POSITION OF CEE AND HUNGARY ON THE GLOBAL SHARED SERVICE DELIVERY MARKET

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Abstract:

There are a lot of benefits of shared service model for any companies using it. Those companies could be successful that have size enough because for example cost-benefits depend on economies of scale. According to SunGard global research in 2010, 54% of companies using shared service centers have 1 billion or more US dollar turnover per a year. Because the larger a company, the larger the likelihood that the company use different separated systems, non-standardized processes. The main benefits of model are available not only in case of big volume exploited but diminishing redundancies.

In this part of my research I am focusing on Central-Eastern Europe region and Hungary to analyze their position on the global service market. I found what are the most tendencies, which countries have good, which have worse positions in the global rankings and what will be in the future. I analyzed the effect of global crisis on the service delivery market and the recovery from it.

Key Words: Service delivery market, shared service organizations, SSO

Introduction

The classic shared-service model was created to achieve savings. It is reached by creating economies of scale and enhancing of efficiency, so delivering services for more and more customers but with the same resources. It was available mostly at the services with high volume and many transactions where it could be minimized the number of interactions with customers. The high number of transactions is important because these functions could be standardized quite well and that is one of the sources for cost-cutting. Beside it the key of the success is process-automatization and technological improvements. It is well prescribed for the workforce employed in the shared service organizations (SSO) in case of different events which process should have to follow. It is called event-management. The work of employees in these organizations is very similar to classic industrial assembly or manufacturing model but interpreted for services. That is why it is called process-driven organization.

The most frequent appearance of the shared service model is captive center that is an organizational unit with the aim to re-manage certain services – that delivered for a broad scale of organizational units – in a specific service center. (Bodnár & Vida, 2006, p. 277)

Captive centers were originally established for getting cost-benefits and lately they were one of the main drivers of offshoring projects. Captive centers deliver internal services exclusively only for units of the parent organization. However there are similar organizational units that deliver services not only for internal units but for external partners, it is called shared service center.

Because the shared service model has a lot of benefits for the companies, more and more company uses the model and these companies find the most appropriate geographical area of their operation. In this market CEE region and Hungary have good position.

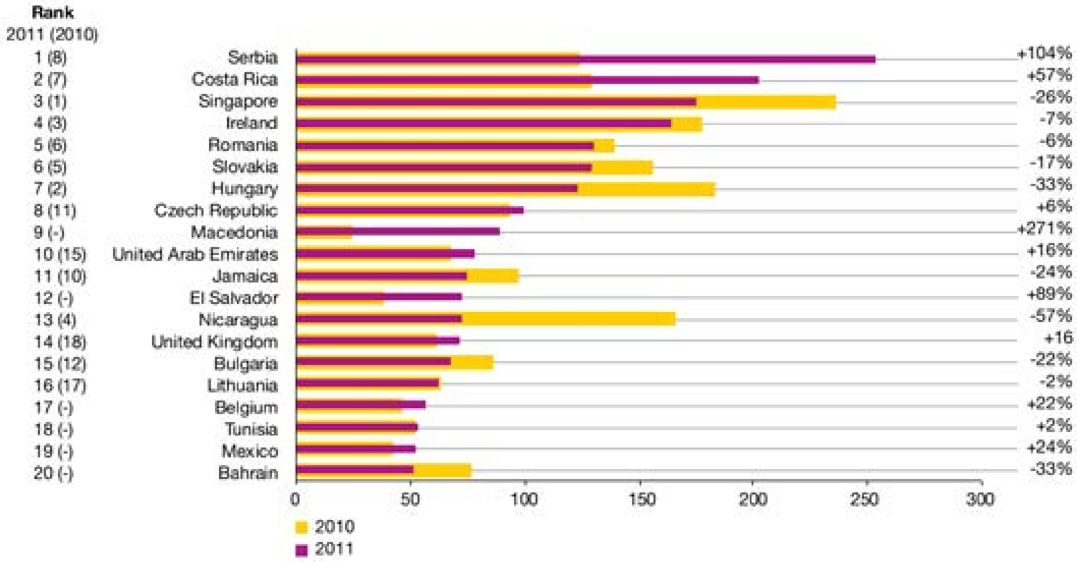
The purpose and methodology of the research

The aim of this research is to explore the position of Central-Eastern Europe and Hungary on the global sourcing market. I analyzed the global service delivery and foreign direct investments rankings to disclose the tendencies of these countries and try to get conclusions from them. The research is based mostly on literature review but there are some own notes and conclusions about it.

