
WHAT IS THE FUTURE FOR OFFSHORING?



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future [inc] FOREWORD

A PLAN FOR AUSTRALIA • NEW ZEALAND'S PROSPERITY

Globalisation, the age of technology and increasing pressure to reduce costs have given rise to outsourcing and offshoring. Offshoring is a strategic tool used by organisations to reconfigure their activities across geographic locations – the focus and trend has traditionally been on information technology and manufacturing, however it is now a common strategy for many organisations in the services sector.

This growth in the offshoring of services from Australia and New Zealand is a consequence of the increased tradability of services, arising from trade liberalisation and rapid technological developments. However, many offshoring models are now maturing and moving away from a focus on pure cost savings to recognise other benefits such as increased efficiency and flexibility and access to a more diverse range of skills.

Our nations face productivity challenges in the future as our

economies shift to an increased dominance from the services sector. At the same time, the services industry itself will face further disruption from increased automation and growing Asian economic development.

This **future**[inc] research explores the role offshoring can play in the economic future of our nations and where the opportunities for organisations may lie. The way we work is becoming ever more geographically dispersed and with the march of technology, offshoring could be the new way of doing business globally.

Join the conversation.



Lee White FCA

CEO, Chartered Accountants Australia and New Zealand



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GLOBALIZATION HAS CHANGED US into a company that searches the world, not just to sell or to source, but to find intellectual capital – **THE WORLD'S BEST TALENTS AND GREATEST IDEAS.**"

JACK WELCH
FORMER CEO OF GENERAL ELECTRIC

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EXECUTIVE SUMMARY

Offshoring has become a common strategy for many organisations in the services sector as a consequence of the increased tradability of services, arising from trade liberalisation and rapid technological developments.

Traditionally associated with manufacturing, the subject of offshoring tends to attract a lot of discussion. With the services industry rapidly increasing in importance, there is much debate as to what growth in offshoring services might mean for the economic future of Australia and New Zealand.

With the demographic tide turning, and the likelihood that the boom days for mineral and rural commodity prices are behind us, Australia and New Zealand will have some challenges in maintaining growth in living standards over time. Sharp improvements in productivity gains are needed. Maximising

the value-add of the existing workforce is an important element, and this paper explores how offshoring can play a role in this.

As a concept, offshoring may encounter some resistance, with cries that the practice is akin to “exporting jobs”, and that barriers should be put in place to prevent it. Such arguments ignore the many benefits offshoring can bring, which can enhance organisational capability and allow organisations to expand operations elsewhere – the essence of “comparative advantage” that trade within an economy and between economies is based upon. Artificially restricting offshoring would essentially be protectionism. From a policy perspective, barriers to offshoring should remain low so that organisations can seek to operate as efficiently as possible, helping to lift productivity across the broader economy.

But that does not necessarily mean offshoring is the best decision for every organisation. Far from it. Whether offshoring is an appropriate solution for an individual organisation is a complex decision.

This paper seeks to explore the future of offshoring for Australia and New Zealand and what it means for organisations and government. It discusses the costs, benefits, risks and opportunities of offshoring business services from Australia and New Zealand. The findings are based on analysis of trade data, a review of existing studies on offshoring, and consultation with a range of stakeholders, including selected services organisations from Australia and New Zealand that have offshoring experience.

THE CHANGING LANDSCAPE: OFFSHORING IN SERVICES TODAY

Offshoring has undergone a significant transformation in recent years. It has become a common part of many services organisations across the world, particularly in business services such as professional services (legal, accounting and management consulting), technical services (architecture and engineering) and computer services.

After a slow-down in offshoring activity following the Global Financial Crisis, services organisations across the world are moving more of their business functions overseas. In Australia and New Zealand this can be seen in the growth in business services imports in recent years. Australia now imports around A\$14 billion in business services per annum, while New Zealand imports around NZ\$4 billion. Although the United States and Australia remain the main offshore providers for Australia and New Zealand respectively, imports from Asian countries such as India, Singapore and China have seen significant growth in recent years, as organisations are moving a greater share of their operations offshore. It is this rapid growth in offshoring to Asia that has gained a lot of attention recently.

But it is not all one-way traffic. Both Australia and New Zealand are also sizeable offshore providers of business services themselves. Australia now exports around A\$11 billion in business services (mostly to the US, Singapore, the UK and New Zealand), while New Zealand exports NZ\$2.5 billion (mostly to the US, Australia and the EU). Growth in the export of services represents a significant opportunity for both nations.

MEGATRENDS: THE FACTORS DETERMINING THE FUTURE FOR OFFSHORING

Four key drivers of change have enabled a greater rate of offshoring and are expected to affect, and in some cases significantly disrupt, the future of services offshoring in Australia and New Zealand.

- **Globalisation:** Reduction of trade barriers, the Trans-Pacific Partnership and recent free trade agreements with Asia have enabled freer movement of business, investment, labour and resources between Australia/New Zealand and other countries, making it easier to offshore services in both directions. Globalisation has also increased competitive pressures, motivating organisations to reduce costs and increase growth through offshoring.
- **Technological advancements:** Rapid advancements in technology have made services offshoring a viable and cost-effective business strategy for many organisations. In this connected world, any work that can be done on computers can be done anywhere in the world.¹ Greater adoption of technology such as enterprise mobility, big data, virtual desktops and cloud computing may drive increased offshoring in the future.
- **Asian economic development:** Rapid development in Asia has increased skill levels and professionalism in more mature offshoring markets. With higher skills come higher wages, and movement along the value chain into more complex business process outsourcing (BPO) and IT offerings.

At the same time, more recent entrants to the business services offshoring market position themselves as low-cost locations for lower-value work.

- **Domestic skills shortages and a global labour market:** Offshoring is not simply a question of cost cutting, and other motivations are becoming increasingly important, for example, having access to skilled employees in areas where onshore competition makes talent scarce. The concept of offshoring itself is also changing, as – due to technological advancements – labour is no longer tethered to fixed capital. Tasks can now be easily outsourced to offshore freelancers, or even automated via the cloud.

THE KEY ISSUES DETERMINING OFFSHORING SUCCESS IN THE FUTURE

Recognising the increasing importance of offshoring in services, a number of key issues will help to determine offshoring success for organisations in the future, particularly as offshored functions become more complex.

- **Recognising the diverse range of benefits:** The benefits from offshoring continue to move away from pure cost savings. Offshoring can enable organisations to operate more effectively and flexibly. Future benefits include access to a more diverse range of skills, movement to higher value-add work onshore, and onshore employee retention.
- **Preparing and getting buy-in:** As offshored functions are quickly becoming a more significant part of day-to-day operations in many organisations, long-term commitment and buy-in are critical for success. While a broader and more mature range of offshoring options and technological advancements will make offshoring easier, good preparation, a clear strategy, and continuous review and recalibration will be even more important in the future. Success is not guaranteed.
- **Dealing with risks and challenges:** Traditional risks and challenges to offshoring have included regulatory concerns and cultural differences. However, new issues are emerging that will need addressing in the future, such as how to retain offshore employees in an increasingly competitive environment and how to deal with offshoring more complex tasks.
- **Finding the right offshoring model:** Offshoring strategies are numerous and varied, with each presenting its own set of advantages and challenges. Organisations should understand that there is no “silver bullet” – the most appropriate offshoring model will be unique to an organisation’s current and future needs and the environment it operates in. While some organisations will continue to move towards an outsourcing model as they become more experienced in offshoring, others may back away from such a model, instead reincorporating newly captive functions to be part of their core business.
- **Finding the right location:** With an increasing range of potential offshoring locations to choose from, organisations will find it easier to diversify their offshoring networks and tap into a broad range of capabilities and skills across geographies in the future. It is critical to understand the various types of future benefits that different locations can provide.
- **Planning for the future:** Offshoring as a business proposition is undergoing rapid change, and many organisations are unsure what the services sector will look like in ten years – making planning for the future challenging. At the same time, new technology trends such as automation will disrupt the offshoring model itself.

CONCLUSION

While it was traditionally about cost cutting in distinct back-office functions, offshoring has become far more complex and its use continues to evolve. Many offshored functions are becoming fully integrated into an organisation's operating model and thus have impacts that extend well beyond the services traded. As a result, offshoring is likely to have an increasingly significant impact on Australian and New Zealand services organisations in the future. But more than that, it can also have an impact on the economic future of Australia and New Zealand.

Offshoring in services can play a key role in addressing future productivity challenges by enabling organisations to operate more efficiently, maximising the value-add of the existing workforce and assisting organisations to be internationally competitive. Although offshoring is already widespread in the services sector, there are areas for expansion as organisations consider more complex functions as part of the offshoring decision.

Further, globalisation and the increase in free trade agreements have enabled Australian and New Zealand services organisations to access new markets. This in turn has created significant opportunities for growth in services exports. We may now see an increasing trend where organisations offshore lower-value services or even automate them, to instead specialise in being the offshore providers of higher-value services to other countries.

The education sector will also need to work closely with organisations to ensure future graduates are leaving with the skillsets and knowledge to perform these higher-value services that the workplace is now expecting.

As the importance of the services sector continues to increase in both Australia and New Zealand, productivity growth – generally and specifically in services – will become the key factor determining the rate at which living standards can be improved over time.

INTRODUCTION

In 2014, we released *Risk-wise and a fair go? A plan for Australia's continued prosperity* in our **future[inc]** thought leadership series. This publication considered how Australia should address the trends and challenges that its economy is likely to face over the next 10 to 15 years and how to best plan for the future.

