The Rising Stars of IT Outsourcing

With A.T. Kearney’s 2014 Global Services Location Index™ as the guide, we look at the top countries for outsourcing information technology services.
The marketplace for IT outsourcing is changing rapidly, and the long-term strategies developed even just a few years ago may now be obsolete. Globalization is evolving, with new, viable locations emerging and upending the classic India-centric onshore-offshore model. Proximity is increasingly becoming a factor in location decisions as companies seek solutions to time zone differences, cultural issues, and operational challenges. The decline of mega-deals in favor of lower-value deals has opened a larger segment of the market to smaller and niche providers based in non-traditional locations. Risk management has become a top-executive issue as companies seek to limit their exposure to operational, financial, and regulatory risks. And technological trends keep moving at hyper speed, with the cloud and crowdsourcing just two major advances transforming IT.

In the face of this change—as well as the slow recovery from years of macroeconomic turbulence and austerity—the landscape for IT outsourcing is ripe for a reassessment. Guided by the 2014 Global Services Location Index™ (GSLI), A.T. Kearney’s study of the top markets for locating offshore services, we examine the leading locations specifically for IT outsourcing. While India remains the global leader, alternatives such as China, Mexico, and Poland offer potential benefits in areas such as skills availability, business environment, and financial attractiveness.

Getting a Lay of the Land

One overly simplistic way to look at the IT outsourcing market is to say it’s India, followed by some alternatives to India. Although India is undoubtedly the leader in IT outsourcing, that point of view overlooks the unique benefits other countries can offer.

For example, although India remains the leading choice for U.S. companies, historically (and for the foreseeable future) the largest consumers of IT outsourcing services, other countries are gaining ground. Mexico offers language skills, strong IT expertise, and both physical proximity and time zone similarities. China offers U.S. companies proximity to business operations in that country, as well as a large pool of resources to choose from.

European companies, meanwhile, are increasingly favoring suppliers in Poland, Bulgaria, and other Eastern European countries, thanks to proximity and language skills. In the Middle East, Egypt is becoming the nearshore location of choice. Japanese companies, which had previously hesitated to outsource due to language barriers, increasingly see China as an attractive IT outsourcing option because of its time zone, language, and cultural advantages. Australia, a mature market for IT suppliers, has many customers choosing Malaysia, Indonesia, Thailand, and the Philippines as alternatives to India.

In the following sections, we examine the four country groupings in the IT outsourcing market and what they can offer to buyers.

India: The Undeniable Global Leader

India remains the world’s undeniable leader in IT outsourcing. Strong processes, a stable IT infrastructure, impressive service capabilities, global exposure, and a renowned service culture and mindset ensure that India retains its crown. Its wide range of desirable IT services includes application development and maintenance, remote infrastructure management, software testing, R&D, and high-end software engineering, among others.
India’s advantages in IT outsourcing have not diminished—nor have the concerns about doing business there. On one hand, the more than 2 million Indians employed in IT is unmatched by any other country, it produces millions of college graduates with degrees in science and technology, and it has strong English proficiency that gives it an advantage with U.S. and UK companies. On the other hand, high employee turnover remains an issue, and India’s business environment is hampered by wage pressures, physical infrastructure issues, and corporate tax rates that are less favorable than other locations.

For buyers, India provides both specialized and commodity IT talent and is well positioned to supplement IT organizational needs. Moreover, the maturity of IT services in India offers flexibility to experiment with newer delivery models and create outcome-based contracts. India has the world’s widest range of IT suppliers. Local leaders include Cognizant, HCL, Infosys, Tata Consultancy Services (TCS), Tech Mahindra, and Wipro; international firms with a sizeable Indian presence include HP, IBM, Accenture, and CSC; India’s long tail of small but solid IT players includes IGATE, L&T Infotech, Mphasis, and Syntel, among many others. These firms have established IT delivery centers in most of India’s tier 1 cities, and their expansion is targeting tier 2 and 3 cities.

