

## Research on Development of China Sourcing in the Background of Service Industry International Transferring

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**Abstract** Service outsourcing has been taken as a new pattern for the service industry's international transition, which has the vital significance for the countries subcontracting outsourcing to alleviate employment problems, industrial structure's optimization as well as the transformation of the mode of economic development. First, this paper introduces the background of China sourcing development, and elaborates the development and characteristic of service outsourcing industry in China. Then, the paper analyses the major matters that have restricted the development of China sourcing from enterprise's contract ability, business environments such as national policies and others, talents and so on. This paper finds that development lag and small in scale of service industry, outsourcing enterprises being small in scale, contracting ability being lower level, the business environments relatively imperfect, and the shortage of the service outsourcing professional are the main difficulties to China. Finally, to the question and linking to the China's realities, some corresponding countermeasures have been proposed.

**Key words** Service industry's international transfer; Service outsourcing; Matters; Countermeasures

### 1 Introduction

In the 21st century, along with in-depth development of economic globalization, and further opening of service market in many countries, following the manufacturing industry of developed country massively transferring to the developing country in last century, the tide that the service industry of developed country represented by the US shift to the overseas is going to emerge rapidly. Service outsourcing has been taken as the new pattern for the service industry's international transition, which has the vital significance for the countries subcontracting outsourcing to alleviate employment questions, industrial structure's optimization as well as the trade growth way's transformation.

At present, the developing countries such as India, Ireland, and Philippines etc. are creating the condition, and are taking on the international service outsourcing positively. In the previous round global manufacturing industry's shift, China is the country that had got the biggest profits, and has become "the Industrial workshop of the world". Therefore, facing to the new round service industry's international shift, China must grasp the opportunity similarly, take action positively and undertake the service industry's international shift on own initiative, and develop the service outsourcing industry vigorously, depending upon which advances Chinese service industry to develop fast, adjust the industrial structure, make China develop from "Made in China" toward "Service in China", and realize the transformation of the mode of economic development.

Recently, the researches on the international transformation of service industries are increasing rapidly, which also come out lots of solutions for the domestic countries to develop their sourcing industries. Some papers studied on the employment effect of the international transformations, some conclusions made by the organization like MS (2009) showed that the transformation made a negative effect on the employment of the domestic industries. However, some other scholars found that the transformation made the employment no difference (Bhagwati et al., 2004; Mary Arti et al., 2004). (Jiang Zhimei 2006) analyzed the influence from the international service industries transformation in China, the results showed that it provided a new chance for China to develop its service industries. Wu Hang studied the developing strategy for China in the background of the international service diversion; it came to the conclusion that the international services diversion is not only an important means for developed countries to display the global strategy distribution but provides developing countries with newly - discovered economic growth points.

### 2 Development and Characteristics of China Sourcing

China is an emerging country for undertaking service outsourcing because of ChinaSourcing industry starting late, but in the recent years, ChinaSourcing's scale has expanded gradually, the

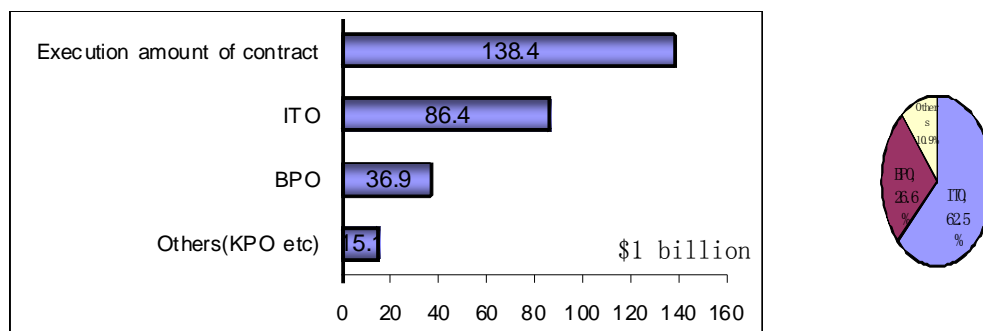
business domain has broadened and mainly involved the software industry, communication industry, financial industry, government service and so on, and its clients have involved Japanese, American, European, South Korean and others.

Core to ChinaSourcing initiative is the “1000-100-10” project, established by the PRC Ministry of Commerce in August 2006. Namely in the period of the 11th Five –Year Plan (2006-2010), with total funding of more than \$1 billion, the project aims to double China’s services exports by establishing 10 Chinese cities as outsourcing bases, attracting 100 international corporations to offshore services to these cities, and cultivating 1000 large and middle scale outsourcing firms that can meet the demands of international corporations. Since this project was announced, China has designated 21 cities as service outsourcing hubs. In a word, development of ChinaSourcing has made good progress and has presented the following characteristics.