Choosing a shared service locations

When investor companies are looking for a location for their shared service center, it is an important question why companies invest in Hungary. They analyze the tax system, labor costs, labor skills, infrastructure, level of bureaucracy, state of the business culture and standard of living. In establishing a shared service center the most important decision factors are cost optimization options, the available modern 'A' category office space, foreign language proficiency, skilled workforce and the infrastructural, cultural and economic environment.

The availability of suitable workforce covers the state of development of the service sector, the geographical distribution of workforce, labor skills and language proficiency and risk of attrition. The characteristics of the business environment include the Foreign Direct Investment (FDI) ranking of the country, the development of infrastructure, culture and the level of protection of intellectual capital.



1. **Figure:** Top ranking destination countries by estimating jobs - per 100k habitants, Source: (Dencik & Spee, 2012)

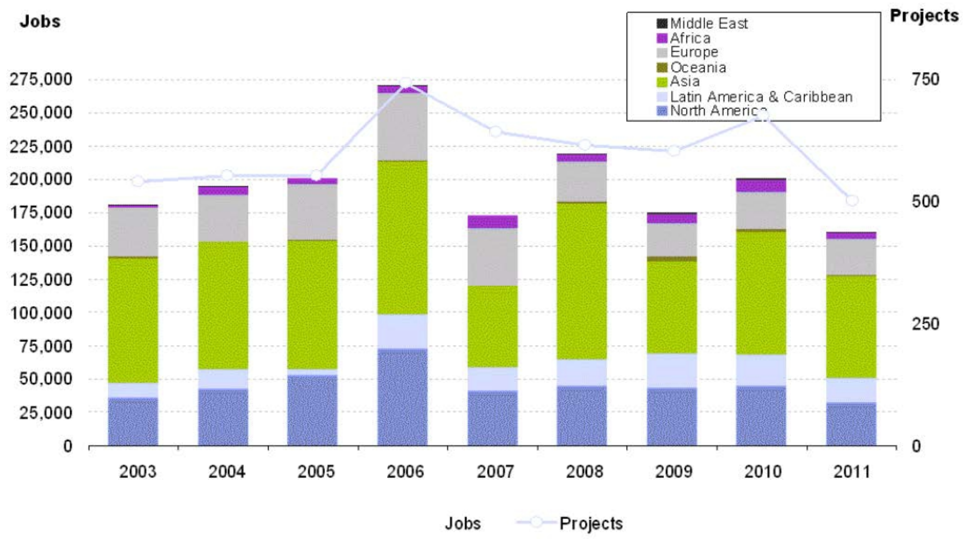
The main competitive advantage of Hungary is that the average salary level is below that in Western European countries. In addition, the low salary level is coupled with a high expertise level in this region and so the companies operating the shared service centers can employ a similarly skilled workforce at a much better price. Not only the salary level is lower but also the other associated costs (office space, training, etc.) are cheaper than in the West-European countries (Nagy, 2010).

Among the many aspects of analysis, all of my interviewees confirmed that the most important decision criterion for investors is the available suitable labor.

Position of cee region in the global service delivery market

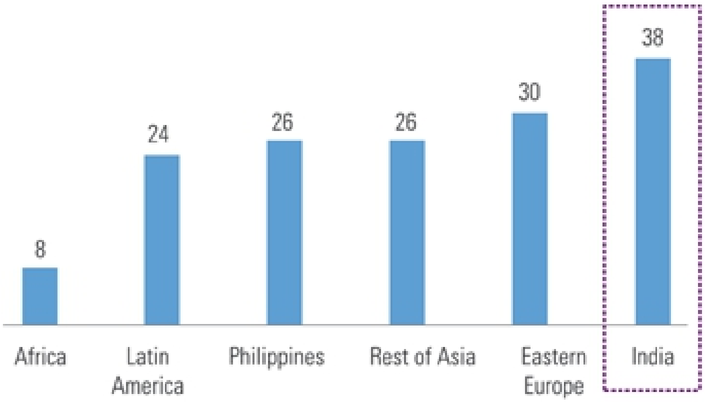
In 2008-2009 emerged global crisis had a very huge negative effect on the foreign direct investments and the global service delivery market as well. (Dencik & Spee, 2012) Albeit after 2009 the market got to normalize but according to the annual IBM market research, the recovery seems to be prolonged and the tendency is confused in short term. (Spee, 2013)

After upturn of 2010, the year of 2011 showed a downturn again and this year was the lowest since 2003. An interesting accompanying of this decreasing tendency is that proportion of domestic shared service centers is increased against of international investments. So Indian companies invested in India rather than in other countries. In 2011 one quarter of the total new SSC investment was this kind and almost 40% of new jobs. The main reason of it was that in the investment market the Asian countries (mainly India, China) had more and more significant role. And companies of these countries invested in new shared service establishment mostly at home.



