



*cutting through complexity*

State of the Nation:

# China Shared Services and Outsourcing (SSO)

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China Leader

Shared Services and  
Outsourcing Advisory

September 2012



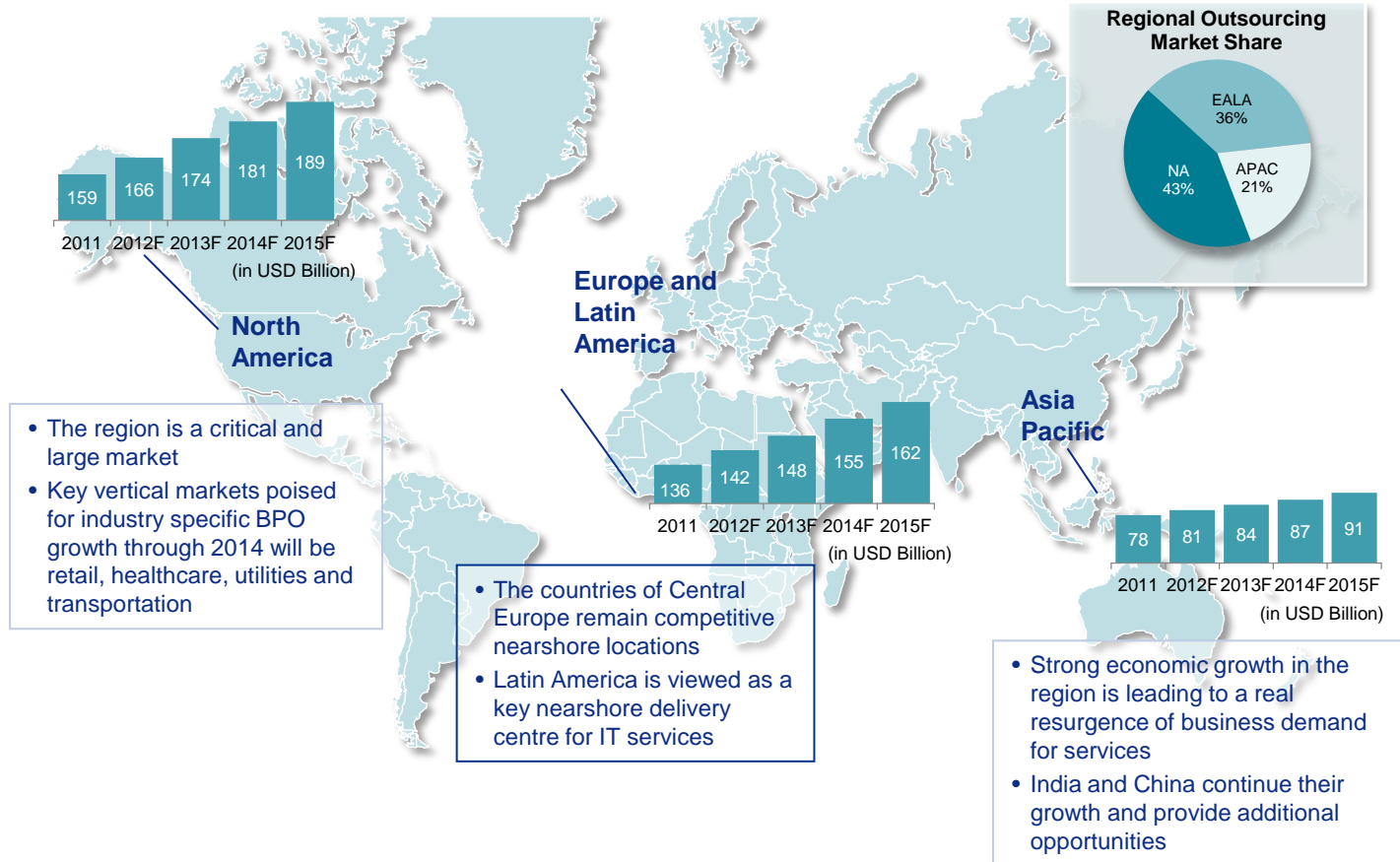
# The world is on offer...

## Setting the scene

“Most developed economies are suffering from predicaments lingering from the global financial crisis”

World Economic Situation and Prospects 2012

Companies around the world are continuously exploring SSO opportunities as a means to improve business operations and control costs under global economic pressure. North America remains the primary outsourcer, while demand from APAC market is resurging



Source: Gartner, Inc. Forecast: IT Services, 2008-2015, 2Q11 Update

# Asia Pacific exhibits robust growth in recent years

## Setting the scene

*Cost advantage of 50 – 60% makes Asia the most attractive destination for shared services and outsourcing*