**2.1 Service outsourcing market continuously vast growing, business largely for ITO**

The international finance crisis's influence, the orders from international market are dropped in 2009, but under supported by national policy and developing the domestic market, China’s service outsourcing still had maintained fast growth. In 2009, the total amount of signed contract of service outsourcing was \$20.01 billion, the execution amount was \$13.84 billion, growing 140.8% compared to those of last year, and off-shore outsourcing reached \$10.09 billion in total.

Looking from the structure of service outsourcing, ChinaSourcing business has largely for ITO all along, but the speed-up of BPO is fast and potential is huge, and others like KPO and so on have also appeared the clue. In the national total execution contract amount of service outsourcing in 2009, ITO occupied 62.5%, BPO occupied 26.6%, and others like KPO and so on accounted for 10.9% (Figure 1).



**Figure 1 Business Market Scale and Ratio of ChinaSourcing in 2009**

Data Source: the PRC Ministry of Commerce

**2.2 Off-shore outsourcing growing fast and coming from U.S. and Japan market mainly**

Although impacted by financial crisis, the off-shore outsourcing market in China had still realized fast growth in 2009. The annual contract signed amount of off-shore outsourcing was \$14.77 billion in 2009, growing 152.9% compared to last year, and the accomplished amount of contract was \$10.09 billion, growing 115.1% compared with last year.

**Table 1 Business Origin of China’s Off-shore Outsourcing (Unite:\$10 thousands, %)**

| No. | 2009 year       |                            |      | 2008 year       |                            |      |
|-----|-----------------|----------------------------|------|-----------------|----------------------------|------|
|     | Country/ Region | Contract value carried out | Rate | Country/ Region | Contract value carried out | Rate |
| 1   | America         | 281137.8                   | 27.9 | Japan           | 97158.3                    | 20.7 |
| 2   | Japan           | 206263.2                   | 20.4 | America         | 90934.5                    | 19.4 |
| 3   | China Hongkong  | 89893.4                    | 8.9  | China Hongkong  | 51292.2                    | 10.9 |
| 4   | Singapore       | 45356.7                    | 4.5  | China Taiwan    | 15404.4                    | 3.3  |
| 5   | China Taiwan    | 34371.1                    | 3.4  | England         | 14856.9                    | 3.2  |
| 6   | Netherlands     | 25887.1                    | 2.6  | Germany         | 14690.2                    | 3.1  |
| 7   | England         | 23588.2                    | 2.3  | Singapore       | 12982.5                    | 2.8  |
| 8   | Germany         | 22846.5                    | 2.3  | Korea           | 6819.1                     | 1.5  |
| 9   | India           | 19910.8                    | 2.0  | Netherlands     | 5750.5                     | 1.2  |
| 10  | Korea           | 19547.9                    | 2.0  | France          | 5136.2                     | 1.1  |

Date sources: <Development Report of ChinaSourcing>2008 year, 2009 year

In the segment market of off-shore outsourcing, ITO had still occupied the leadership and accounted for 63.9% in the execution of contract amount of 2009, and the proportion of BPO and others (KPO etc) respectively were 24.8% and 12.3%. Moreover, the off-shore business markets centralization was obvious, mainly coming from the markets of America, Japan and China Hong Kong. The total execution contract amount of these three regions occupied 57.2% in off-shore outsourcing's total amount in 2009, raised 6.2 percentage points compared to 2008 (Table 1).

### **2.3 Jobholders for service outsourcing growing rapidly and becoming the important channel for employing the university students**

With the development of service outsourcing industry in China, jobholders for service outsourcing have grown explosively in scale. Jobholders who are engaged in service outsourcing starting from 2009 had 711,000 persons, and total numbers of employees have reached 1.547 million peoples by the end of 2009. These jobholders have mainly concentrated in 20 demonstration cities of ChinaSourcing and achieved 1.198 million workers, accounting for 77.4% in total.

The university graduates (including technical college) reached 490 thousand persons in newly increased jobholders in 2009, occupied 68.9%. Besides, according to be investigated 7752 outsourcing enterprises, the total numbers of employees reached 1.387 million, the university graduates had 1072 thousand in total and accounted for 77.3%. Thus it can be seen, the service outsourcing industry has been becoming the important channel for employing the university students (Table 2).