One issue, which generated significant interest, was whether Australia was making a fundamental mistake in offshoring work. While traditionally associated with manufacturing, offshoring has become a common strategy for many services organisations as a consequence of increased tradability of services, arising from trade liberalisation and rapid technological developments.²

This comes at a time when the services sector is rapidly increasing in importance in both the Australian and New Zealand economies. The services sector accounts for around 60% of Australia's output, and around 70% in New Zealand. Hence, there is much debate as to what offshoring in services might mean for the economic future of both nations.

OFFSHORING HAS BECOME A COMMON STRATEGY for many services organisations at a time when the services sector is rapidly increasing in importance **IN AUSTRALIA AND NEW ZEALAND.**

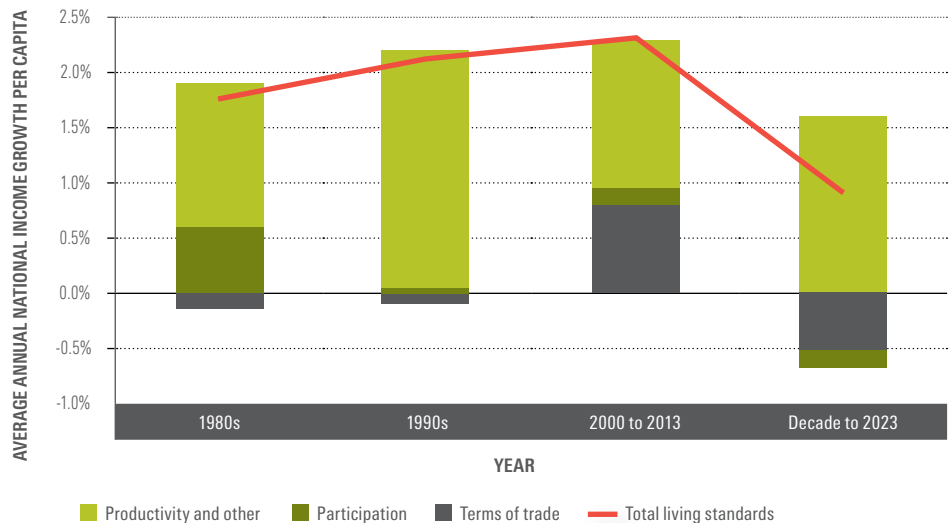
With the demographic tide turning, and the likelihood that the boom days for mineral and rural commodity prices are behind us, Australia and New Zealand will have some challenges in maintaining growth in living standards in the future. As chart 1 highlights, productivity growth in Australia has slowed considerably since the 1990s. However, it will be essential for maintaining growth in national income per capita in the coming years, as participation rates fall due to an ageing population, and as commodity prices decline from their peaks.

As participation rates fall due to an ageing population, and commodity prices decline from their peaks, **AUSTRALIA AND NEW ZEALAND NEED TO FIND NEW WAYS TO BOOST PRODUCTIVITY IN SERVICES.** Offshoring can play a key role in this.

Sharp improvements in productivity gains are essential in order to maintain Australia's living standards. To maintain the current growth in living standards, Australia's productivity growth would have to double. While the New Zealand economy is currently faring better than Australia, it too faces its own productivity challenges. Economy-wide productivity growth in New Zealand has been lower than in most other OECD countries for the last 15 years, and labour productivity is now significantly behind the OECD average.³

Hence, both Australia and New Zealand need to find new ways to boost productivity – generally, but also specifically in the services industry, which has become such a dominant sector in both countries. This can come from a variety of sources, including technology and deregulation. Maximising the value-add of employees is another important element, and this paper explores how offshoring can play a role in this.

CHART 1: COMPONENT CONTRIBUTIONS TO GROWTH IN NATIONAL INCOME PER CAPITA, AUSTRALIA⁴



Offshoring refers to the relocation of a business function from a domestic location to an overseas location, resulting in the import of business services such as “back-office operations”. In the broadest sense of the concept, any imported business service can be considered offshoring, even if the provision of the service never previously took place onshore. Offshoring is not restricted to large companies, but may also be undertaken by small to medium-sized enterprises, not-for-profit organisations and the public sector.

There are a number of business models for the delivery of offshore services, depending on the level of control an organisation wants to retain. They include:

- **captive offshoring** – where a business function is moved overseas but remains part of the organisation
- **joint venture model** – where organisations form joint ventures with overseas service providers and transfer their functions into the new entity
- **offshore outsourcing** (or specialist multi-vendor model) – which involves the use of a third party, such as a specialist service provider, which may provide offshore services for one or many organisations.

For the purpose of this paper, Australia and New Zealand are jointly treated as a domestic market; hence relocation from Australia to New Zealand or vice versa is not considered offshoring, and is not discussed in detail – even though there are a number of examples of organisations moving business functions between the two countries.

As an economic concept, offshoring can make a lot of sense: organisations concentrate on what they do best and trade the resultant surpluses with other organisations and/or nations who are relatively better at other things. Such trade can boost prosperity and make both sides of the deal better off. Offshoring becomes simply a story around “trade in services”. Both captive offshoring and offshore outsourcing involve international trade in services, although trade by foreign affiliates is typically not reported in official trade statistics. Analysis of import statistics can tell much of the story, but not all.

While it was traditionally about cost cutting of distinct back-office functions, offshoring has become far more complex. Many offshored functions are now fully integrated into an organisation’s operating model and thus have impacts that extend well beyond the services traded. However, given the investment and commitment required to make offshoring work, it is not necessarily a winning strategy in all cases.

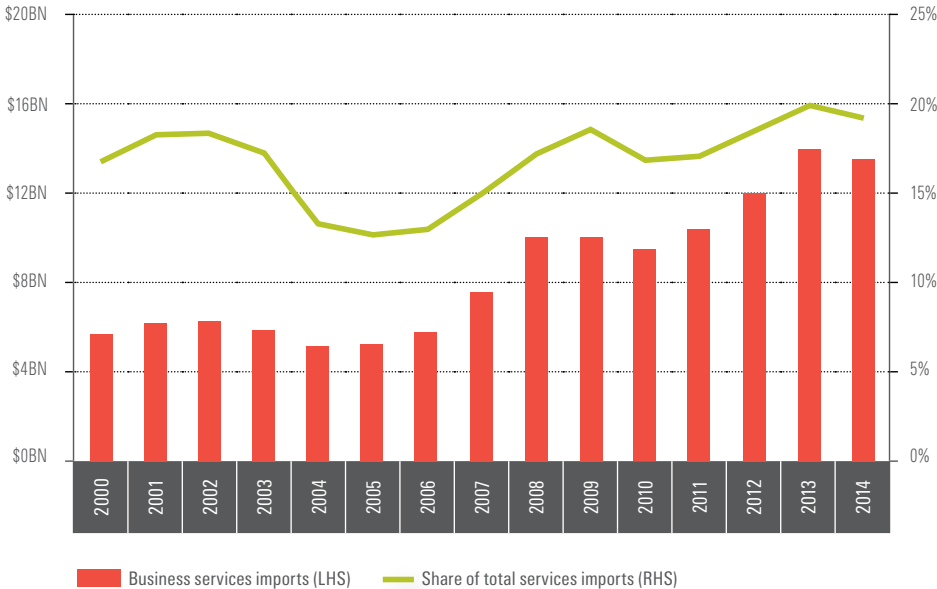
THE CHANGING LANDSCAPE: OFFSHORING IN SERVICES TODAY

Offshoring has undergone a significant transformation in recent years. It has become a common part of many services organisations around the world, particularly in business services such as professional, technical and computer services. After a slow-down in offshoring activity following the Global Financial Crisis, services organisations across the world are moving more of their business functions overseas.⁵ In Australia and New Zealand this can be seen in the growth in business services imports in recent years. The focus is on optimising vendor relationships, improving operational flexibility and diversifying the range of functional offerings based offshore. Internationally, organisations are seeking to expand their geographic footprint from mature markets to new locations.

OFFSHORING SERVICES FROM AUSTRALIA

Services have accounted for a growing share of Australia's economy over the past 30 years, rising from 54% to 61% of total GDP, based on technological advancements and changes in consumer preferences. In 2014, the services sector had an output of around A\$820 billion. Growth has been particularly rapid in the finance, information technology and professional services components. Many organisations within these growth areas are providers and/or purchasers of business services.

To ensure that the analysis remains relevant to the offshoring of business-related functions, we focus on two key types of services imports, which are most likely to be associated with

CHART 2: BUSINESS SERVICES IMPORTS TO AUSTRALIA, 2000 TO 2014⁶

offshoring: telecommunications, computer and information services, and other business services. Imports of these business services came to almost A\$14 billion in 2014, representing around 20% of total services imports to Australia. The dollar value of business services imports has increased significantly over the past decade, with an average annual growth rate of 10% between 2004 and 2014.

The majority of business services imports to Australia are made up of three key areas, which together represent around 70% of total business services imports.