Although high interest rates are pushing up capital costs and wages, the rupee has devalued by more than 20 percent since 2011, protecting the business environment and sustaining the 60 to 75 percent cost advantage it has in IT programming over the United States. With the labor supply market expected to remain favorable and tier 2 and 3 cities offering additional cost competitiveness, India’s dominance of the IT outsourcing market looks set to continue for the foreseeable future.

The Global Alternatives: China and Mexico

Even as India’s lead in IT outsourcing remains strong, China and Mexico are quickly catching up on the global stage. With corporate taxes and interest rates lower than India and infrastructure that rates more highly, both countries offer cost advantages (see figure 1). Historically, China has remained a steady second place to India in the GSLI; Mexico’s star is rising, thanks to its proximity to the United States, and it ranks fourth in the 2014 Index.
China’s advantages include good infrastructure, a low ratio of public debt to GDP, and a stable environment that helps de-risk IT outsourcing decisions. The Chinese government has made progress in terms of protecting intellectual property (IP), but past issues still influence customer thinking when it comes to IT outsourcing in China. China produces even more science and technology graduates than India, but its English proficiency remains a barrier to becoming a true challenger to India’s dominance.

IBM remains the leader in China’s IT outsourcing market, with Capgemini, Genpact, Infosys HP, Pactera, PCCW, and Tata Information Technology among noteworthy challengers. Companies considering China as a location for IT are evaluating and aligning their own corporate needs with the diverse location options in China, each offering different advantages in terms of cost, government support, and economics. China is becoming the preferred offshore destination in areas where intellectual property is not a huge concern, such as local IT delivery operations, localization, and application development of packaged software.

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Mexico, in contrast, features a skilled, multilingual workforce and a platform for serving Latin American, North American, and European organizations. In particular, its geographical proximity to (and shared time zones with) the United States make it an attractive service hub. Risks are also reduced by language and cultural similarities and NAFTA-facilitated economic alignment.

Mexico’s IT industry includes nearly 500,000 professionals, with low attrition rates, and universities and technical schools that produce a steady source of new talent. Most major U.S. IT firms have established delivery centers in Mexico, with HP and IBM the leaders. Accenture, Softtek (based in Mexico), T-Systems, Tata Consultancy Services, Stefanini, Carvajal, and many more provide a diverse supply base offering both nearshore opportunities for U.S. and Canadian clients and attractive IT delivery centers for Spanish-speaking countries. Mexico’s labor cost arbitrage is not as large as India, but for some buyers, proximity tilts the balance in Mexico’s favor.

Developing Global Locations: Malaysia, the Philippines, and Poland

Malaysia, the Philippines, and Poland have the potential to become global players offering specialized IT service capabilities. Malaysia and the Philippines benefit from advanced English skills and cultural adaptability, which could put them in position to capture demand from the United States and United Kingdom once they expand their service offerings. Poland’s linguistic capabilities—which span many European languages—its excellent infrastructure, and advantageous labor costs present a particularly strong case for European investment (see figure 2 on page 4).

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Malaysia has consistently ranked third in the GSLI, and in terms of IT outsourcing it is emerging as a top location due to its stable economics, low interest rates, low inflation, and good infrastructure. Outsourcing accounts for roughly 60 percent of Malaysia’s IT services market. With major infrastructure investments in connectivity, Malaysia is making a play in outsourcing for cloud computing and software as a service (SaaS). A slew of global IT companies (including IBM, Accenture, HP, CSC, Capgemini, HeiTech, Getronics, and Samsung SDS) and India-based providers (such as Tata Consulting Services, Wipro, Cognizant, HCL, and IGATE) are present in Malaysia, although at a relatively small scale.

With a history as a provider to the banking industry, Malaysia is well suited as a spot for captive IT service centers, and today the country boasts almost 100 regional and global shared service centers. As with China, client concerns over IP protection and personal data loss are important factors when considering locating IT in Malaysia.

The Philippines’ IT outsourcing sector is dominated by business process outsourcing (BPO), with most of its business coming from the United States and Japan. This developing player has a small labor IT pool and a limited set of IT service capabilities, but it is building up its specialized IT outsourcing services for niche markets (such as Web design, software development, and animation) by taking advantage of its current strengths and customer base in call center and BPO services.

