

Labor Cost Advantages of "Offshore" Locations Decline in 2006 According to New A.T. Kearney Study

- *Latest Global Services Location Index finds talent and policy environment increasingly define competitive landscape*
- *India, China continue to lead; new contenders in Southeast Asia, Latin America and Eastern Europe perform well*

WASHINGTON (15 March 2007) - The wage cost advantage of offshore locations for office services is set to last for another 20 years, says the latest annual survey by global management consulting firm A.T. Kearney. Even though wages in offshore locations for services, such as IT, business processes and call centers, have started to rise, they will remain cheaper for the foreseeable future under the most aggressive projections of wage inflation and currency appreciation in developing countries.

The labor cost changes are partly the result of accelerating wages and currency appreciation in offshore hot-spots, as well as downward pressure on wages in impacted sectors in developed countries. At the same time, key emerging markets have continued to improve their attractiveness in terms of access to talent, industry experience, quality certifications and their regulatory environment.

"What is most striking about the results of this year's Global Services Location Index is how the relative cost advantage of the leading offshore destinations declined almost universally, while their scores for people skills and business environment rose significantly," said Paul Laudicina, managing officer and chairman of A.T. Kearney. "These findings reinforce the message that corporations making global location decisions should focus less on short-term cost considerations, and more on long-term projections of talent supply and operating conditions."

The findings also send a message to policy-makers in both developed and developing countries: The key to maintaining and enhancing long-term competitiveness lies in skills development, infrastructure investment and the regulatory environment, not in attempts to control wages. Virtually every country in the Index, even those that fell in the rankings, improved their absolute score in the last year — confirming that competition is intensifying, and simply maintaining current performance levels is no longer sufficient to attract and retain the world's fast-growing remote services business.

Now in its fourth year of publication, A.T. Kearney's Global Services Location Index comprises more than 40 metrics comparing the financial attractiveness, people skills and business environment of 50 countries worldwide. The latest Index is based on full year data for the year 2006. Reflecting the growing number of countries competing to establish themselves as remote services locations, ten new countries have been added to this year's Index — the three Baltic States and Ukraine in Eastern Europe, Sri Lanka and Pakistan in South Asia, Uruguay in Latin America, and Morocco, Senegal, and Mauritius, further expanding the Index's coverage of francophone locations.

The complete results of this year's Index are provided below. A more detailed analysis of the results and information on regional performance can be found at

atkearneylink. Highlights from this year's Index include:

- India and China continue to lead the Index by a wide margin, with declines in cost advantage offset by further improvements in talent supply and business environment.
- South East Asian countries reinforce their position as the primary alternates to India and China, with all six major ASEAN markets (Indonesia, Malaysia, the Philippines, Singapore, Thailand and Vietnam) now ranked among the top 20 locations.
- Reflecting new policy initiatives to promote service exports in many countries, Latin America performs well, with all five major contenders (Argentina, Brazil, Chile, Mexico and Uruguay) rising in the rankings.
- As projected in previous years, newer contenders in Central and Eastern Europe are increasingly outshining more established players, as Bulgaria, Slovakia and the Baltic States move ahead, while Poland maintains its ranking and the Czech Republic and Hungary slip in the rankings.
- The Middle East and Africa continue to rise in visibility, with Egypt, Jordan, the United Arab Emirates, Tunisia, Ghana, South Africa, Israel and Turkey all maintaining or improving their position, while Mauritius, Morocco and Senegal debut in the rankings
- While most "on-shore" or "near-shore" locations in developed countries improved their absolute scores, almost all fell in the rankings, as emerging markets improved their people skills and environment scores at a faster rate.

"While total compensation costs for sample positions like IT programmers or call center representatives rose by 5-10% in most developed countries, average wages for similar positions in India, China, the Philippines and parts of Eastern Europe and Latin America grew anywhere from 20% to 40%," said Martin Walker, senior director the Global Business Policy Council, the A.T. Kearney sponsor of the research. "At the same time, we have seen telecom costs in many emerging markets drop by 25% or more, as competition and volumes in the telecom market increase. Similarly, we saw double-digit growth in university enrollment in countries like China, Brazil and Egypt, and the number of firms with quality endorsements like Carnegie Mellon's CMMI certification and the ISO 27001 data-security certification almost doubled in several emerging markets."

As focus on the sector increases, the quality of data also improves. "Some of the movement in this year's Index seems to be the result of more extensive research being conducted in key emerging markets and hence more accurate data becoming available — on factors like export revenues, compensation costs, effective tax rates and telecom pricing," commented Johan Gott, manager of research for the Global Services Location Index.