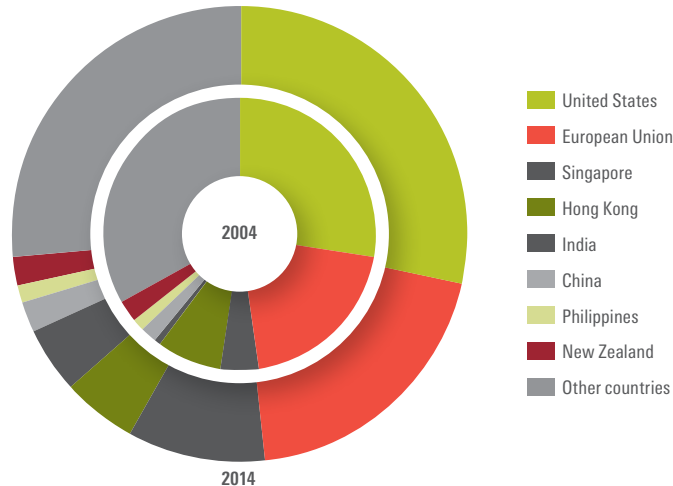
- **Professional services**, including legal, accounting, management consulting and public relations (A\$4.4 billion of imports in 2014), grew at an annual rate of 13% between 2000 and 2014,⁹ as business services firms moved back-office jobs offshore.⁷
- **Architectural, engineering and other technical services** (A\$3.0 billion), which grew at an annual rate of 20% between

2000 and 2014, with many engineering firms moving parts of their design and drafting work overseas⁸ due to the high proportion of design practice costs represented by labour (around 40%).⁹

- **Computer services** (A\$2.1 billion), primarily hardware- and software-related services, grew at an annual rate of 8% between 2000 and 2014. The sector has grown strongly since 2012 as more organisations chose to offshore IT functions.¹⁰

The single largest source of business services imports to Australia is still the United States, from which almost A\$4 billion (30%) of imports originated in 2014. However, growth in business services imports has been fastest across Asian countries such as India and Singapore, and it is this rapid growth that has affected public opinion of key offshoring locations. The rapid growth in business services imports to Australia from Asia has primarily been concentrated in the professional and technical services sectors outlined above.

⁶ Excludes advertising and market research services

CHART 3: SOURCES OF BUSINESS SERVICES IMPORTS TO AUSTRALIA, 2004 AND 2014¹¹

While imports of business services to Australia have grown in recent years, the domestic services sector has continued to see employment and wages growth. Wages across the IT, finance and professional services industries have grown at around 3% per year over the past five years, in line with the economy-wide average,¹² while employment in these industries has generally remained stable or increased.¹³ This suggests that the offshoring of business services has not had a substantially adverse effect on jobs and growth in the domestic services sector. Potentially, the offshoring of business services is allowing employees to move towards higher-skilled or greater value-adding roles within the industry.

OFFSHORING SERVICES PROVIDED BY AUSTRALIA

In addition, Australia also has sizeable exports of business services to other countries, which have grown at around 5% per annum since 2000 to reach A\$11 billion in 2014. This is where Australia is the offshore provider, exporting services to other countries. Growth has been particularly strong in computer and information services as well as professional and management consulting services exports. The largest destinations for Australian exports are the United States, Singapore, United Kingdom and New Zealand. The increased imports of business services may be one factor that is actually enabling the growth in business services through comparative

Continued growth in wages and employment in business services suggests that **OFFSHORING HAS NOT HAD A SUBSTANTIALLY ADVERSE EFFECT** on jobs and growth in the domestic services sector.

advantage – for example, Australian organisations can offshore lower-value services and specialise in higher-value services that can then be exported to other countries.

OFFSHORING SERVICES FROM NEW ZEALAND

New Zealand imported around NZ\$16 billion (approximately A\$14 billion) of services in the year to March 2015. Relative to GDP, services imports form a more significant part of the New Zealand economy than that of Australia.

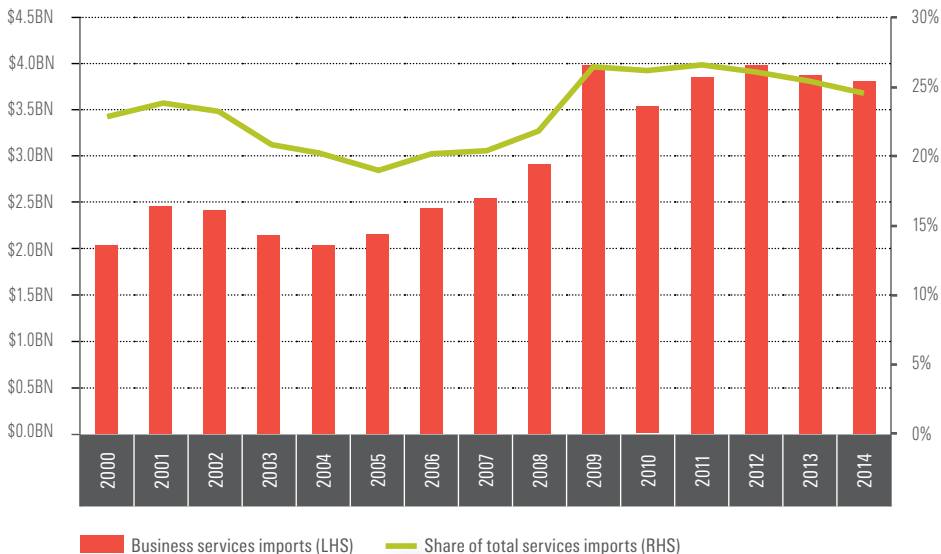
Imports of business services were valued at just over NZ\$4 billion in the year to March 2015, representing around 25% of all services imports. Offshoring business services peaked as a share of total services imports in 2009, before experiencing a significant decline in dollar value. Although business services imports appear to have plateaued of late, growth over the past decade has been strong, with an annual average growth rate of 6.4%.

The offshoring market, like in Australia, is led by professional services (including legal, accounting, consulting, public relations), with four sectors representing over 50% of total business services imports:

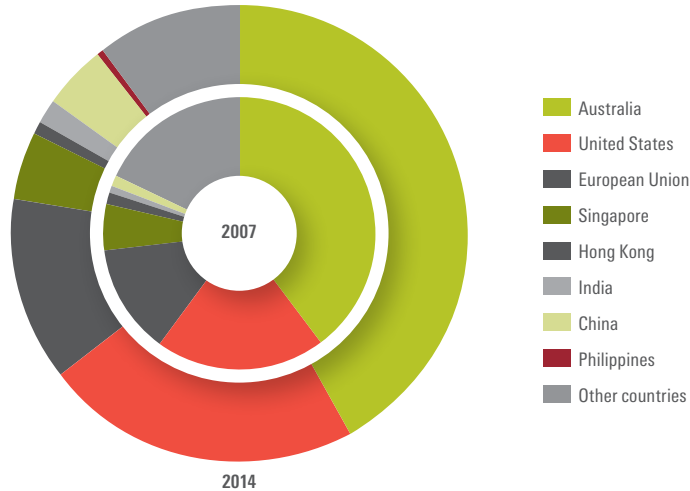
- **professional services** – NZ\$713 million, 18% of business services imports in 2014
- **computer services** – NZ\$626 million, 16%
- **operating lease services^b** – NZ\$401 million, 10%
- **architectural, engineering, scientific and technical services** – NZ\$337 million, 8%.

Australia is the largest source of business services imports to New Zealand, and offers not only a much larger pool of skilled labour from which to draw, but also geographic and cultural proximity to New Zealand. These latter points are particularly important as cultural, linguistic and time zone barriers can greatly reduce the value and efficiency of offshore services.

CHART 4 : BUSINESS SERVICES IMPORTS TO NEW ZEALAND, 2000 TO 2014 (YEAR TO MARCH)¹⁴



^b Operating leasing services consist of renting out produced assets under agreement to provide the use of a tangible asset to the lessee. According to the official statistical bureau, operational leases in New Zealand are usually for aircraft and oil rigs.

CHART 5: SOURCES OF BUSINESS SERVICES IMPORTS TO NEW ZEALAND, 2007 AND 2014¹⁵

Since 2012, business services imports from Australia have declined, while those from the United States have grown consistently over this period. Countries that provide fewer services to New Zealand tend to have more erratic import figures, particularly those in Asia, though business services imports from China have increased by more than 25% in the past five years and now represent more than 4% of all offshored services.

The prominence of Australia and the United States is perhaps unsurprising, as, contrary to popular belief, offshoring is not simply a question of cost reduction, and organisations are progressively moving away from an attitude of “cheaper is better”. This reflects quality concerns and a growing understanding that cost savings can be negated by language and cultural barriers.

OFFSHORING SERVICES PROVIDED BY NEW ZEALAND

New Zealand is also a significant services exporter, being an offshore provider of services to other countries. In 2014, business services exports were valued at more than NZ\$2.4 billion, growing approximately 5.4% per annum since 2000. While growth in ICT services exports has been modest, research and development services exports grew almost 8% per annum between 2000 and 2014, and technical and trade-related services grew at almost 10% per annum. New Zealand’s primary business services export destinations are the United States, Australia and the European Union, though Singapore and Japan also represented important segments of the export market in 2014.

MEGATRENDS: THE FACTORS DETERMINING THE FUTURE FOR OFFSHORING

Offshoring as a concept has already undergone a significant transformation, which will continue in the future. To analyse how offshoring in services might evolve over time, we look at four megatrends that have already had an impact on offshoring and will affect, and in some cases significantly disrupt, it in the future:

- **globalisation**
- **technology**
- **economic development in Asia**
- **domestic skill shortages and a global labour market.**

These megatrends are considered the most important drivers of change over the next 10 to 15 years and are likely to affect Australia and New Zealand alike. They are also interrelated – for example, technology has enabled an increasingly global market for labour.

GLOBALISATION

Globalisation represents the integration of markets and economies around the world, and the progressive reduction or removal of barriers to allow business, trade, investment, labour and other resources to move more freely across national borders. Globalisation is not a new trend, with various waves of globalisation having taken place in preceding centuries with the emergence of international trade and capital markets.

In recent decades, globalisation has accelerated, with an increase in free trade agreements (FTAs) and regional integration.¹⁵ For example, in the last year Australia has entered into FTAs with China, Korea and Japan, and is currently negotiating FTAs with a number of other countries, including India and Indonesia. New Zealand also has a number of FTAs that have come into force

over recent years, including with Taiwan, Hong Kong, Malaysia and Singapore.