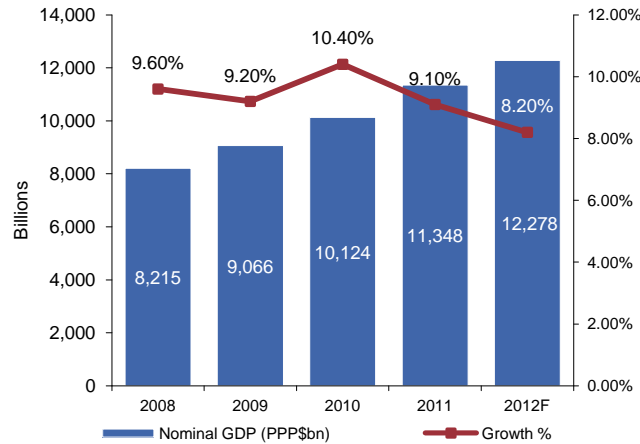


Source : KPMG research

# China exhibits healthy economic indicators...

## Setting the scene

### Well managed GDP growth



Source: World Bank, 2012

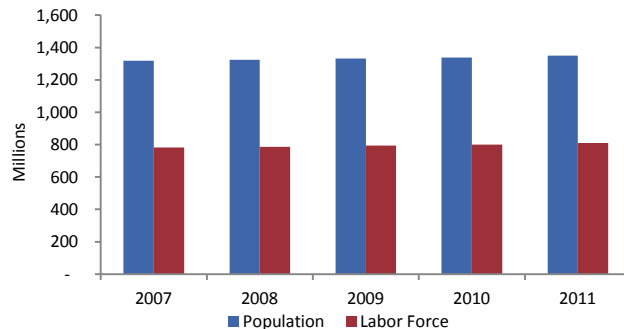
### Accelerating development of the service industry



CAGR (%)	2006 - 2011
γ GDP (Service)	16%
γ GDP (Agriculture and Industry)	10%
<b>Total</b>	<b>13%</b>

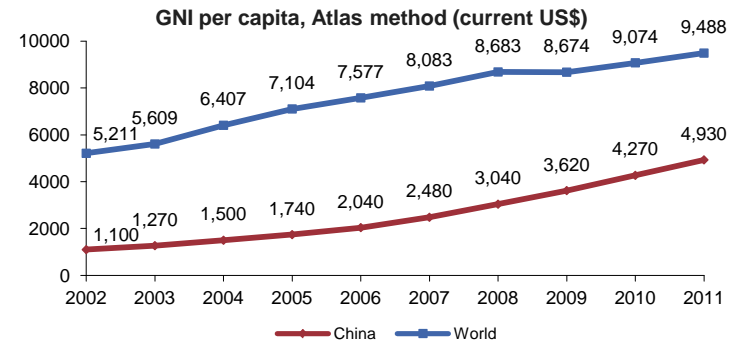
Source: World Bank, 2011

### World's most populated with 1.3 bn people and over 800 mil labour force



Source: World Bank and EIU, 2011

### Continual increase in national income boosts domestic consumption



Source: World Bank, 2011



# Big 3 play in China

## Setting the scene



*The 12th five-year plan points to three significant areas of focus*

- Shared Services and Outsourcing
- Payments
- Cloud Computing

**“Combining Outsourcing, Shared Services and Cloud Computing together can provide greater benefits than on their own”**

Achieve efficiencies from economies of scale provided by third parties who themselves are embracing Cloud Computing

Internal adoption and support of Cloud Computing is unlikely to be successful without business alignment

Achieving improvement by business transformation from within and integrating Cloud technologies

**“Most strategic roadmaps will not be a straight line, but will be affected by the point in time desire to implement all three solutions”**

# China's strengths and weaknesses in SSO

## Industry

“While competing countries, such as India and the Philippines offer better language skills to European and American businesses, China will continue to attract business from the regions.”

*Amneet Singh, vice president of global sourcing at Everest Group*

### Strengths

- Strong government support**
- Fast-developing infrastructure**
- Large talent pool**
- Stable social economic environment**

### Weaknesses

- Lack of scale and full service capacity**
- Immature commercial law environment**
- Insufficient mid / senior management talent**

### Opportunities

- Emerging market segments**
- Accelerating consolidation of service providers**
- Moving up the value chain**
- Growing cloud computing capacity**

### Threats

- Global economic downturn**
- Appreciation of Yuan**
- Competition from emerging SSO destinations**

# Key growth verticals in SSO space

## Industry

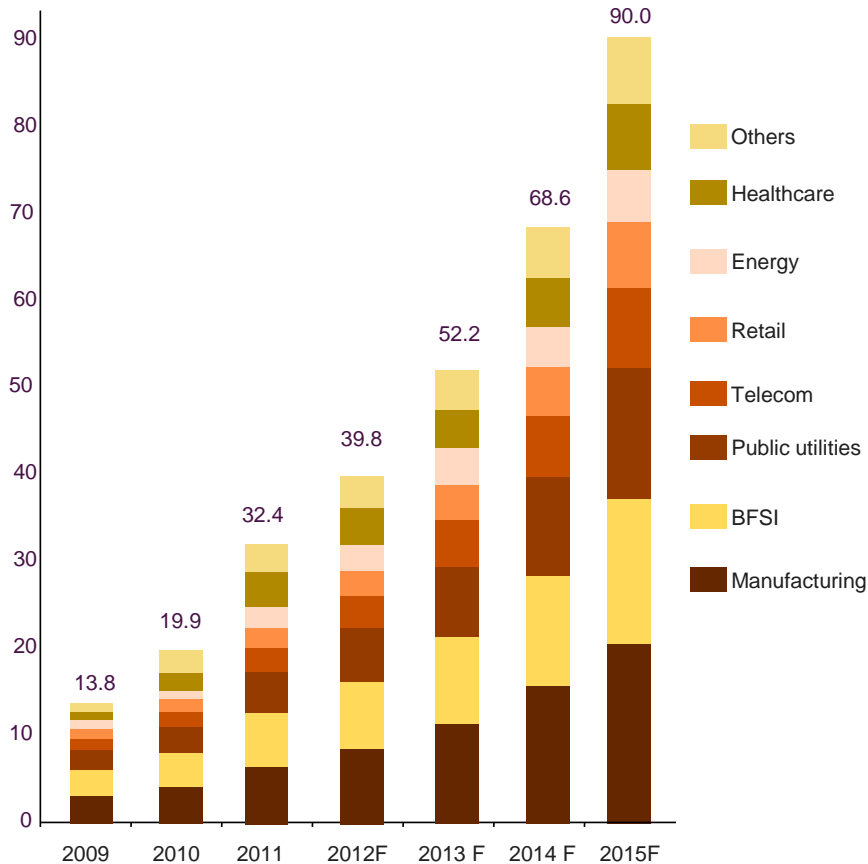
Chinese pharma services industry has been developing extraordinarily fast in the past decade, and has attracted a large number of pharma and biopharma companies almost from all over the world for a variety of outsourcing opportunities