Implications for global location decisions

"The clear message from the 2006 Global Services Location Index is that short-term cost advantage should not be the primary driver of location decisions," concluded Laudicina. "Currency appreciation and demand growth in key locations will gradually erode their cost advantage. At the same time, continued improvements in infrastructure and policy-

making in emerging markets will slowly erode the business-environment competitive advantage of developed countries. The key differentiator in the future will be the talent base and future projections of skilled labor supply will be imperative for companies making long-term location decisions."

"For policy-makers too, education and training are the key: investing to expand the quantity and quality of tertiary education, designing training and certification programs in collaboration with industry players, attracting skilled workers from outside the country, opening labor markets within the country - all will be key to ensure a supply of skilled labor that is responsive to ever-changing global needs," said Walker.

For more detailed information, read the [2007 Global Services Location Index: Regional Highlights](#).

About The 2007 Global Services Location Index

The A.T. Kearney Global Services Location Index analyzes the top 50 services locations worldwide against 41 measurements in three major categories: cost, people skills and availability, and business environment.

The Index assigns weightings reflecting the drivers of offshoring decisions based on A.T. Kearney research and engagement experience. Because cost advantages have been the primary impetus behind offshoring, financial factors constitute 40 percent of the total Index weight. People skills and availability and business environment each receive a 30 percent weighting.

About the Global Business Policy Council

The Global Business Policy Council is a strategic service of A.T. Kearney that helps chief executives monitor and capitalize on geopolitical, economic, regulatory, technological and social change worldwide. Council membership is limited to a select group of corporate leaders and their companies. The Council's core program includes periodic meetings in strategically important parts of the world, timely analytical products, regular member briefings, regional events and other services.

About A.T. Kearney

A.T. Kearney is a global strategic management consulting firm known for helping clients gain lasting results through a unique combination of strategic insight and collaborative working style. The firm was established in 1926 to provide management advice concerning issues on the CEO's agenda. Today, we serve the largest global clients in all major industries. A.T. Kearney's offices are located in major business centers in 32 countries.

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Figure 1: Global Services Location Index 2006

1. India
2. China
3. Malaysia
4. Thailand
5. Brazil
6. Indonesia

7. Chile
8. Philippines
9. Bulgaria
10. Mexico
11. Singapore
12. Slovakia
13. Egypt
14. Jordan
15. Estonia
16. Czech Republic
17. Latvia
18. Poland
19. Vietnam
20. United Arab Emirates
21. United States (Tier II)*
22. Uruguay
23. Argentina
24. Hungary
25. Mauritius
26. Tunisia
27. Ghana
28. Lithuania
29. Sri Lanka
30. Pakistan
31. South Africa
32. Jamaica
33. Romania
34. Costa Rica
35. Canada
36. Morocco
37. Russia
38. Israel
39. Senegal
40. Germany (Tier II)*
41. Panama
42. United Kingdom (Tier II)*
43. Spain
44. New Zealand
45. Australia
46. Portugal
47. Ukraine
48. France (Tier II)*
49. Turkey
50. Ireland

*Based on lower-cost locations in each country: San Antonio (U.S.), Belfast (UK), Leipzig (Germany) and Marseilles (France).

Asia: still on top

India and **China** continue to dominate the Index. India maintains a wide, albeit slightly shrinking, lead over China, confirming what industry surveys and visiting executives repeatedly find – for all the concern about overheating, wage inflation and service levels, India still offers an unbeatable mix of low costs, deep technical and language skills, mature vendors and supportive government policies. In both countries, double-digit growth rates have fuelled wage inflation, with average compensation costs for sample functions rising by around 30% in China and around 20% in India. But these cost escalations have been matched by corresponding increases in skill supply and quality indicators. While India maintains a strong-lead in terms of language skills and vendor maturity, China has been catching up in several areas, growing university enrollment by more than 25%, and almost doubling the number of firms with CMMI and ISO quality certifications.

Southeast Asian nations continue to do well, with Malaysia, Thailand, The Philippines, Indonesia and Singapore occupying 5 of the top 12 spots and Vietnam entering the top 20. Somewhat surprisingly, both **Singapore** and **The Philippines** dropped several places in this year's rankings. Singapore maintains its score from last year, but has been overtaken by larger, lower-cost countries now competing to establish themselves as service centers – in the same way that Singapore itself did 20 years ago. In the Philippines' case, growth in the sector and currency appreciation has driven up wages in US dollar terms by as much as 30%, reducing relative cost advantage. Nevertheless, the Philippines remains one of the lowest wage locations in the Index and now offers the lowest telecom costs of any country in the Index.

Malaysia, Thailand, Indonesia and **Vietnam** have also seen significant declines in telecom costs, while slower growth rates have moderated wage inflation. At the same time, all six ASEAN countries have significantly improved quality indicators, increasing the number of CMM-certified firms in the region from 100 in 2005 to over 150 in 2006 and the number of ISO 27001-certified firms from 0 in 2005 to 45 in 2006. Despite their rise in this year's Index, Thailand and Indonesia will likely remain challenged by lesser English language capabilities and concerns over their economic and political stability.