The establishment of the **Trans-Pacific Partnership (TPP)** is another significant development. The TPP covers Australia, New Zealand and ten other Pacific nations including the United States and Japan – collectively 40% of global GDP – making it the world’s largest regional free trade agreement. The agreement will open up **export opportunities for Australia’s and New Zealand’s service sectors**. This includes increased access for universities and vocational education providers in TPP country markets. The financial services, telecommunications and health sectors will also benefit from increased market access and a simplification of access rules in TPP countries.

Globalisation has resulted in significant opportunities and challenges within both countries. Increased global economic integration has changed the competitive landscape faced by organisations, as they face new competition from overseas organisations in domestic markets, as well as enabling them to compete with overseas organisations in foreign markets. The fact that a sizeable share of Australian and New Zealand economic activity is currently tied to international trade and investment flows suggests that both countries have largely benefited from globalisation, and this is expected to continue as these international economic linkages grow stronger in the future.

Globalisation has not only allowed Australian and New Zealand organisations to access new markets, but also to relocate or offshore specific business processes. By lowering barriers to trade, globalisation has facilitated increases in both production offshoring (organisations relocating their manufacturing processes overseas, such as Pacific Brands transferring its Australian manufacturing to Asia in 2009¹⁷) and services offshoring, which is the focus of this paper.

The trade barriers which prevent the offshoring of business services, can be quite different to tariffs, quotas and other more “traditional” barriers associated with goods trade. The OECD’s Services Trade Restrictiveness Index (STRI)¹⁸ identifies five key types of barriers that can restrict trade in services: restrictions on foreign entry, restrictions to the movement of people, other discriminatory measures, barriers to competition, and regulatory transparency.

Not all of these policy areas apply to the offshoring of business services, and some barriers can have a larger impact on particular types of business services. For example, restrictions such as qualifications and licensing requirements are relatively high for trade/offshoring in legal and accounting services.¹⁹ Meanwhile, for trade/offshoring of architecture and engineering services, discriminatory measures were identified to be a significant factor, as large-scale infrastructure projects are often publicly funded and procurement processes can involve discrimination against organisations where services are partially provided overseas.²⁰

Globalisation has not only enabled organisations to engage in offshoring by breaking down trade barriers and regulations, but has also provided further motivation for organisations to offshore because of the impact on competition discussed above. In particular, “offshoring has been encouraged by global deregulation, reductions in international trade barriers, greater worldwide competition, and risk mitigation

THE INCREASING INTEGRATION OF GLOBAL ECONOMIES and the reduction in barriers to services trade will facilitate more offshoring of business services.

strategies based on diversification”.²¹ In the new globally competitive environment, the fact that Australian and New Zealand organisations can potentially reduce their operational costs by offshoring service-related processes (as well as production processes) can be important in giving organisations a competitive edge in their overall business strategy.

Looking forward, the reduction in barriers to services trade and the ongoing negotiations of FTAs between Australia and New Zealand and the rest of the world will facilitate more offshoring of business services. Deloitte’s *Global Outsourcing Survey 2014* found that “future opportunities [for offshoring] exist in areas with low levels of current offshore service delivery”.²² In particular, the report highlighted Latin America as a region where offshoring activity is relatively low at present, but where governments are supportive of free trade and promoting English language support programmes to attract offshoring service providers. Around 20–35% of global organisations surveyed stated that they are planning or would consider offshoring

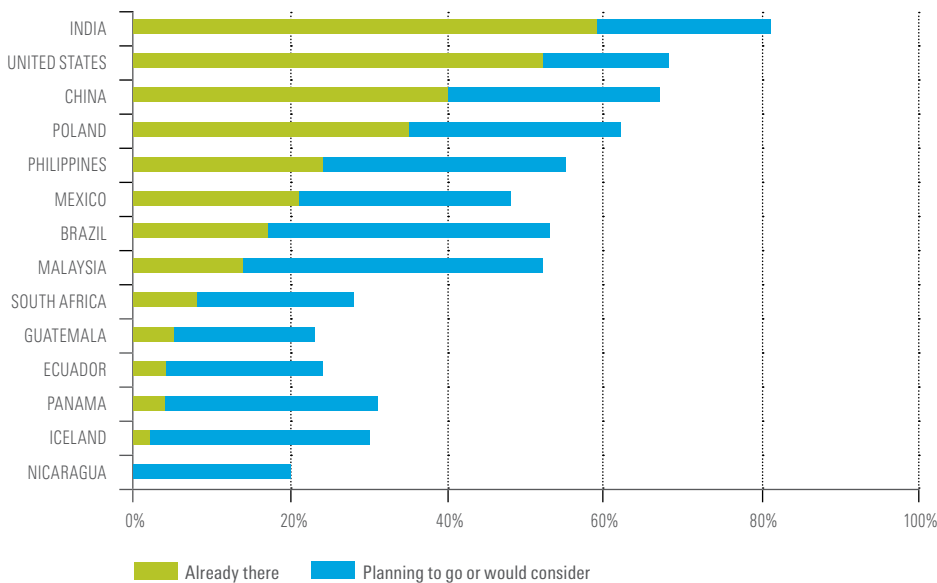
to countries such as Brazil, Panama and Ecuador in the future. In particular these were US organisations, as Latin America is closer to them in terms of geographical distance and time zone.

TECHNOLOGY

While globalisation has enabled organisations to engage in offshoring by reducing barriers to cross-border flows of business, trade, investment and labour, it is the rapid advancement in technology over recent years that has made services offshoring a viable and cost-effective business strategy for many Australian and New Zealand organisations – in much the same way that cheaper transportation costs made production offshoring viable. Importantly, however, unlike production offshoring, which is only an option for organisations with a manufacturing (or similar) component, “service offshoring is a transversal concept across sectors [and] does not involve one particular sector only”.²⁴

Information, instructions and outputs can be conveyed electronically, allowing for more timely interactions and almost instantaneous

CHART 6: GLOBAL OFFSHORING LOCATIONS²³



Developments in enterprise mobility, big data, hosted virtual desktop, business process as a service and cloud computing will **IMPACT UPON ORGANISATIONS' OFFSHORING DECISIONS.**

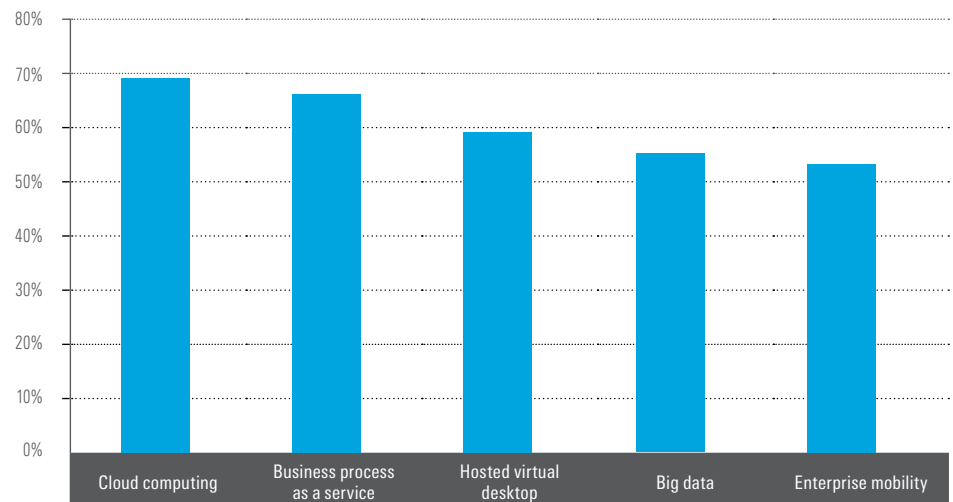
delivery of the required materials. Further advancements have provided organisations with a variety of efficient and convenient methods to increase connectivity across geographies. In a connected world, "any work that can be done on computers can be done anywhere in the world".²⁵ Developments such as document management systems and integrated development environments are also making it significantly easier to manage a globally distributed workforce.²⁶

In the future, technological developments will continue to impact upon Australian and New Zealand organisations' offshoring decisions. Over 50% of organisations have indicated that developments in enterprise mobility, big data, hosted virtual desktop, business process as a service, and cloud computing will increase outsourcing [in the future].²⁷

Many of these are new technologies that organisations have only just begun to adopt in their operations. The wider adoption of these technological advancements will create new opportunities for offshoring by both large and small organisations across Australia and New Zealand. Cloud-based computing and products in particular have the potential to be embedded across the scope of services offered by many organisations across a wide range of industries, and this could significantly impact upon future offshoring decisions. Chart 7 shows the percentage of organisations that are more likely to outsource as a result of cloud-based computing and other technological developments.

Furthermore, new digital technologies are opening up new roles and operations which can be performed offshore. Examples include

CHART 7: IMPACT OF TECHNOLOGICAL DEVELOPMENTS ON FUTURE OUTSOURCING DECISIONS²⁸



the increase in demand for data analytics capabilities amid growing interest in “big data”, as well as the use of digital marketing for connecting and transacting with a wider range of customers. These functions have emerged as technological advancements enable organisations to engage with information and communications technology in new ways. Several organisations have begun to offshore at least some of these operations, and over the coming years these functions could represent significant areas of future growth in offshoring.

The interaction between globalisation and technological advancements has been important in facilitating the offshoring of business services globally: “Globalisation has been made possible largely as a result of developments in technologies. At the same time, closer integration fostered by globalisation and the increased importance of innovation as a result of global competition has led to significant technological breakthroughs.”²⁹ Given that greater global economic integration and further technological advancement is expected in the future, this interaction could become increasingly important in driving offshoring trends.