*Chinasourcing 2012*



Key verticals to pay attention to are banking, financial services and insurance (BFSI), Telecom and Healthcare

Size of outsourcing in China's vertical industry  
2009 – 2015 (USD billion)



Source: IDC, MOFCOM and KPMG Research, 2012

### • BFSI

- Growth rate: over 20%
- Separation of business operations
- Great demand for HRO, call centres, ITO, disaster recovery and marketing
- Commercial banks are more active in ITO
- Large banks like CMB, CMBC have outsourced software development, card processing, etc.

### • Telecom

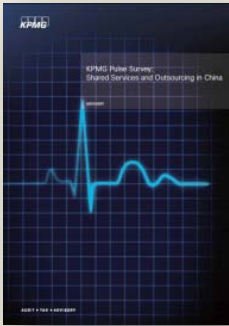
- Call centre outsourcing is still an important field
- Booming mobile value-added services are creating a large outsourcing demand in ITO and R&D
- Large telecom enterprises like ZTE and Huawei have outsourced call centres, software development, etc.

### • Healthcare

- CRO, CMO market is emerging fast
- Strong growth (~25%) in e-healthcare:
- Some large hospitals have outsourced IT system development

# Evolving SSO models

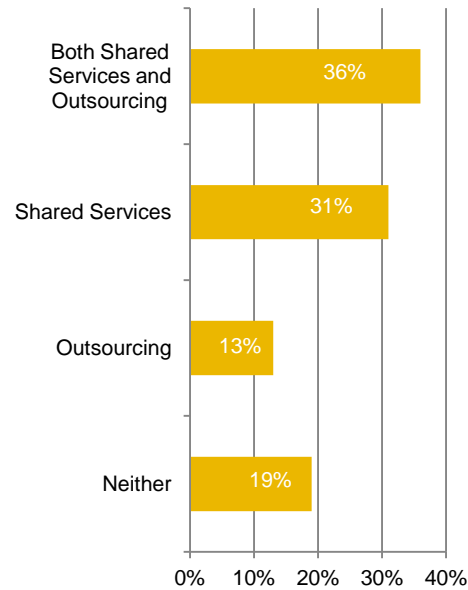
## Industry



Details of shared services and outsourcing landscape in China in KPMG publication "KPMG Pulse Survey"

*Different shared services and outsourcing models, i.e. hybrids, have evolved in recent years to meet strong demands in both domestic and export markets*

**Sourcing models utilised by organisations**



Source: KPMG Pulse Survey Report 2011  
N = 286 respondents. Figures may not add up to 100% because of rounding

- With the influx of foreign direct investments (FDI) and an increasing level of confidence in service delivery, offshoring projects started to proliferate in addition to a huge concentration of onshore work which characterised early development of the industry in China
- Use of shared services, or captives, remains predominant in the China market
- Over 70% of SSO business were from offshore market, mainly serving North Asia countries (e.g. Korea, Japan) and MNC clients from Western markets (e.g. North America and Europe)
- Meantime, in the domestic market, transactional volumes from continual robust economic performances are significant enough for organisations (e.g. SOEs, POE, local MNCs) to setup onshore captives



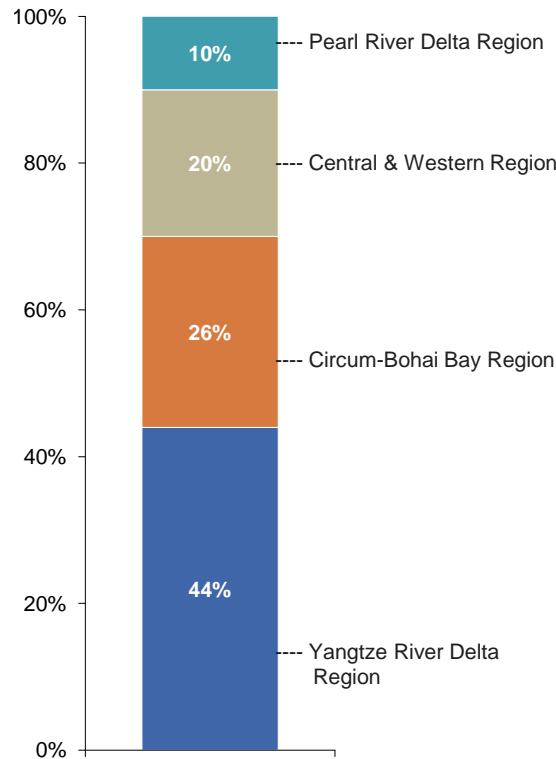
# Potential growth region

## Industry

With the “Go-West” initiative laid down in the 12th Five-Year Plan, the central and west region is expected to have high potential for growth