2. Figure: General trends in Shared Service jobs by world region, Source: (Van Hove, 2011)

After 2010, in 2011 Europe got the third position after Asia and North-America in the absolute number of shared service projects. The leading position of Asia is unquestionable. Half of all new position is linked to this continent. North-America got 20% in creating new positions, Europe has a quite similar result but Latin America got only 10%. Middle East and North Africa got only marginal result because of its political changes and instability. (Van Hove, 2011)



3. Figure: New service delivery centers established, Source: (Parakala, et al., 2012)

Europe has a stable and well-balanced position in the global service delivery market. This position is stable because the number of new SSC jobs was not decreased and well-balanced because the European SSC jobs are divided half-by-half between West-Europe and Central-Eastern Europe. (Van Hove, 2011)

Shared service competition within cee region

There is a very high competition in the CEE region for attracting new Shared Service Centers. Within the regional competition the most important term of establishing shared service centers in Hungary was the early 2000's. Compared to the regional competitor countries the advantage of Hungary was not the foreign language skills – though it has rare European language speaking young workforce – but from the research of the EU public research agency, the Eurobarometer released its 2001 study, Hungary is quite weak in foreign language speaking.

The attraction was rather the good regional conditions, the close geographical lying to the West European countries and had almost unlimited amounts of skilled labor that cost was half than in the West but twice as much than in India. (Erdős, 2005) Since then the cost of labor is emerging year-by-year in the region. This closing up to the level of West-Europe's cost stimulates the leaders of service centers to improve their efficiency indices. (Thorniley, 2003)

Over the last decade rapid growth the business service industry and within the shared service sector outgrown itself and became one of the key segments of service industries and the major employer in the country. Today, there are more than 80 shared service centers in Hungary, that primarily employ foreign language speaking, educated workforce with about 40.000 employees. (Sütő, 2012)

The shared service centers provide a range of business services – most notably in finance, accounting, procurement, logistics, information technology and human resources area – mostly in regional and sometimes in globally. Besides this sector is a major employer, around 1.2% of state budget came from taxes on it in 2010.

The key question is that a parent company why chooses Hungary when looking for an investment location to establish a new service center. To win this competition Hungary has to prove that the society is cosmopolitan, capable of operating international level, young people speak several languages and well-educated. But there is a serious responsibility on government and the leaders of local government. If cities have close, well-equipped offices and public transport infrastructures then it could mean a high attraction. At such a decision about 40-50 countries compete on a list.

Several consulting firms make rankings that can help in choosing an investment location. Perhaps one of the most famous lists is the A.T. Kearney annually compiled Global Services Location Index (GSLI), that ranking the most favor 50 countries on the base of service sourcing. Three aspects took into account in the methodology of ranking: financial attraction of the county (40%), the availability of adequate human resources and training (30%), and the business environment (30%). The first ranking was in 2004 and since then the first three countries are India, China and Malaysia. Position of Hungary is continually changing but it was constantly in the first 40 countries. Unfortunately within Central and Eastern Europe Hungary is not too competitive.