ECONOMIC DEVELOPMENT IN ASIA

Over the last two decades, emerging economies in Asia have been a major driver of global economic growth, led by China, where annual output growth averaged 9% between 2000 and 2013. China’s growth in turn lifted the economies of many other neighbouring nations through increased investment, as well as demand for goods, services, minerals and agricultural products. Much of this growth has been due to rapid industrialisation, and the broader trend in countries like China and India is one of urbanisation as rapid income growth and job opportunities attract people to the cities.

With rising economic development comes higher wages, and for several Asian economies their place in the value chain is

changing. IT powerhouse India is capitalising on higher skills levels to expand into more complex business process outsourcing (BPO), while expanding traditional IT offerings to include complex R&D. This trend is not confined to India either, with wage growth reducing the cost savings of offshoring business services in several Asian economies (especially China) and elsewhere, such as Brazil.

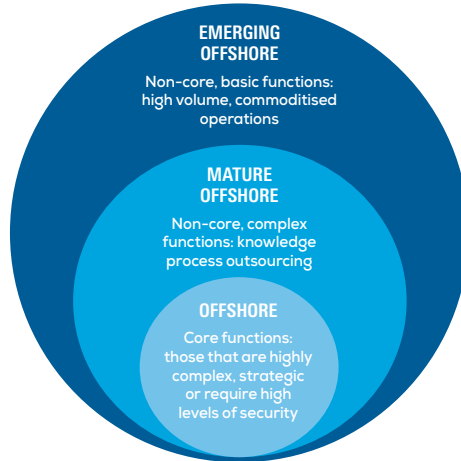
While new low-cost opportunities have emerged with more recent entrants to the offshoring market, such as Bangladesh and Indonesia, service providers in India and China are not homogenous, and higher wages are not a universal reality. Moreover, higher wages do not necessarily mean fewer opportunities for service providers. In countries like Malaysia, business service providers offer highly skilled employees in a politically stable, multilingual environment, which appeals to more risk-averse organisations.

The development of Asian economies, and consequently the development of business services export sectors, has a number of important implications for offshoring.

- With higher rates of education, and higher levels of attainment, the scope and complexity of tasks that may be outsourced increases.
- The quality of output increases, narrowing the professionalism gap between developed and developing nations. A 2014 survey found that “professionalism” was the primary consideration in choice of offshore service provider,³⁰ and Asia’s economic development is crucial to forming a modern and professional business culture.
- As service providers (and countries) position themselves at distinct points on the value chain, organisations have the option of dividing functions among service providers according to their competitive advantage.

A more indirect impact of economic development in Asia is a shift in the types of products sought by these emerging

FIGURE 8: EVOLVING ECONOMIES PRESENT OPPORTUNITIES FOR MULTI-LOCATION OFFSHORING



economies. In recent years, rapid population growth, urbanisation and industrialisation have underpinned unprecedented demand in Asia for the products of primary industries in Australia and New Zealand. While demand for agricultural and mineral resources will continue to grow, as Asian economies mature their demand for high-quality services will expand more rapidly. This will be driven in part by the growth of more mature businesses, but will also be supported by a burgeoning middle class expected to reach 3.2 billion people by 2030.³¹

While this is ostensibly an opportunity for services exports to Asia, business services imports will play a fundamental role in the

expansion of organisations from Australia and New Zealand, if they are to successfully capture this enormous opportunity. Not only does offshoring provide a unique means of extending an organisation's global footprint through foreign affiliates and subsidiaries, but outsourcing peripheral tasks also facilitates rapid business expansion by allowing organisations to focus on core processes. The same survey referenced above found that almost two-thirds of respondents' decisions to use more affordable employees overseas was based on a desire to expand their overall team.

DOMESTIC SKILLS SHORTAGES AND A GLOBAL LABOUR MARKET

Not all offshoring is to low-cost destinations, and can often be driven by domestic skills shortages. As discussed earlier, Australia and New Zealand both outsource a substantial proportion of business services to the United States, and Australia itself is the largest offshore provider of business services to New Zealand. For smaller countries, this can often be driven by a desire to increase the quality of output by drawing on services from countries with larger skilled workforces. However, it can also be the case that in large countries, smaller organisations struggle to compete with industry leaders for talent, and must look elsewhere.

Within emerging economies, particularly in high-growth regions like South East Asia, rapid economic development has brought with it a new generation of highly educated, young

Rapid economic development in emerging economies has brought with it a **NEW GENERATION OF HIGHLY EDUCATED, YOUNG EMPLOYEES.**

Through offshoring, they can help fill skills shortages in developed nations.

employees. Increasingly, where skills shortages exist in developed nations, organisations are turning to offshore solutions.³²

Increases in technical skills and professionalism, as well as the internationalisation of professional qualifications and software platforms, have also allowed organisations to offshore core and more complex functions. The rise of knowledge process outsourcing has been largely driven by this increasing supply of highly qualified labour in offshore locations, and this trend is expected to continue as technological literacy grows in emerging economies and access to education increases further.

Perhaps the most significant trend in offshoring in recent years is a movement away from the term itself, and toward a more nuanced understanding of the modern workforce. Offshoring as a concept often engenders thoughts of jobs that once “belonged” to the domestic economy being moved overseas. This may once have been appropriate when the types of work being moved overseas were manufacturing tasks that required significant

investment in fixed capital, followed by employment of a workforce proximate to that capital investment.

However, the nature of work being offshored is changing, and as fixed capital (plant and equipment) becomes less relevant, the market for labour becomes global. That is, jobs are no longer located either in Australia or India; instead, the task is located in Australia, and the labour used to complete that task may come from anywhere.

This shift will likely continue to gain momentum, aided in particular by two primary forces. The first is the rise of freelance offshore employees. Freelance platform Upwork now claims to have nine million registered freelancers, servicing four million registered clients,³³ with 60% of hours worked in BPO.³⁴ Given this growth, will we now see the next generation of graduates choosing to work as freelancers rather than for large organisations? Second, the automation of tasks will greatly reduce the focus on location. While basic automation is nothing new, rapid increases in computing power and automation possibilities are dramatically changing the nature of work that machines can perform. In the short term, however, this trend will struggle with human acceptance of technological capabilities, and the significant initial investments required. These forces potentially represent a major disruption to the existing offshoring service model.

As fixed capital becomes less relevant, the market for labour becomes global. **THE LABOUR USED TO COMPLETE TASKS MAY COME FROM ANYWHERE.**

THE KEY ISSUES

DETERMINING OFFSHORING SUCCESS IN THE FUTURE

Recognising the increasing importance of offshoring in services, a number of key issues have arisen during our consultations with industry and wider research. These issues will determine offshoring success in the future, as the business case for offshoring continues to change and offshored functions become more complex. Key issues noted during consultations include:

- recognising the diverse range of benefits
- preparing and getting buy-in
- dealing with risks and challenges
- finding the right offshoring model
- finding the right location
- planning for the future.

While offshoring of services has never been easier, it is not necessarily a sure-fire recipe for success. Planning for offshoring – now and in the future – is important, especially as Australian and New Zealand services organisations tend to be behind their international counterparts in making offshoring part of their business model.

RECOGNISING THE DIVERSE RANGE OF BENEFITS

The benefits from offshoring continue to move away from pure cost savings. Offshoring can enable organisations to operate more effectively. Future benefits include access to a more diverse range of skills, movement to higher value-add work onshore, and onshore employee retention.

LOWER COSTS AND COMPETITIVE PRESSURES

Consultation with industry suggests that one of the primary motivations when organisations are beginning to consider whether to move particular functions or processes offshore is the lower costs associated with offshoring. Competitive pressures such as increased competition from overseas organisations entering domestic markets, or smaller client and customer bases in the aftermath of the Global Financial Crisis, have motivated organisations to look towards cost-cutting

measures as a means of maintaining profits. Furthermore, as offshoring has become a business strategy that is widely employed across various sectors, some organisations have adopted offshoring practices simply to be able to compete with others in their industry.

In moving functions offshore, Australian and New Zealand organisations generally report labour cost savings of between one-half to one-third across a range of business functions, including both back-office and (easily commoditised) front-office tasks. Some organisations choose to pass these savings on to customers or clients in order to offer more competitive prices and increase market share, while others have opted to maintain their prices and secure larger margins.

Given that many industries continue to be disrupted by new and increasing competitive forces – such as the emergence of online sources of competition – this cost saving benefit will remain an important motivator for offshoring in the future. At the same time, the potential cost savings associated with moving services offshore could decrease in the future as rising economic growth in the developing countries traditionally chosen as offshoring locations drives higher wages across the labour market. These trends could have significant implications for organisations' motivations in offshoring services with respect to the drivers of cost savings and competitive pressures.

ACCESS TO A DIVERSE POOL OF SKILLED EMPLOYEES

The other key motivation that Australian and New Zealand organisations have for offshoring is the ability to access a larger and more diverse pool of skilled employees to overcome domestic skills shortages. The benefits associated with this are two-fold. Firstly, it allows organisations to employ specialist knowledge and resources that might not have been available domestically

– niche IT skills such as specialised technical developers was one area where this benefit was viewed as being particularly important. Therefore, the quality of the work performed in the offshore centre would be better. More generally, any skills shortages experienced by organisations onshore can potentially be mitigated by using offshore employees, who are becoming increasingly qualified. This motivation could become more important in the future as domestic labour markets become tighter with increasing baby boomer retirements, while offshore locations offer an increasing supply of high-quality labour.

As domestic labour markets become tighter with increasing baby boomer retirements, offshore locations offer **A DIVERSE AND INCREASING SUPPLY OF HIGH-QUALITY LABOUR AND SPECIALIST SKILLS.**

The second benefit associated with being able to access more employees is that it provides organisations with a degree of workforce flexibility that would be difficult to achieve in-house. Offshore employees that are hired on a flexible basis can allow organisations to employ a core team of onshore employees to handle the expected or regular workflow while still ensuring that the organisation has capacity to take on additional work during busy periods. In some cases, the agility and flexibility provided by having an offshore team enables organisations to engage in large projects that otherwise would not be achievable with the onshore team alone, because of the requirement to be able to scale up quickly. Offshoring can provide an efficient staffing model that allows organisations to have onshore employees to manage continuous workflow while still retaining the flexibility to deal with the peaks.