The central and west regions are expected to have high potential for growth

Geographic distribution of outsourcing cities in 2011



Source: 2011 China Service Outsourcing Cities Investment Attractiveness Assessment, MOFCOM

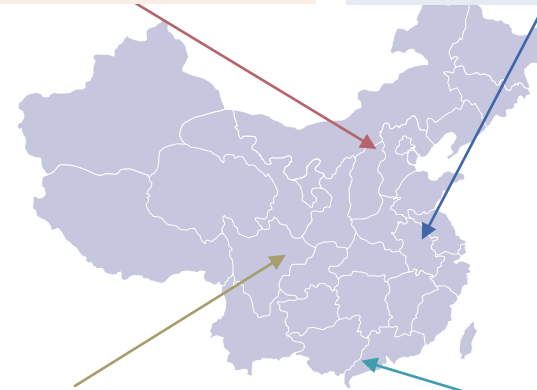
Types of major outsourcing services

### Circum-Bohai Bay region

- Outsourcing of auxiliary services for the manufacturing sector
- Outsourcing of government services and other services related to the tertiary industry
- North Asia language capabilities

### Yangtze River Delta region

- Outsourcing of back-office services for the financial sector
- Outsourcing of auxiliary services for the manufacturing sector
- Outsourcing of cartoon and animation services



### Central and Western China

- Outsourcing of software R&D
- Outsourcing of customer service centres
- Outsourcing of digital entertainment

### Pearl River Delta region

- Outsourcing of software and information services for Hong Kong and Southeast Asia
- Outsourcing of industrial design and cartoon/animation design
- Outsourcing of modern logistics / supply chain management

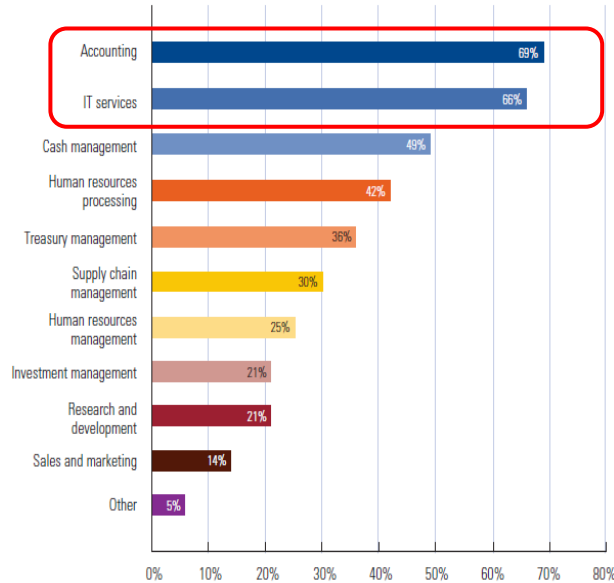
Source: CSIP 2010

# Shared services and captive (SSC) market

## Industry

*The growth of captives has driven mostly by new onshore and offshore shared service operations focusing on finance & accounting and IT services across a broad spectrum of industries*