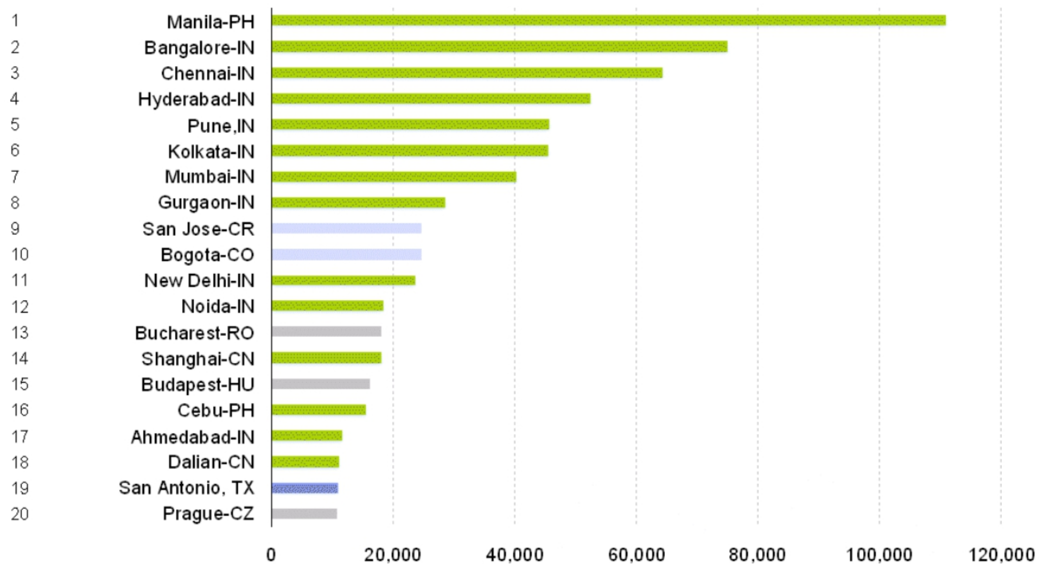
Unfortunately, in recent ten years Hungary has completely sidelined in the first 10-20 positions, as the same has happened with the Czech Republic, Poland and Slovakia. Although the business service sector has been growing during this term.

However the position of the Baltic countries (Latvia, Lithuania and Estonia) has significantly strengthened but the judgment of Romania and Bulgaria also improved a lot. So these countries are the he major competitors of Hungary now. It is true that more Asian countries overtook Hungary on the global service market but for example the world-leader India is not competitive because companies choose India for one purpose and Central and Eastern Europe for another. In India there are such services that are like to mass production and do not need special skills. On the global service market it contributes to the position-loosing of Central and Eastern European countries the fact that Middle-East and North-Africa has also appeared among the most popular locations. The reason of their uprising is based on the large and educated population and proximity of Europe.

Hungary's biggest competitive advantage is that labor cost is still lower than West-European. This has reinforced the fact that low labor costs are coupled with higher expertise and the investor company could get workforce similar to West-European but at lowest price. And not only the labor costs are lower but the other incremental costs (training, office, etc.) are also cheaper. (Nagy, 2010)

But the risk of continuous growth of labor costs is modulated by the fact that Central and Eastern Europe should not compete with the Far East. Those countries that contend in this competition only with their cheapness of workforce could not win in the long term. If countries want to stimulate investments, they have to aspire added-value creation because the educated, skilled, languages-speaking workforce is more valuable. So in the attraction and retention of service centers will be successful those countries that undertake not for low added-value, transactional work but focusing on more difficult, knowledge-based tasks. Reaching this country and regions have to invest in developing education and training.

If we see the ranking of global service delivery cities, there is very high advantage for Indian cities in the top ten but other Asian cities are also well-positioned in this ranking.



4. Figure: Top ranking SSC agglomerations by estimating jobs, Source: (Van Hove, 2011)

Among the European cities the first is Bucharest with its 13th rank, then the second is Budapest with its 15th rank and Prague is on the 20th rank.

Romania has very good position in the SSC cities ranking because besides Bucharest there is Cluj-Napoca also on the list. The two most promising countries were in Europe in 2011 Turkey and Serbia. (Van Hove, 2011)

Conclusion

As in every country in the Central-Eastern region, the development of the shared service sector plays an increasingly important role in the growth of the Hungarian economy as well. Between 2005 and 2010 this sector showed the largest growth, an annual 20% on the national level. In the CEE region and in Hungary the salary level, geographical proximity, cultural homogeneity and the development of infrastructure attract investor companies. Mostly ‘mass-production’, highly standardized business services requiring mainly secondary-school-educated labor has migrated to Hungary (NFM, 2010).

As a result of the last ten attractive years, today there are more than 80 shared service centers in Hungary and the vast majority of them are operating as subsidiaries of large international companies. Naturally the largest Hungarian companies (mainly regional multinational companies and state-owned companies) also have similar service centers, but their number is much lower than that of the subsidiaries of foreign investors.

Because of this sector has a great effect on the national economies in this region, it is sure that competition will continue among these countries to attract new investments and play important role in the global service delivery market. The Hungarian government has the duty to highlight the results, strengthen the efforts and support the sector.

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