MOVEMENT TO HIGHER VALUE-ADD WORK AND ONSHORE EMPLOYEE RETENTION

Another benefit that organisations report is that by offshoring basic routine tasks such as low-level data processing and information gathering, onshore employees are able to move to higher value-add tasks, such as higher-level analysis or engaging more with current and potential new clients and customers. This may be particularly beneficial for smaller organisations, where the domestic time savings generated by offshoring particular tasks can have a greater impact on the resourcing capacity of the organisation as a whole.

This outcome also benefits domestic employees, with organisations reporting that onshore employees generally have little interest in working on the basic routine tasks that are commonly offshored. As offshoring these tasks can allow junior employees to be fast-tracked up to higher-level work, consultations indicate this often leads to an improvement in employee retention. Onshore employees are not only able to work on tasks that they view as more interesting, but there could also be opportunities for faster career progression from a graduate level in certain industries – particularly if these junior employees take a role in managing the offshore team. In doing so, it is important that the domestic team continues to maintain some capabilities in the tasks being offshored, so that they are able to understand and manage the work that is sent back from offshore.

PREPARING AND GETTING BUY-IN

As offshored functions are quickly becoming a more significant part of day-to-day operations in many organisations, long-term commitment and buy-in are critical for success. While a broader and more mature range of offshoring options and technological advancements make offshoring easier, good preparation, a clear strategy, and continuous review and recalibration will be even more important in the future. Success is not guaranteed.

TEAM SUPPORT AND COMMITMENT

Having the support and commitment of domestic employees within the organisation is important for offshoring to become part of a long-term business strategy. While this is applicable to employees across all levels of the organisation, the support of the leadership team is particularly critical to ensure the quick and smooth implementation of any offshoring strategy. Industry consultations suggest that in organisations where offshoring has been developed organically across an organisation (rather than being mandated), business functions aligned to senior executives who were more supportive of offshoring and more engaged in the process tended to have greater success in setting up an offshoring unit compared to those that were not.

The **COMMITMENT AND SUPPORT** of the senior leadership team will be an important factor in determining the success of offshoring ventures.

As an organisation's senior leadership determines the strategic direction of offshoring decisions, it is essential that they are committed to the entire process to ensure an efficient and effective transition between onshore and offshore operations. Aversion to change or a low appetite for risk within the senior management team can be significant hurdles to overcome when offshoring. Conversely, having senior executives that are motivated to use offshoring to achieve other strategic outcomes (such as shifting to a more customer-centric model) can help to drive the implementation of an offshoring strategy. In the future, as the number and complexity of tasks moving offshore increases, the commitment and support of the senior leadership team will be an important factor in determining the success of offshoring ventures. Strategic planning at the high level with a long-term framework in mind can help to mitigate future risks and challenges that could arise.

A common perception surrounding offshoring in both Australia and New Zealand is that it involves "sending local jobs offshore". It is therefore important that when preparing to implement an offshoring strategy, organisations keep their employees informed on the process – the purpose of offshoring, how it will happen and the role of domestic employees in the future model – and discuss their concerns and perceptions on offshoring. In general, organisations reported that offshoring did not result in reducing existing employee numbers onshore. While in some cases future hiring was reduced after moving functions offshore, the purpose of offshoring was primarily to add to the resourcing capacity of the organisation rather than relocating entire units overseas. Communicating these intentions to the broader workforce in a clear and timely manner can help to allay some of the common concerns surrounding offshoring.

PROCESSES AND QUALITY CONTROL

It is essential that in preparing to offshore, organisations have the right systems and processes already in place. Generally, organisations reported that any inherent problems within their internal processes were not solved by offshoring – the same issues were experienced by the offshore team and these were reflected in the work that was sent back to the onshore office. Any tasks or processes that are sent to be done offshore need to be clearly mapped out by the domestic team, with instructions provided to the offshore team. One example highlighted by industry was of organisations looking to offshore particular functions shortly after significant merger and acquisition activity. These organisations tended to have greater difficulties with offshoring because their operations had not been properly consolidated and organised before moving them offshore.

Even once these business processes have been streamlined and communicated to the offshore team, it is important when preparing an offshoring strategy that quality control standards and procedures are implemented internally to ensure that the work received from offshore is of sufficient quality. This is particularly important for organisations just starting to offshore, as they work to build an understanding of expected standards with the offshore team. A number of organisations that were consulted had only decided to expand their offshore operations once quality standards had been assessed as being adequate following the initial move offshore. As a number of countries

It is important when preparing an offshoring strategy that **QUALITY CONTROL STANDARDS AND PROCEDURES** are implemented internally.

are now becoming established centres for business and knowledge process offshoring, organisations looking to offshore in the future may be more confident in their ability to source appropriately skilled employees in these offshore locations, enabling more rapid expansion of offshoring operations.

DEALING WITH RISKS AND CHALLENGES

Traditional risks and challenges to offshoring have included regulatory concerns and cultural differences, but new issues are emerging that will need addressing in the future, such as retaining offshore employees in an increasingly competitive environment and offshoring more complex tasks.

RETAINING OFFSHORE EMPLOYEES

Employee retention overseas was highlighted by a number of organisations as a challenge associated with offshoring. One reason for this is that the tasks being sent offshore are typically low-end jobs that can be repetitive or not very interesting. While some organisations have found that offshore employees can be more willing to specialise in such areas compared to their employees in Australia and New Zealand, in general the key to retaining offshore employees is ensuring that people have diversity in their work and can progress their careers over time.

Another relevant issue is increasing competition between organisations for quality or specialist offshore employees in particular locations. In established centres for offshoring, where many international services organisations are represented, such as India

and the Philippines, employee turnover can be higher due to a more competitive labour market. A number of organisations noted that turnover is particularly an issue in large cities, where demand for quality employees is high.

Economic development in Asia could see employee retention become an increasing challenge in the future. Although there is a growing supply of high-quality labour, the competition for talent increases as more organisations choose to offshore more complex business functions. Offering higher pay is not the only way to attract and retain offshore talent. Other factors such as an inclusive culture, employee engagement and diverse career paths are also key considerations. Solutions could include rotating people across processes and tasks, or allowing them to do higher-level work that is more technical or analytical as they advance through their careers. One example of this is having offshore employees who have built some experience in processing data move onto analysing the data to draw out relevant insights. This also benefits the organisation as the offshoring team offers more value in the tasks performed.

REGULATORY CONCERNS AND RISKS

The regulatory framework in offshore locations can have a significant impact on offshoring decisions. Regulatory risks are a concern – both in countries that have poor regulatory frameworks, and those where the government does not enforce the regulations that are in place. This was viewed as an issue not just because of the difficulties associated with offshoring in a country with a poor regulatory framework, but also because of the potential impact on customer and client perceptions. Organisations generally deal with these regulatory risks by choosing not to offshore in countries where there are concerns surrounding the regulatory framework – even if it would make sense to have an offshore presence there in the context of the organisation's capabilities.

The key to retaining offshore employees is ensuring that **PEOPLE HAVE DIVERSITY IN THEIR WORK** and can progress their careers over time.

In addition, some organisations have used previous experiences in other countries (for example, setting up an office in an overseas location or early experiences with offshoring to particular locations through third-party providers) to assess the potential regulatory challenges that could arise when offshoring in a particular destination.

One particular regulatory concern that could have an increasing impact in the future is a country's privacy laws and standards. Industry consultations suggest that in some countries, the standards surrounding privacy mean that the government is legally able to access client and other information of organisations with offshore operations in that jurisdiction. This could apply even if an organisation is only using IT services, such as cloud technology or automation services, hosted in the jurisdiction. This then raises concerns regarding whether data security and information confidentiality, including domestic laws and regulations, might be compromised. Given that global interconnectivity is expected to increase and the use of cloud computing and automation is on the rise, these privacy concerns could become a more critical risk factor in the future when organisations decide on where to locate their offshore operations.

CULTURAL DIFFERENCES

One challenge that organisations suggested was generally underestimated by those looking to offshore is that cultural differences can be a large barrier to a successful offshoring strategy if they are not addressed. These differences include interpretations of local language, and Australian or New Zealand slang words that are not used elsewhere, as well as verbal tones and cues that can get lost in translation across different cultures (for example, a misunderstanding of sarcasm by

offshore employees that come from a more "literal" culture).

Cultural understanding differs based on the offshore location, but is important in ensuring that offshore employees are integrated with the onshore team – particularly in the future, as offshoring tasks become more integrated. Cultural differences can be bridged through cross-office interactions such as visits between the offshore and onshore teams and offices. As organisations become more experienced in offshoring, they offer cultural training programmes to educate offshore teams in Australian and New Zealand culture, though there was a lack of examples of the reverse (onshore teams being trained in the culture of the offshore country).

In general, it appears that cultural differences are a challenge that can be overcome through education and frequent engagement between offshore and onshore employees; however, the concern is that organisations often underestimate the costs and time required to do so. Cultural differences should be addressed by promoting mutual understanding between onshore and offshore teams, rather than seeking to impose the onshore culture on the offshore office (both with respect to social and work culture). A number of organisations consulted with raised the idea of using compromise to get around cultural differences, and being flexible enough to adapt business processes to suit the offshore team's culture.

Cultural differences should be addressed by **PROMOTING MUTUAL UNDERSTANDING** between onshore and offshore teams.