Services undertaken by SSCs in China



Source: KPMG Pulse Survey 2011

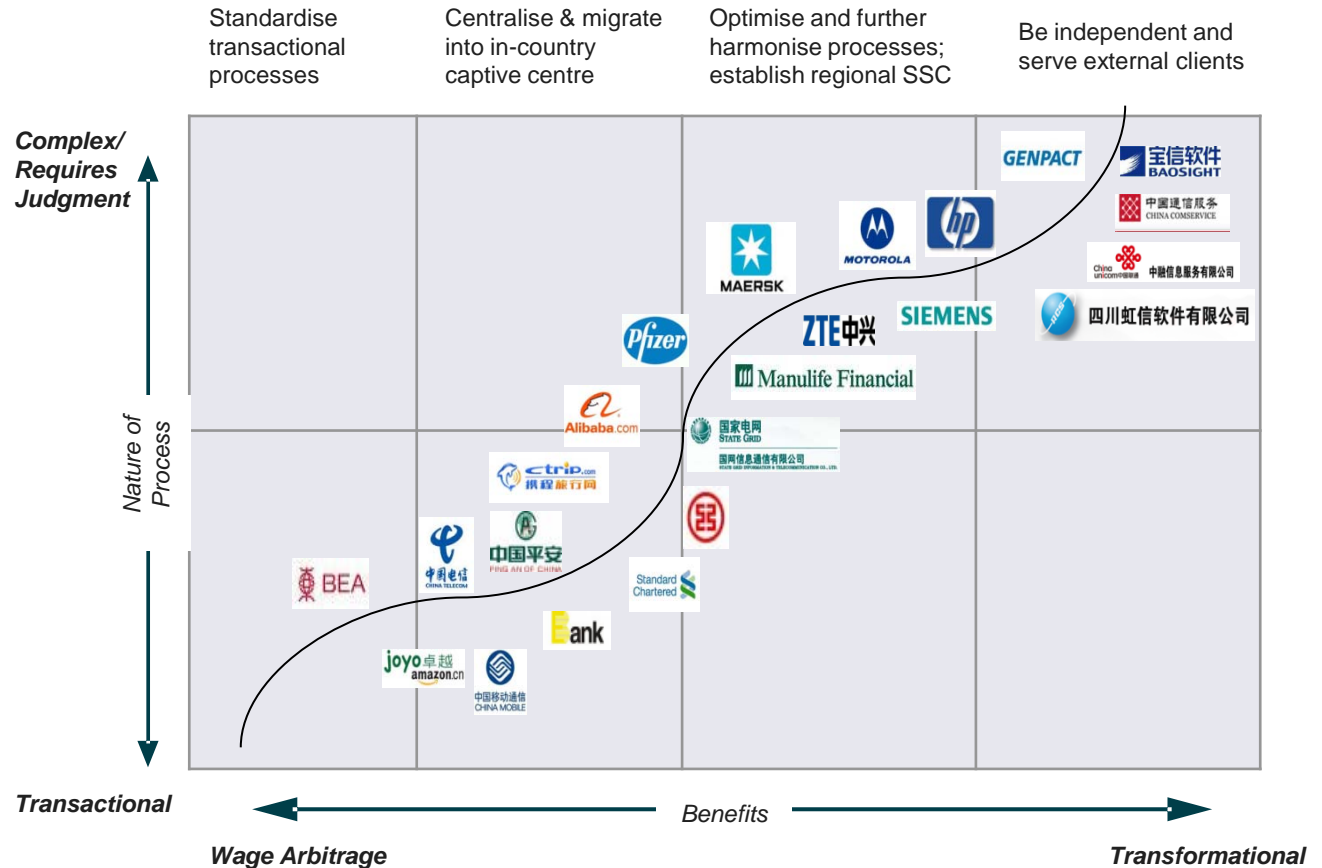


# Maturing SSC market

## Industry

As China SSO market matures, new entrants to the market are able to leapfrog on collective experience and expand more quickly and deeply thus gaining value more quickly

*Captives are continuously growing, expanding and maturing in its business models as well as types of services under management*



Source: KPMG research



# What is generating SSC Demand?

## Demand generation

### “What Are Your Numbers Telling You?”

Businesses are challenging their captive and outsourced operations to influence business outcomes. This requires a deep understanding of how the work of the SSO impacts the business, the tools needed to capture granular operational data and how to combine business knowledge and analytics to create meaningful improvement opportunities to IMPACT the bottom line.

SSON, 2012



MNCs are currently the most active outsourcing buyers. However, the government is expected to become one of the most important revenue sources in the medium term...then scale becomes a key focus

Services go beyond IT and business process services; innovation and skills will drive industry

Technology, automobile, logistics and healthcare sectors will be the key drivers of development

Knowledge services and R&D (e.g. analytics, **BIG** data, internal/ IT audit, risk assessment, design, animation) to impact business

‘India + 1’ factor to mitigate risks for multinationals

Multinational companies de-risking drug R&D

Mobile internet technology introduces great opportunities to service outsourcing (CCIIP)

# Key drivers for shared services in China

## Demand generation

Success of such initiatives largely depends upon the following key elements:

- Absolute management commitment
- Organisation wide restructuring
- Transformation mindset in corporate culture

*Improvement of delivery processes, controls and transparency on operations are influencing decisions to use SSCs...in particular for SOEs low cost is not the primary consideration*

### MNC

- Synergy across Business Units to get economies of scale
- Cost efficiency by consolidation and standardisation of support functions
- Improvement in service levels of internal customers
- Better control and transparency of operations

### SOE

- Access to Global Best Practices followed
- Focus on better People management as opposed to headcount reduction
- Process improvement and better visibility of operations

### POE

- Cost reduction and improvement in profit margin
- Better control and transparency of operations
- Better people management to be able to focus on core elements

Source: KPMG research





# SSC Captives Vs Outsourcing

## Service provider

“Even though it has been for some time that the outsourcer to participate shares or even control shares of the contractor, the cooperation between Huawei and CS&S undoubtedly produces more extensive and far-reaching impact as several Chinese outsourcing giants are involved with.

It may change the market structure of China's service outsourcing industry in the near future.”

Sherry Sha, Deputy Director, Devott Service Outsourcing Research Centre, 2012



Consolidation of services providers through M&As and JVs will continue to flourish

The market is **big** enough to foster differentiation

Partnering with local service providers is increasing

Delivery centres continually move to lower tiered cities towards central and western China

Scale and capability is a draw for customers and service providers alike

Service providers will benefit from favourable cost arbitrage for the next 13 - 14 years, facilitating long-term strategy

Operating costs in China's biggest metropolitan areas are still 60 to 70 percent cheaper than major U.S. cities

# Service providers in China outsourcing market

## Service provider

*Until end of July 2012, 18,977 service providers were providing employment to over 3.72 million workers in China's SSO service industry*

### Trends

- Foreign service providers: transition from India to China
- Chinese service providers: new wave of M&A and IPO
- Increase in the bundling of ERP consolidations and F&A outsourcing contracts



