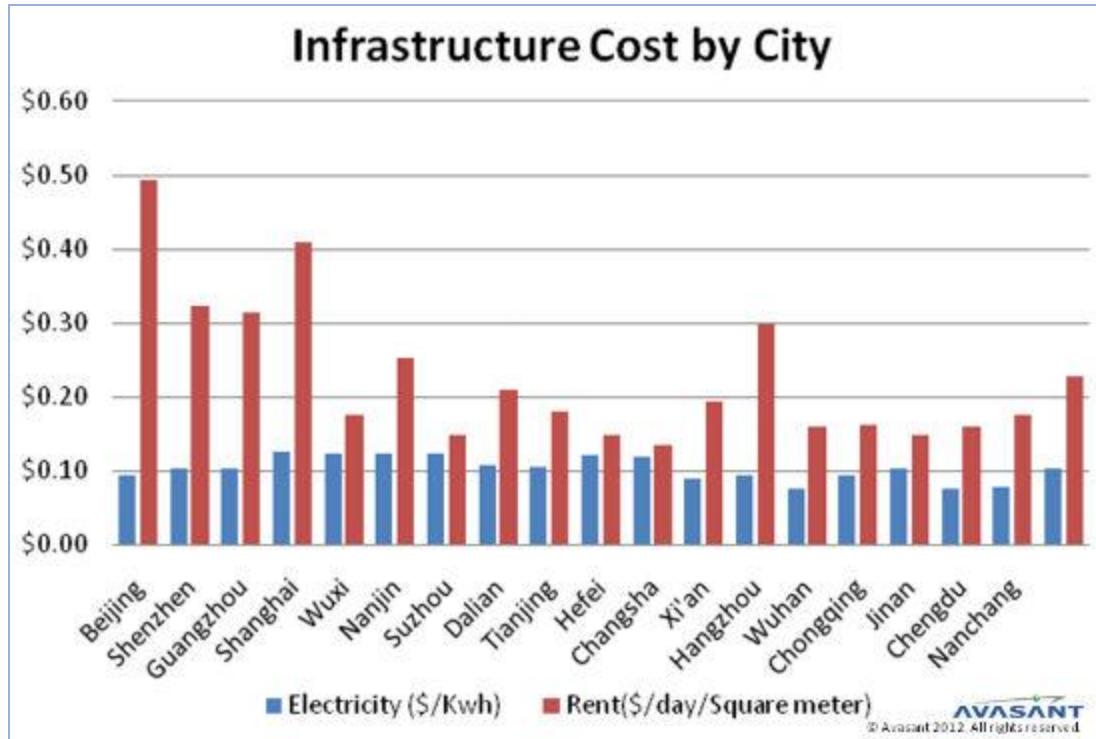
Advertise consistent and transparent incentive packages

During interactions with different outsourcing cities and local technology parks, Avasant's team noticed that although cities and technology parks issue general guidelines that describe economic incentive packages, there are often significant variances in the final incentive packages received by the investors depending on different factors. These factors are neither consistent nor transparent across different cities or industry parks, and have added a layer of unnecessary costs and uncertainty for small-to-medium-sized overseas investors. Accordingly, in order to reduce uncertainty and build trust among the investor community, outsourcing cities and technology parks should provide a more consistent and transparent set of incentive packages.

Market the low delivery and infrastructure cost

Despite increasing inflation rates, a rising local currency against key international currencies, a lack of middle-level management resources and rising attrition, China still retains some advantages in cost differential over other leading outsourcing services destinations, as there is a large gap in the labour and infrastructure costs between Tier 1 cities and Tier 2 & 3 cities. These Tier 2 & Tier 3 cities have become more attractive to global service providers as potential destinations. China should continue to promote Tier 2 and Tier 3 cities, and provide support for infrastructure maintenance, in order to more fully exploit this competitive advantage and capture more of the potential business for outsourcing services. Below are a set of graphical representations describing salaries and infrastructure costs among various Chinese outsourcing cities.







About Avasant

With its global headquarters in Los Angeles, California, Avasant is a top management consulting, research, and events firm servicing global clients across the public, private, and non-profit sectors. Our talented team of consultants, lawyers and technologists average over 20 years of industry-honed experience and have conducted 1,000+ engagements in over 40 countries worldwide. Avasant drives customer value through the use of our proprietary consulting and advisory methods, which have been refined over decades of 'real-world' transaction and engagement experience. The combination of our world-class resources allows Avasant to yield superior business outcomes in three primary domains: Strategic Sourcing, Technology Optimization and Globalization Consulting.

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3601 N Aviation Boulevard, Suite 3000, Manhattan Beach,
CA, 90266, USA

Tel: 310-643-3030

Fax: 310-643-3033

Email: contactus@avasant.com

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For any further communications, please contact: marketing@avasant.com