FINDING THE RIGHT OFFSHORING MODEL

Offshoring strategies are numerous and varied, with each presenting its own set of advantages and challenges. Organisations should understand that there is no “silver bullet”. The most appropriate offshoring model will be unique to an organisation’s current and future needs and the environment it operates in. While some organisations will continue to move towards an outsourcing model as they become more experienced in offshoring, others may back away from such a model, instead reincorporating newly captive functions to be part of their core business.

CAPTIVE OFFSHORE

While offshoring as a concept is often thought of as a rather homogenous collection of strategies, the reality is quite the opposite. Offshoring strategies are both numerous and varied, each presenting its own set of advantages and challenges.

One model used by organisations who wish to retain control over their offshore operations, is captive offshore centres, which are owned and operated by the organisation onshore. These centres need not operate merely as an offshore office that services the organisation onshore, but can instead operate as a self-contained office servicing a market overseas while also performing work for the organisation onshore. For those with overseas offices, this can be a way to:

- build overflow capacity in offshore locations
- test the offshoring waters using an in-house model, and
- encourage a modern business model where work can be packaged, and performed by anyone with the right set of skills.

While many early players in the offshore market established captive offshore models in places like India, some have since sold those offices to third parties and hired back the services on a contract basis. However, a recent trend of returning key functions to captive offshore sites reveals a future

challenge for those considering offshore outsourcing. Outsourcing core competencies, or those business functions that handle confidential or sensitive information, can lead an organisation to lose depth of capability and data security.

OFFSHORE OUTSOURCING

Outsourcing as an offshore solution has grown in popularity since the 2000s. The offshore outsourcing industry is enormous and dominated by major offshore service providers (such as IBM, Accenture and Tata) and major offshore destinations (such as the US, India or the Philippines). For instance, India’s National Association of Software and Service Companies estimates that offshore IT, BPO and contact centre work now accounts for 25% of India’s exports, with offshore outsourcing popular due to its lower investment costs and flexible options.

While some organisations remain concerned about quality and risk, providers have become more advanced in addressing such concerns (such as through onshore tests). Success often has more to do with building partnerships with the offshore service provider and its employees. Organisations cannot assume that it is a “set and forget” situation, and must invest in the relationship, align employee and organisation incentives, and provide training where appropriate (such as cultural training for contact centres).

One of the primary advantages of engaging an offshore third party is the flexibility it provides, and the increasing quality of service driven by competition between providers. This flexibility can be dramatically reduced as switching costs increase, and yet without investment in training and relationship building, organisations onshore cannot expect to reap the full benefits of offshore outsourcing. Consultations suggest that it can take time, and extensive engagement with service providers to ensure that they understand onshore requirements, and can therefore add real value by proposing new capabilities rather than merely meeting demands.

Consultations have also revealed that outsourcing contracts can require careful monitoring due to the risk of perverse incentives. For example, in a well-established outsourcing relationship, where benchmarks are revised based on previous performance, service levels may plateau as providers seek to avoid having their targets revised upwards.

FREELANCE OFFSHORE EMPLOYEES

A more recent trend in outsourced offshoring is that of freelancing. Freelancers provide a low-cost, small-scale alternative to more traditional outsourced offshoring, and allow organisations to take advantage of talent from a wider range of locations without long-term contracts and start-up expenses. Freelance platforms such as Upwork and Work Market allow organisations to link with freelancers in higher-risk locations such as Pakistan and Ukraine, without having to make significant investment in those locations.

The future of freelancing is undoubtedly bright within developed economies such as the United States, where the industry derives a lot of strength from the supply side, as modern employees increasingly expect more control over how and when they work. In the world of offshoring, the future is less certain, though the potential is enormous. The combination of freelancer platforms, and co-working space providers such as WeWork, may create collaborative workplaces where individuals may use their skills for overseas clients. Domestic organisations can therefore access offshore talent without cumbersome service level agreements or significant investment in high-risk locations. This transition will be made

SIGNIFICANT INVESTMENT in offshore capacity now may not be appropriate if automation combined with onshore capacity will be sufficient within a ten-year timeframe.

easier as freelancing grows in popularity, and perceptions of freelancers evolve from temporary staff at small enterprises, to strategic hires for large organisations.

FINDING THE RIGHT MODEL

As there is not one model that suits all types of organisations, choosing the most suitable model is about working out the strengths and weaknesses, leveraging existing assets (such as offshore offices) and doing the research. Regular reviews of offshoring arrangements are also an important part of any successful strategy. Reviews should be implemented to ensure targets are being met, and relevant relationships are being managed effectively. Consultations indicate that cultural differences in certain offshore locations can often lead to overwhelmingly positive performance reviews that do not reflect reality, and this may necessitate more rigorous review processes.

At the same time, organisations need to be aware of their long-term strategy. For instance, significant investment in offshore capacity now may not be appropriate if automation combined with onshore capacity will be sufficient within a ten-year timeframe. Offshoring also poses the danger of important skills being lost in the onshore office, so it is essential that organisations

FREELANCERS PROVIDE A LOW-COST, SMALL-SCALE ALTERNATIVE

to more traditional outsourced offshoring that allows organisations to take advantage of talent from a wider range of locations without long-term contracts and start-up expenses.

identify what should be retained in-house. Overall, it is important that organisations continuously review and recalibrate their model to ensure it remains appropriate.

FINDING THE RIGHT LOCATION

With an increasing range of potential offshoring locations to choose from, organisations will find it easier to diversify their offshoring networks and tap into different capabilities and skills across geographies. It is critical to understand the different types of future benefits that different locations can provide.

UNDERSTANDING THE SKILLS NEEDED

Rapid economic development in emerging economies, as well as the proliferation of offshore service providers, has dramatically increased the diversity of offshore locations. As with finding the right offshoring model, finding the right location is far from straightforward.

At the heart of offshoring is a desire to realise efficiencies, such as in the recruitment process or labour rates. On the surface, this can appear to be a rather simple process. Developed nations offer skilled employees in stable political environments, and in some places, such as “tier 2” cities in the United States, this labour force can often prove more affordable than in local markets. Equally, developing nations have in recent years experienced strong growth in both rates of education and levels of attainment. Along with strong overall economic growth, this has produced enormous pools of skilled employees in modern cities all over the world.

BEWARE THE HIDDEN COSTS

It is important that organisations look beyond simply lower wages when making decisions about the location. Each offshore location carries with it additional costs in much the same way that onshore operations require overhead expenditure. As well as infrastructure and regulatory costs,

low-cost labour may require additional supervision. This may simply require external service providers to manage and report on operations overseas, or it may also require the relocation of onshore management. These costs tend to increase with cultural and language barriers, and consultation with industry has revealed a preference for countries with a strong tradition of English language education, and use of English in government, such as India and the Philippines. Additionally, instability in the location’s foreign currency may make it harder to forecast the expected cost savings, particularly in the short to medium term.

Beyond these more obvious concerns, consultations have shed light on more subtle anxieties. Relevant experiences include a desire to avoid jurisdictions where client information may be compulsorily obtained under national security legislation (including the United States), as well as those jurisdictions where closing offshore operations can lead to lengthy legal battles with overseas authorities. In the coming years, as new offshore destinations emerge, and mature markets seek to differentiate themselves, operating environments and regulation are likely to become more business-friendly, and the cost of operation in unfamiliar markets will come down. However, unlike corruption, political instability or inefficient regulations – which tend to decrease with economic development – invasive national security legislation remains a feature of even the most advanced democracies.

However, unlike corruption, political instability or inefficient regulations – which tend to decrease with economic development – **INVASIVE NATIONAL SECURITY LEGISLATION** remains a feature of even the most advanced democracies.

Understanding these potential costs is an important step in finding the right offshore location, and there are many ways of mitigating risk. Partnering with organisations overseas, whether as external service providers or as part of a joint venture, has been regularly noted as a successful strategy by providing an on-the-ground understanding of political and legal systems.

In selecting the right offshore location, however, it is important to be aware of the hidden benefits as well. By maintaining offshore operations in overseas markets, organisations often gain both a deeper understanding of those markets, their drivers and opportunities, and exposure to industry players. Such understanding can be useful in later efforts to expand into those markets, and this potential upside is a worthwhile consideration when selecting an offshore destination.

CURRENT AND FUTURE OFFSHORING LOCATIONS

In the early days of offshoring, many large organisations established a presence in Asia. Since then, offshoring has grown to become such a significant part of many Asian economies that the region now dominates the global offshoring market, offering a variety of value propositions.

India is regularly described as the most desirable offshoring location, with particular expertise in IT, BPO and contact centre operations. As major Indian cities have developed around the industry, so too have the services evolved. Service providers that once offered skills in basic, commoditised tasks are now providing complex IT services, bundled BPO services and even R&D.

China, which has more recently emerged as a desirable offshoring location, is fast developing a reputation in the IT sector, though wages are in some cases rising faster than in competitor nations. Elsewhere in Asia, Thailand and Indonesia have gained popularity due to their large, well-educated populations, although organisations

expressed concern regarding the quality of English language education. This is less of an issue in countries like the Philippines, where many organisations now have contact centre operations. The Philippines, among others, has also benefited from concerted government efforts to promote the BPO sector and insulate it from risks such as endemic corruption, by establishing the Philippine Economic Zone Authority.

Importantly, offshoring is not limited to emerging economies or low-cost destinations, and the prominence of the business services trade between Australia, New Zealand and the United States is evidence of the success that can be achieved through offshoring work to traditionally high-cost jurisdictions.

The diversity of offshoring locations will only continue to increase in the future, making it even more important for organisations to understand why they choose offshoring and what they want from an offshoring location (be it low labour costs, particular technical skills, language capabilities or a low-risk business and legal environment).