- Demand in outsourcing services could not be fulfilled by leading global and offshore centric players alone and presents huge opportunity for Chinese service providers
- China service providers are relatively small in size compared to leading global and offshore centric vendors at present however are growing at a faster pace and focusing on building capabilities towards higher value BPO/ KPO services
- Consolidation of Chinese players is expected to create scale and expertise to be competitive
- Customers are presented with bewildering number of choices and clarity on selection criteria become paramount to having the best service partner(s)

Source: KPMG research



# Consolidation of service providers accelerates

## Service provider

“The combined company will be a clear market leader ...with the largest resource base, most comprehensive breadth of IT services capability and the most balanced geographic customer profile”

*Mr. Tiak Koon Loh, current CEO of hiSoft*

“The joint company can take advantage of the strong market growth opportunities while continuing to attract the best people”

*Mr. Chris Chen, current Chairman and CEO of VancelInfo*

“To achieve sustainable growth and profitability, iSoftStone needs to scale revenues and deepen vertical capabilities. This T&C-focused JV, combined with our other two major verticals of BFSI (Banking, Financial Services, and Insurance) and ETP (Energy, Transportation, and Public), will accelerate our pace to become a full IT services provider and become a billion dollar revenue company.”

*Mr. T.W. Liu, Chairman and CEO of iSoftStone*

*We observe a new wave of consolidation of Chinese service providers in 2012, driven by increasing competition on profit margin, client base, talents, scale and service delivery capacity. The trend is expected to continue and accelerate in coming years*

10 August 2012

### VancelInfo and hiSoft to Merge to Create China's Leader in Global IT Services

- The merger of equals of the two leading IT outsourcing companies would create the largest offshore IT services provider in China, with a combined market value of \$875 million
- Over US\$670 million revenue is expected in 2012 for the combined company
- It will employ over 23,000 people across 13 locations in China and 14 additional locations worldwide
- Its vertical areas of strength will include TMT, BFSI, Transport and Manufacturing

*Source: Reuters and Wall Street Journal, 10 August 2012*

4 September 2012

### iSoftStone Announces JV with Huawei

- The JV, 75% owned by iSoftStone and 25% owned by Huawei, with registered capital of RMB 100 million, will officially start operation in January 2013
- Huawei has been a major client of iSoftStone for over a decade, and the JV is expected to deepen this partnership
- Huawei will purchase a significant amount of IT services from the JV in the next three years, and also provide favorable terms in billing rates, payment terms, and profit allocation
- iSoftStone will contribute selected technology and communications businesses into the JV

*Source: China Business News, 4 September 2012*

# Talents Pool in China – Enabler or Challenge?

## Talent

The Ministry of Information Industry of China has been working on national-scale IT skills and outsourcing talent development projects, such as the outsourcing training project jointly-operated by MII and NEC; aim to produce several hundred thousands outsourcing and IT



Turnover is high;  
recruitment process is  
beginning to evolve and  
mature

Experts are expensive;  
and can easily switch  
jobs

Business are building  
shared services brands  
to attract people

Leadership crunch;  
training the next  
generation of leaders is a  
key focus

Explore new training  
models by government,  
industry and universities

Government and local  
authorities continue to  
offer attractive training  
subsidies