Almost all major global IT/BPO vendors have a presence in the Philippines. The current services footprint is skewed toward multilingual IT help desks, with growing application development and maintenance and infrastructure services. Accenture, Convergys, IBM, Aegis, and Genpact are some of the larger players in the Philippines, and in the past five years, large India-based providers (Cognizant, Infosys, Wipro, Tata Consulting Services, and Tech Mahindra) have opened or expanded their capabilities, given the strong demand for call center services.

Poland has risen in the GSLI from 38th in 2009 to 24th in 2011 to 11th in the newest rankings. With high educational standards, more than 500 institutions of higher education, and skilled and multilingual staff (the country’s providers have the ability to support many languages), Poland has a solid platform for serving European and U.S. companies.
About 40 percent of IT sector companies are in Krakow, Poland’s “Silicon Valley.” Among the global and Indian providers in Poland are IBM, HP, Accenture, Atos, Capgemini, and HCL, alongside tech giants such as Google and Cisco.

For European and English-speaking companies, Poland is a feasible outsourcing destination. In particular, its proximity and language availability make it an ideal, cost-competitive location for Western European companies.

**Strong Regional Players: Bulgaria, Brazil, and Egypt**

Three more countries are making their names as regional hubs with a wide range of skills. Bulgaria, Brazil, and Egypt are becoming favored locations for companies in neighboring countries that want solid skills and the benefits of proximity.

**Bulgaria** is becoming a hot location for specialized high-level application outsourcing in areas such as computer-aided design (CAD), computer-aided manufacturing (CAM), and other scientific and engineering applications and product development. Among the challenges with locating in Bulgaria are an IT labor pool smaller than global players, and low English proficiency (roughly one-quarter of the population).

Bulgaria is gaining in the IT outsourcing market for many reasons, however. It has a talented and creative labor force, with particular proficiency in C++ and Java, stable economic, business, and regulatory climates, low inflation and public debt, and regionally competitive costs for resources and real estate. These fundamentals are a main reason HP has chosen to locate its center in Bulgaria (see figure 3).

**Brazil** is poised to rise as an IT outsourcing location—building upon its growing domestic consumption, where it already serves diverse niche markets. The country’s open market economy is politically and economically stable, and government tax incentives—as high as 15 percent—encourage the export of IT services and software, IT innovation, and IT workforce development.
Many large global vendors are making sizable foreign direct investments in Brazil’s IT infrastructure. Global entrants include Accenture, Capgemini, IBM, TCS, Tivit, and T-systems, all of which have their delivery centers in Brazil, resulting in an experienced IT workforce. Brazil’s ability to become more attractive as an offshoring destination will depend on increasing public investments in education and infrastructure, and simplifying its labor, tax, and regulatory environment.

**Egypt**’s political instability is overshadowing its attractive IT outsourcing capabilities. Near-term obstacles include high inflation rates and rising public discontent. However, its location makes it an attractive nearshore possibility. And with recent investments in IT, Egypt has the elements to become a global player.

Egypt is geographically convenient for the United States, Europe, Asia, and Africa, and its multilingual population is culturally compatible. For global companies, Egypt is increasingly the preferred location to serve operations in the Middle East and North Africa, with costs that are comparable to India. IBM and Wipro both count Egypt as the leading delivery center location in the region. Long term, an improved political climate will go a long way to capturing foreign investment and more buyers.

**Developing Regional Locations:**
**Thailand, Indonesia, and Other Notables**

Thailand and Indonesia are developing regional locations with the long-term potential to become major players in their region. Each offers financially attractive options for companies, but their challenges limit their near-term potential.

**Thailand** offers a quality, low-cost labor pool and a strong infrastructure; its financial attractiveness and business environment are strong. However, political instability, poor English capabilities, data security concerns, and piracy are bottlenecks to growth.