**Table 2 State of Employees and Enterprises of China Sourcing**

|                                    | By the end of 2007 | By the end of 2008 | By the end of 2009 |
|------------------------------------|--------------------|--------------------|--------------------|
| Employees (10 <sup>4</sup> person) | 42.7               | 83.6               | 154.7              |
| Outsourcing enterprises            | 1731               | 4775               | 8950               |
| Enterprise certification           | /                  | 2338               | 4608               |
| Among: International certification | /                  | 898                | 1745               |

Date sources: the PRC Ministry of Commerce

### **2.4 Service outsourcing enterprises increasing rapidly, overall competitiveness obvious promotion**

Outsourcing enterprises that have been established in 2009 reached 4175, qualifications and certifications have been awarded in 2009 reached 2270 and the international certifications had 847 in total. By the end of 2009, the total numbers of service outsourcing firms had reached 8950 in China, growing 87.4% compared to the same period in last year. All kinds of certifications had achieved 4608, and in all the international certifications had achieved 1745, growing 94.3% compared with last year. Moreover, looking from the regional distribution, these enterprises had been mainly distributed in Jiangsu, Liaoning, Zhejiang, Beijing and Shanghai five provinces or cities and accounted for 62.6%.

## **3 Major Problems in Restraining Development of China Sourcing**

On the whole, ChinaSourcing has made better progress, but also China has some advantages to undertaking the international transfer of service industry through developing service outsourcing, Mainly manifested such as stability in the social and political, continue to improved investment environment, abundant labor resources and large market potential and so on. But compared with foreign countries, China's services outsourcing industry started late, the overall size is still small, the international competitiveness is weak, at present China has been still existed many factors that block up undertaking service outsourcing.

### **3.1 Development lag and small in scale of service industry**

Although recently China has made fast progress in service industry, the overall backward development is untouched. Mainly manifested in some aspects: overall scale is small, employment rate is low, structure is irrational and institutional innovation is lag behind. In 2009, Value-added of service industry sector occupied 42.6% in the national GDP, service employment proportion was approximately 40.0%, Service sectors mainly make up of traditional services like transportation, tourism and catering service etc, modern service industries have been in the low developing level such as modern logistics, finance, insurance and so on. While the developed countries like America England and Japan not only rate of value-add of service in the national GDP, but also service employment proportion have been more than 70%, the developing countries also average level above 50%.

### **3.2 Outsourcing enterprises being small in scale, contracting ability being lower level**

In 2009, scale enterprises employing more than 1000 peoples are 219 and account for 2.45% in overall 8950 service outsourcing enterprises; Forms that Annual execution amount of contract is above \$10 million of service outsourcing are only 299, account for 3.34%; Enterprises that have obtained the

authentication related to service outsourcing are 2734, account for 30.55%, among which owning the international authentication of CMM5/CMMI5 are 104, just account for 1.16%. The service outsourcing enterprises average jobholders 173 peoples, the average carried out amount of contract is \$ 9 thousand/per person<sup>①</sup>

In addition, according to investigates came from Mckinsey & Company, IT Service companies which rank the first ten in China occupied 20% in the international market scale, but the market share occupied by the Indian's first ten big IT service companies reached as high as 45%<sup>②</sup>. Thus it can be seen, China's service outsourcing number of enterprises established increases rapidly, but the small and medium-sized enterprise majority, contract ability is weak. Thus it can be seen, China's service outsourcing enterprises have increased rapidly in quantity, but the medium and small enterprises are majority, which contract ability is weaker.

### 3.3 The business environment's relatively imperfect

Although in order to impel the development of service outsourcing industry, the Chinese government has promulgated one after another <Betritt Concerning Promotion to Development of Service Outsourcing Industry> (Letter of the PRC State Council [2009] No.9), <Inform Concerning Related Tax Policy about Technical Advanced Service Enterprise> (Finance and Taxation [2009] No.63) and so on many preferential policies or measures. But the threshold that enters these support policies is high, the requisition procedure is complex and the review period is long, therefore which created the coverage of enjoying encourages policy to be small, the pull force is insufficient. In 2009, the enterprises that enjoyed the favorable tax policy only to account for 5%, and that enjoyed the central level funds to support the university students to get employed account for 10%.

At the same time, China's legal safeguard system is imperfect, particularly intellectual property rights (IPR) protection's legislation is insufficiencies, which close related with the service outsourcing involving data security, patent protection, customer information security, technical privacy protection and so on. While the IPR protection and the information security management are one of significant basis to the foreign client to choose the service vendor. Therefore the IPR protection directly relate competitive power of that China's Enterprise undertake off-shore outsourcing.