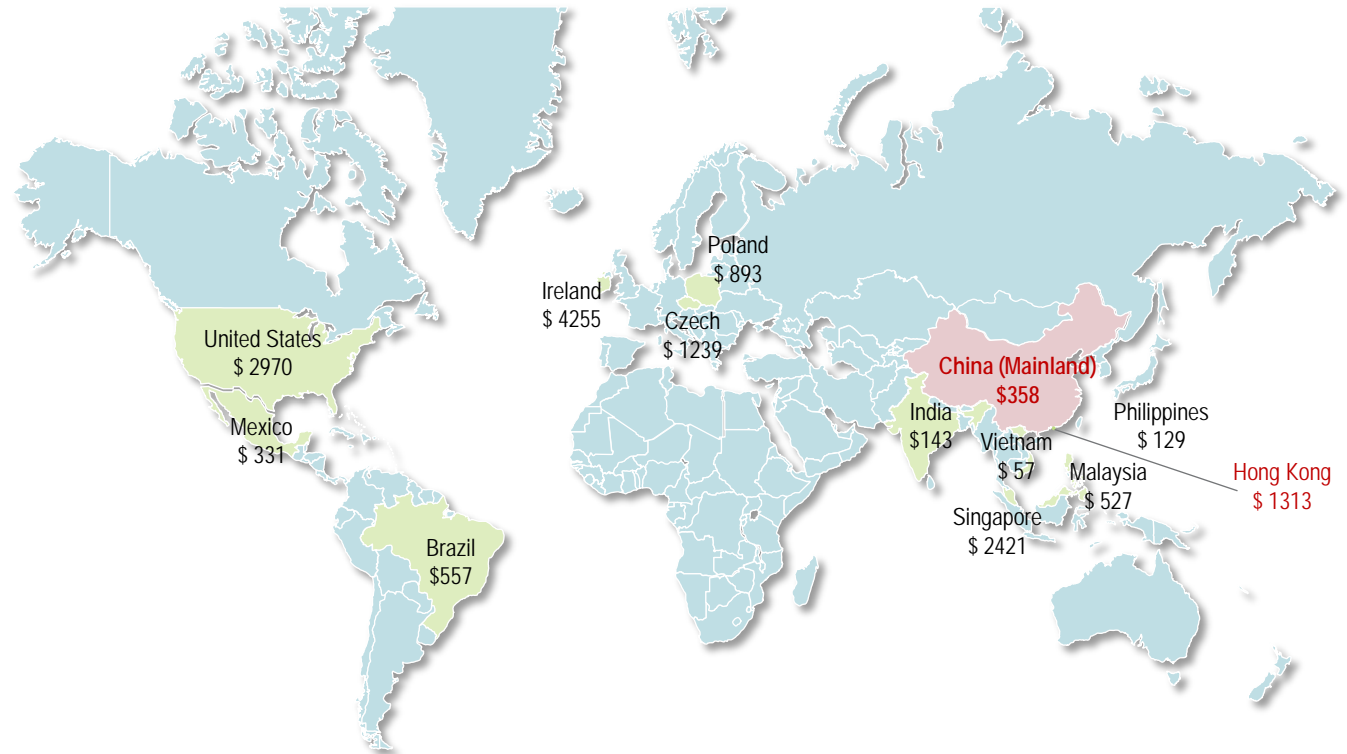
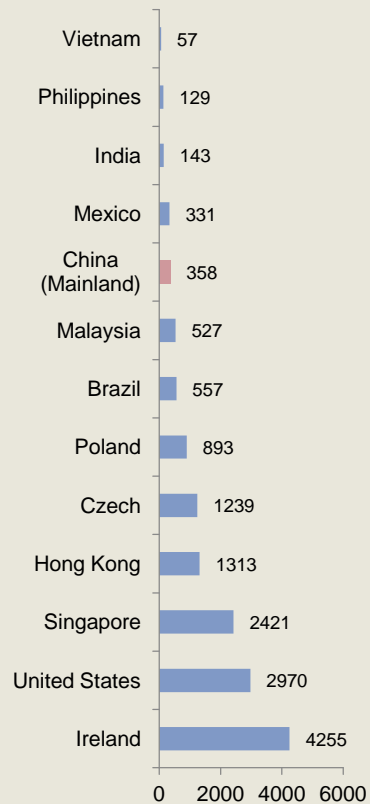
Cloud (e.g. cloud HR) and  
virtualisation may solve  
talent strain

# China has a relatively low labour cost

## Talent

*China's labour cost is relatively low from a global perspective, although rising cost has been an issue facing all the major SSO destinations. The competition is not a pure cost play, other factors such as size and skills of talents are of increasing importance*

Average Monthly Wages in USD



Source: International Labour Organisation & Key Indicator of Labour Market, 2009, Central Statistics Office, Ireland 2010



# Labour cost varies across different Chinese cities

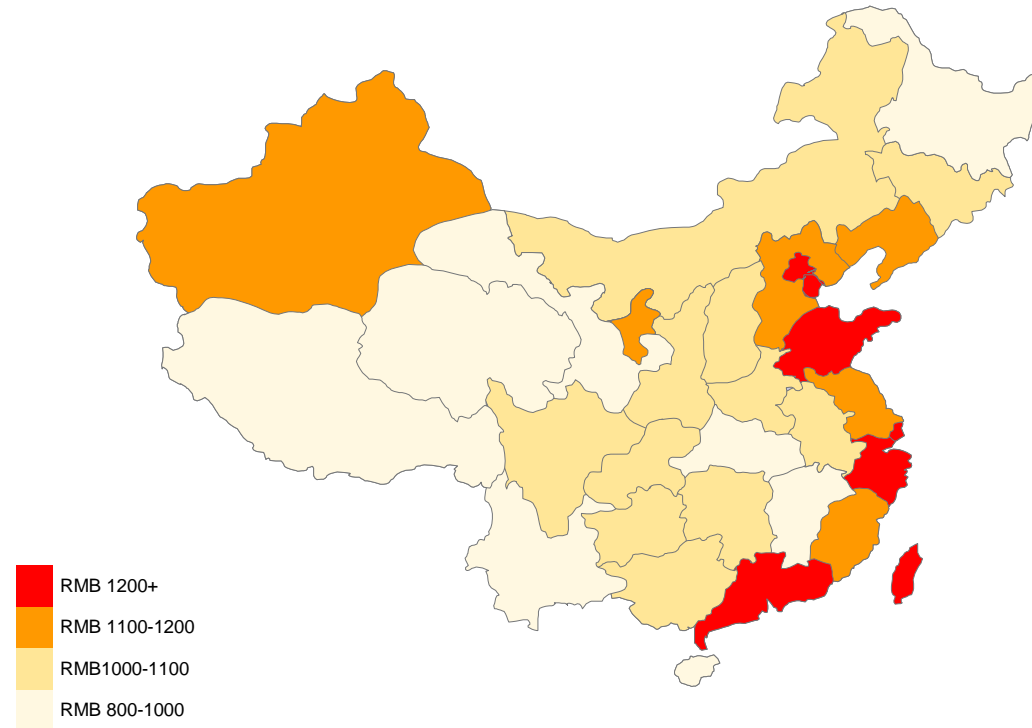
## Talent

### Average Yearly Wage of some Outsourcing Model Cities in 2011 (in RMB)

Rank	City	Wage
1	Guangzhou	57,473
2	Beijing	56,061
3	Nanjing	54,713
4	Hangzhou	54,408
5	Shanghai	51,968
6	Wuhan	45,643
7	Hefei	45,442
8	Changsha	44,497
9	Tianjin	42,240
10	Xi'an	41,679
11	Chongqing	40,042
12	Nanchang	39,816
13	Harbin	36,465
14	Jinan	35,435
15	Chengdu	34,008