PLANNING FOR THE FUTURE

Offshoring as a business proposition is undergoing rapid change, and many organisations are unsure what the services sector will look like in ten years – making planning for the future challenging. At the same time, new technology trends such as automation will disrupt the offshoring model itself.

AUTOMATION

Planning for the future of offshoring is difficult. The offshoring industry is moving at a remarkable pace, and this will only increase as technology continues to facilitate new offshoring models and reduce the significance of geographic boundaries.

Perhaps the most significant shift in offshoring over the coming years will be the movement toward automation of operations.³⁵ Already, sectors such as finance in which highly skilled

roles also require employees to complete small, time-consuming tasks, are looking to robotic solutions to increase time spent on high-value activities.

However, this trend is not limited to basic tasks. Already, software is available that in 15 minutes can perform tasks that previously occupied urban planning and engineering professionals for weeks. By drawing on enormous databases, and learning from results, computers are performing increasingly complex tasks with ease.

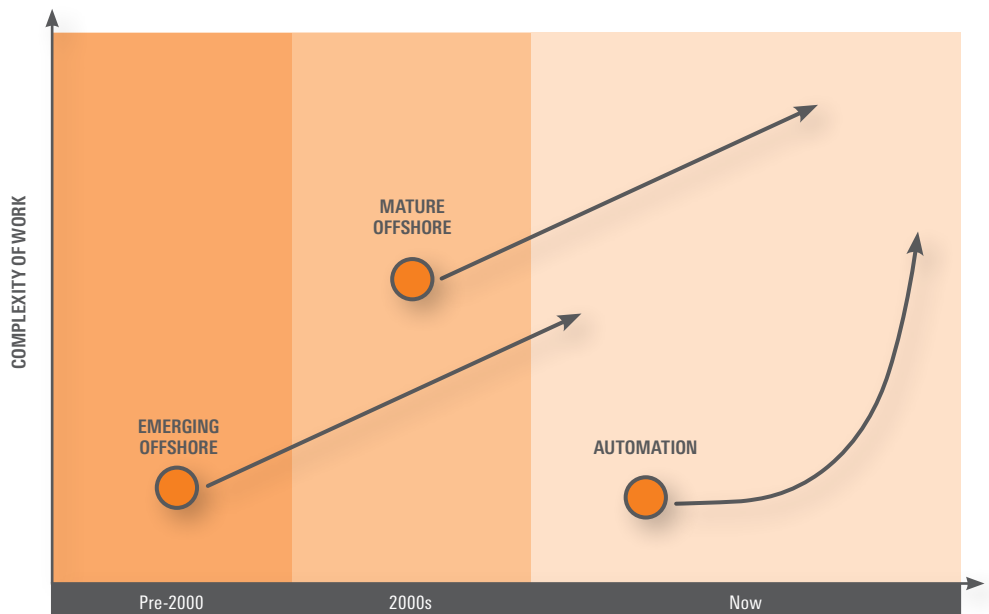
This trend is not important for offshoring because it necessarily involves payment to an overseas software provider; rather it is important because:

- it will radically alter the way in which offshoring is used, and offshore service providers will be forced to improve their value proposition as low-level tasks become automated

- consultations suggest that organisations onshore are increasingly looking to offshore service providers to **introduce** organisations to the potential of automation and facilitate that development.
- automation may reduce dependence on offshore headcount, as organisations look to automatic problem detection and basic trouble-shooting, lessening the need for contact centre and problem resolution employees.

Chart 9 illustrates the expected rise of automation. In the 1990s, emerging offshore markets began as captive centres for the completion of basic tasks in low-cost destinations. In the 2000s, the arrival of high-quality offshore service providers heralded the advent of complex task offshoring, and the quality and scale of this work has only increased since then. Automation is now slowly gaining acceptance as an alternative to labour, and though the complexity of

CHART 9: THE RISE OF AUTOMATION



tasks remains low, it is expected that this will rise quickly.

Automation is not, however, an immediate or panacean solution. Just as with offshoring, organisations will be hesitant to make significant investments. This is especially true of high-cost software, which renders organisations beholden to technology providers. Despite this, an understanding of robotic process automation is an important part of forward looking analysis. Organisations must ask how automation will play a role in future operations, how it might reduce or change their reliance on offshore operations, and whether offshore capacity will be a useful or necessary complement.

HUMAN CAPITAL

In a similar vein is the need for organisations to manage the impact of offshoring (and indeed, automation) on their human capital. The search for wage-cost savings can often lead to the sacrifice of employees' development, and organisations need to be aware of what they could lose in the process.

Consultation with industry revealed that many organisations with offshore operations tended to lack long-term plans for offshore employees. This raises two key issues. The first is that in high competition regions such as the Philippines, employee turnover rates are often unattractive due to the lack of investment in employee retention. This can lead to significant expense.

The second is that over time and with increasing skills levels, career consideration given to offshore employees becomes increasingly important. While contractors may not require such career development, a permanent staffing model requires training and options for career progression. Industry accounts reveal that offering career pathways, and treating offshore employees with the same respect afforded to onshore employees, increases employee engagement, reduces turnover, and in turn increases the quality of output.

Another aspect that will be important in the future is that as the basic or lower value-add tasks are offshored (or indeed automated), the onshore career ladder for new graduates will be missing the bottom rungs. Graduates will be expected to start at a different level or have different skillsets, such as high levels of reasoning, judgement and strong creative and collaboration skills.³⁶ These structural changes will have a profound implication for services organisations as well as the tertiary education sector. Universities will need to review their curriculum to ensure they are preparing graduates for future roles. Without change, they could be preparing graduates for entry level jobs that no longer exist or that will require different skillsets. Organisations also have a role to play working with the education sector around the skillsets they are looking for and the jobs they have to fill.

CONCLUSION

While it was traditionally about cost cutting of distinct back-office functions, offshoring has become far more complex and its use continues to evolve. Many offshored functions are becoming fully integrated into an organisation's operating model and thus have impacts that extend well beyond the services traded. In a sense, offshoring is similar to the use of digital technology. While digital technology used to be a distinct offering, it has now become part of normal business practices. As a result, offshoring is likely to have an increasingly significant impact on Australian and New Zealand organisations in the future. But more than that, it can also have an impact on the economic future of Australia and New Zealand.

Offshoring in services can play a key role in addressing future productivity challenges by enabling organisations to operate more efficiently, by maximising the value-add

of the existing workforce and by enabling organisations from Australia and New Zealand to be internationally competitive. It can provide organisations with the ability to circumvent domestic constraints and drive future organisational growth.

However, despite the range of potential opportunities that offshoring offers, success is not guaranteed, and offshoring requires significant preparation, investment and long-term commitment. Organisations in Australia and New Zealand need to carefully consider if and how offshoring can fit into their future business strategies as they strive to lift their productivity and, in turn, lift the productivity of both nations. For instance, significant investment in offshore capacity now may not be appropriate if automation combined with onshore capacity will be sufficient within a ten-year timeframe.

Offshoring also requires buy-in from onshore employees and acceptance by clients, and – though becoming more widespread across many services organisations – public perception is lagging behind and often focused on the cost cutting element alone. Therefore, better communication of how offshoring is being used and integrated in Australian and New Zealand services organisations is important. Offshoring will undoubtedly become more widespread as more of the benefits are realised and competitive pressures provide increasing motivation to offshore business functions where it is more efficient to do so.


There are a number of supply-side trends that will influence offshoring as a business proposition in the future. For instance, higher education levels in Asian countries, as well as their increasing experience in working with offshore suppliers, will result in the possibility of offshoring more complex tasks. In addition, the expansion of potential offshoring destinations increases the diversity of tasks that can be offshored and can provide organisations with further reasons to move work offshore, such as access to new geographies, languages and time zones.

Moreover, demand-side trends will continue to support significant growth in the industry. Organisations that are experienced in offshoring are starting to become more strategic in their offshoring decisions, and are beginning to offshore more complex functions. There remains substantial growth potential in this area as organisations

become increasingly capable of integrating complex functions performed overseas, as well as negotiating cultural differences and managing regulatory risks.

Demand will also increase as offshoring continues to spread to all types of service industries, and not merely professional, technical and computer services. However, there is still significant scope for growth as it is not yet fully utilised across the whole services sector. In part, this may be because it requires significant investment and commitment, which may not be a winning strategy in all cases. However, it may also be that in some services areas, such as education and health, it is still less accepted or understood as an option, and thus opportunities for productivity improvements may be missed. Automation will disrupt offshoring further, with tasks currently offshored having the potential to be automated either on or offshore. Technological advancement will also have significant impact on productivity within the services sector.

Globalisation, the TPP and increase in FTAs have enabled Australian and New Zealand services organisations to access new markets. Australian and New Zealand organisations now have the opportunity to offshore lower-value services, and instead specialise in higher-value services that can then be exported to other countries. Further, the education sector will need to work closely with organisations to ensure future graduates are leaving with the skillsets and knowledge to perform these higher-value services that the workplace is now expecting.



As the importance of the services sector continues to increase in both Australia and New Zealand,

PRODUCTIVITY GROWTH –

generally and specifically
in services –

**WILL BECOME
THE KEY FACTOR
DETERMINING
THE RATE AT
WHICH LIVING
STANDARDS CAN
BE IMPROVED**

over time.

GLOSSARY

BPO	Business process outsourcing
CA ANZ	Chartered Accountants Australia and New Zealand
DAE	Deloitte Access Economics
FTA	Free trade agreement
GDP	Gross domestic product
ICT	Information and communication technology
OECD	Organisation for Economic Cooperation and Development
R&D	Research and development
STRI	Services Trade Restrictiveness Index
TPP	Trans-Pacific Partnership

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