In addition, the funding that government department invested to the related construction of public service platform, promoting outsourcing investment etc are insufficiency. All sorts of imperfect business environment have affected the development of ChinaSourcing industry greatly.

### 3.4 Shortage of the service outsourcing professional

Although the human resources are rich, who have obtained the education of over Chinese junior college, the professionals who are engaged in the service outsourcing are deficient. Concrete shown in: Lack of the practical talented persons who can communicate in foreign language fluently; Lack of medium and high-level project managers who can consult business with foreigners, and can carry out the projects; The service enterprise are lacking of talented peoples, particularly the medium and high-level management.

Recently Mckinsey & Co.'s research pointed out that China will be short of 340,000 qualified personnel in off-shore outsourcing in the next 5 years. Therefore, it is the key to win the competitive advantage to China that will train and supply the practical persons who own professional skill, project management competence and foreign language ability.

## 4 Conclusion

### 4.1 Vigorously development of service industry

Development of service outsourcing industry takes service industry's development as foundation; therefore China should make significant efforts to develop service industry. For example, Relying on formulating the industry guidance policy, speeds up the development of emerging service industries such as finance, insurance, communication, legal consultation and so on; Further opening the service market, positively attracting FDI of service industry, depend on which impels the upgrading of Chinese service industry and promotion of it's serviceability. These actions both can promote the development of Chinese service industry, and contribute to enhance the competitive advantage on undertake the international service outsourcing to China, which can promote development of service outsourcing in

<sup>①</sup>Reference source: the PRC Ministry of Commerce

<sup>②</sup>The Economic Observer, 7.9. 2007

these professions.

#### **4.2 Further consummation related policies and regulations**

Profiting from India's experiences, China should adjust related policies and increase the force of policy support. Can do the following works: ①Increasing the finance and taxation support, causes the enterprises to enjoy more preferential benefits. For instance, besides a tax reduction may provide financing support like establishing special funds, offering loans and credit support and so on. ②Lowering admittance criteria of preferential policies, let more enterprises enjoy favorable policies. For example, China should relax the cognizance conditions for technical advanced outsourcing enterprises. Some policies should maybe turn to on-shore outsourcing form supporting off-shore sourcing only, etc. ③Enhancing government's service consciousness, simplifying approval link, promote the working efficiency.

Meanwhile, to promote off-shore outsourcing's development, China should impel the IPR legislation for copyright and patent protection, commercial secret and customer data secrecy and so on, and strengthen protection of the IPR and information security, depend on which eliminates the overseas client's worry. In addition, the government department should build the public service support platform of outsourcing public technology, professional training, publicity and promotion etc with increasing the funding invested.

#### **4.3 Cultivating outsourcing scale firms, pushing enterprise cluster's forming and promoting the firms ability for undertaking sourcing**

Developing and strengthening scale firms, is the key to promote the international competitiveness, and exploit the international market of service outsourcing. First, encourages outsourcing firms to expand scale by annexation, purchase, strategic cooperation or alliance, by which promotes own services ability and management level, and sharpens contract ability of outsourcing business. Next, push the outsourcing firms having owned a certain scale to gather and form industrial cluster, obtain the international certification, makes the ChinaSourcing brand, relying on which sharpen the firm's competitive ability.

#### **4.4 Strengthening introduction and cultivation of the outsourcing talents**

China must strengthen introduction and cultivation of talents according to demands of outsourcing industry's development, in order to solve the "bottleneck" question created because of insufficient professional. Firstly, bring in the talents who has possessed the experience having been engaged in the service outsourcing, and has very known the international outsourcing market from home and abroad, particularly the specialized technical talents who can discuss business directly with the oversea customers in foreign language fluency, and medium or high management talents who can carry out the projects. Secondly, raise practical talents who have owned certain foreign language ability for communication and the professional skill for operation depend on the regional universities. Thirdly, strengthen the university-business cooperation, develop the talent training with "the order form" type, and cultivate the talents demanded actually by enterprises.

#### **4.5 Give play to demonstration and lead role of demonstration city**

By the end of 2009, total numbers of the service outsourcing enterprises have reached 7013 in the 20 outsourcing demonstration cities in China, accounts for the 78.4% in total, which has shown that the demonstration effect is obvious. From now on, China will should be continue to implement "1000-100-10" project positively, will increase the support to 21 demonstration cities, advocate differentiation and specialized development strategy, will speed up construction of centralization of service outsourcing that suits the region's characteristics, will attract more business of service outsourcing diligently and lead development of the service outsourcing industry in other districts.

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