Thailand is emerging as a serious choice for Asian firms, with IT software the cornerstone of its offerings, particularly animation, design, graphics, and embedded and mobile application software development. For companies with significant outsourcing scale in these niche areas, Thailand is a viable option within a multi-location delivery strategy. Most ITO suppliers have a relatively smaller presence in Thailand today, primarily with a view of servicing the domestic market. IBM, Atos, HP, Unisys, Accenture, CenturyLink, Samsung SDS, and NTT DATA are the largest players in Thailand.

**Indonesia**, one of Southeast Asia’s largest economies, is financially attractive and has an engaging business environment and the world’s fourth-largest workforce. However, the volume of its IT services exports today is low compared to India and China, as it has a smaller IT labor pool and a limited set of IT service capabilities.

However, the Indonesian government is liberalizing economic policies to support its outsourcing industry and helping it expand beyond programming and IT support. For now, companies with significant outsourcing scale in these two areas could see Indonesia as a viable potential addition to a multi-location delivery strategy. Compared with Thailand, Indonesia has relatively more large-scale operations of key ITO suppliers, including Accenture, Cipta Caraka, IBM, PT Sigma Unify, PT Visionnet, Samsung SDS, and Tata Consulting Services.
While the 11 countries above represent the GSLI’s top countries, other notables are worth considering for nearshoring and for specific IT requirements, including software engineering, localization, and helpdesk. Countries where we have seen increased IT outsourcing include: Russia, for excellence in software engineering and emerging technology areas such as product development and user experience; Spain, for its large IT resource pool and time-zone favorability in Western Europe; and Romania and the Czech Republic, as nearshore locations for continental Europe with large software engineering talent pools. As in any location, the benefits and risks should be weighed when making the decision.

Leading companies will refresh and rebalance their strategies on an ongoing basis, actively reassessing their location strategies and delivery footprints.

What Does This Mean for IT Leaders?

Today’s IT leaders are blessed with more options than ever before—and challenged to navigate a more complex landscape. While considering their organizations’ priorities, overarching IT strategy, and existing operating models, they must also balance costs, risk, and proximity benefits.

For many organizations, establishing an IT outsourcing strategy is often a periodic exercise, reviewed every three to five years. But as the blossoming markets show us, strategies that are even a few years old can fast become obsolete. Instead, leading companies will refresh and rebalance their strategies on an ongoing basis, actively reassessing their location strategies and delivery footprints. These leaders will do three things:

Understand the value of individual IT capabilities and where IT services are best placed. The first step is separating insourced services (typically core, high-value activities such as process and business analysis, and architecture) from the more transactional services best served by outsourcing. Not all transactional services can be serviced in the same manner or from the same locations. Building an optimal mix of onshore, nearshore, and offshore choices by IT service line (for example, development, project work, application maintenance, and help desk) is a crucial first step in ensuring successful IT delivery.

Identify best-fit locations for specific IT services. Once an optimal location mix has been defined, the next step is to identify the best-fit physical locations, taking into account criteria such as available skills and capabilities, cost arbitrage, time zone requirements, local content laws, taxation, financial incentives, and the long-term market outlook. It is imperative to build a solution which balances the number of physical delivery locations so as to avoid sub-scale scope in multiple sites that would require higher coordination and result in greater costs.

Redefine the global IT operating model and sourcing strategy. The operating model must find the right mix of in-house and outsourced capacity and skills. Outsourced services mix,
scale, and location have a direct link to in-house IT organization skills, capacity, and location, and neglecting these links is a sure-shot path for delivery and cost inflation issues. The sourcing strategy is primarily driven by the nature of IT services and scope for outsourcing, existing supplier relationships, supplier strengths and weaknesses, and locational delivery footprint.

Jostling for Position

Today’s IT outsourcing landscape is far more varied, with multiple countries and suppliers jostling for position. This is good news for organizations looking to outsource or trying to rebalance current outsourcing relationships. However, long-term success will only come if IT leaders create comprehensive, well-thought-out IT outsourcing strategies with the right location and vendor mix, and stay abreast of market and vendor developments.

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