Sri Lanka and **Pakistan** enter the Index for the first time at 29 and 30 respectively. Both countries offer many of the same advantages as India, with similar labor costs, widespread

use of English, strong education systems and increasingly open and well-regulated business environments. However, both countries have only recently woken up to the enormous opportunity of the offshore services sector and therefore lack India's breadth and depth of experience. Both countries are also disadvantaged by their relatively smaller population-base and obvious concerns over internal security.

Latin America and the Caribbean: bearing fruit

Latin American countries are collectively the biggest gainers in this year's Index, with Brazil, Chile and Mexico rising to 5th, 7th and 10th spots in the Index. Spurred on by India's success, governments throughout the region have begun to recognize the potential of the export services sector, particularly in the context of providing near-shore support to North America and Iberia.

Despite currency appreciation, strong sector growth and corresponding wage inflation (aggravated by high non-wage labor costs imposed by the government), **Brazil** has begun to leverage the traditional strengths of its indigenous IT sector, rapidly expanding university enrollment and quality certifications. While less spectacular than Brazil, **Chile, Mexico** and **Argentina** have also seen significant sector growth (and corresponding wage inflation) and some increases in graduation rates and company certifications. Chile continues to benefit from the best business environment and tax structure in the region, while Mexico leverages its proximity to the US, and Argentina offers relatively lower costs.

Uruguay makes a strong first appearance in the Index at 22, benefiting from relatively competitive labor costs and a positive business environment, albeit disadvantaged by its small population size. Like Singapore and the Czech Republic, **Costa Rica** is the traditional leader in the region and maintains its absolute score, but falls in the rankings as larger regional players enter the competition. Weaker infrastructure and a decline in the perceived quality of the business environment remain problematic. **Jamaica** holds more or less steady as the leading contender in the English-speaking Caribbean, while **Panama** is beginning to catch up with neighboring **Costa Rica**.

Central and Eastern Europe: new contenders climb the rankings

The trend from last year continues as the established service providers in the region, Czech Republic, Hungary, and Poland lose ground while emerging locations quickly move up the rankings. **Bulgaria** replaces the Czech Republic as the only country from the region in the

top 10. Both Bulgaria and **Romania** see big jumps in their business environment scores, as they complete preparations to join the European Union in 2007. Despite a larger population base, Romania's relatively higher costs put it among the middle of the pack at 33rd place. **Slovakia** continues to do well, just edging out the neighboring Czech Republic at 12th place. The Baltic States, **Estonia**, **Latvia** and **Lithuania**, jump into the Index at 15th, 17th and 28th place. Albeit small in size, all three countries combine a business environment similar to that of most developed countries with a superior cost structure. Estonia today is what Ireland used to be ten to 15 years ago, a relatively low-cost European location with top class, largely untapped, talent and a pro-business policy environment.

Continued improvement in the business environment in the **Czech Republic** and **Hungary** can not offset deterioration in cost competitiveness and they slip in the rankings, despite maintaining or improving their absolute scores. Among the big three Central European countries, only **Poland** manages to maintain its position, thanks to lower wage inflation and infrastructure costs. Despite competitive wages, large populations and strong technical skills, very weak business environment scores (only Pakistan, Senegal and Indonesia fare worse) leave **Russia** and newcomer **Ukraine** low in the rankings at 37th and 47th place.

Middle East and Africa: a growing cadre

Contrary to the perceived challenges in both regions, Middle Eastern and African countries are increasing their visibility as remote services locations. **Egypt**, **Jordan** and the **United Arab Emirates** maintain roughly the same positions in the top 20, reflecting the increasing number of US, European and Asian companies choosing these locations as centers for regional or global support activities. The rise of **Mauritius**, **Tunisia**, **Morocco** and **Senegal** reflects growing interest in locations with the ability to serve francophone markets. Stronger business environments in Mauritius and Tunisia contend with lower costs and larger populations in Morocco and Senegal. **Ghana** maintains its position as a low-cost English language location in Africa, while **South Africa**, **Israel** and **Turkey** all see their rankings improve, largely as a result of improvements in the policy environment and infrastructure quality.

Developed economies: slipping in the rankings

"On-shore" and "near-shore" locations in developed countries all slipped in this year's rankings. In the case of the **US**, **UK**, **Germany**, **France**, **Iberia**, **New Zealand** and **Ireland**, each country has maintained or improved their score, but has been overtaken by

lower-cost emerging markets and new entrants. Once again, the US scored significantly better than any of the European "on-shore" options, thanks mainly to its larger population size and industry depth. In the case of **Canada** and **Australia**, currency appreciation and hence wage inflation in US dollar terms eroded their cost advantage.