*High labour cost in cities along the coastline is driving enterprises to seek lower-cost alternatives in tier 2 / 3 cities in the Central and Western region*

Heatmap of minimum monthly wage across China



Source: Chinanews, 2012; Council of Labour Affairs Taiwan, 2011

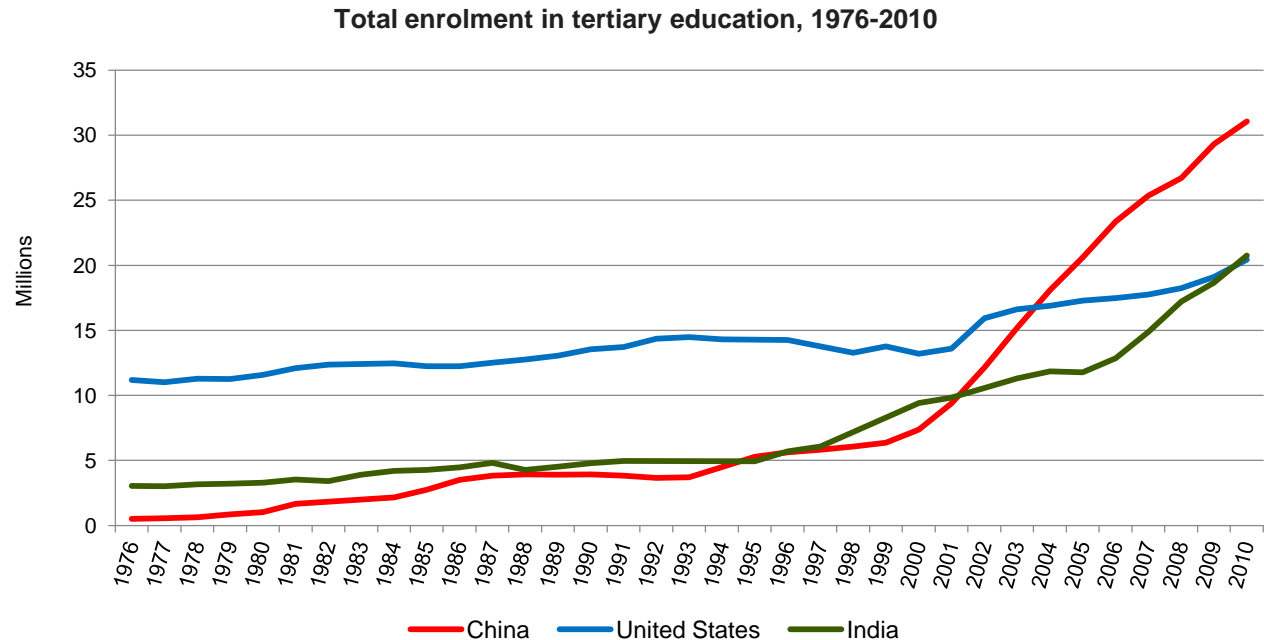
# Talent pool of China is growing fast...

## Talent

The Times Higher Education - QS World Rankings 2011 have placed six of the Chinese universities among the top 100 universities in the world. They are:

- University of Hong Kong (22nd)
- Chinese University of Hong Kong (37th)
- Hong Kong University of Science and Technology (40th)
- Peking University (46th)
- Tsinghua University (47th)
- Fudan University (91st)

*China has been catching up quickly in the past three decades through a positive education policy... Output of the education system surpassed US and India since mid 2000s*



Source: UNESCO, 2011

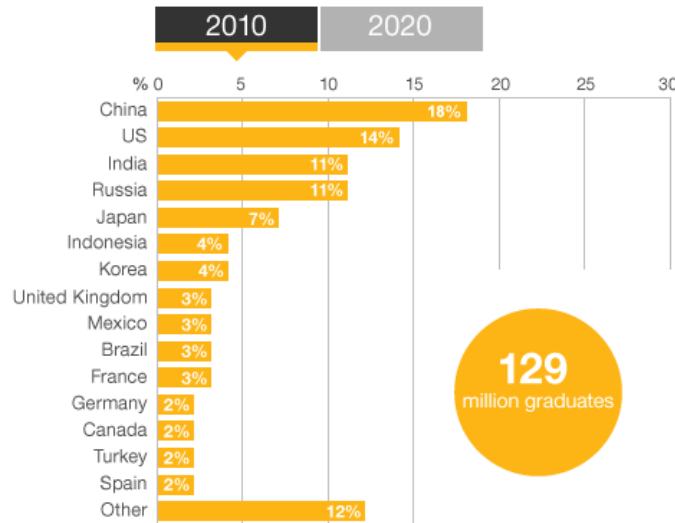
# China will have a dominate share of the world's graduates by 2020

## Talent

*By the end of this decade, three out of every 10 of the world's young graduates are going to come from China*

**The changing share of the world's young graduates**

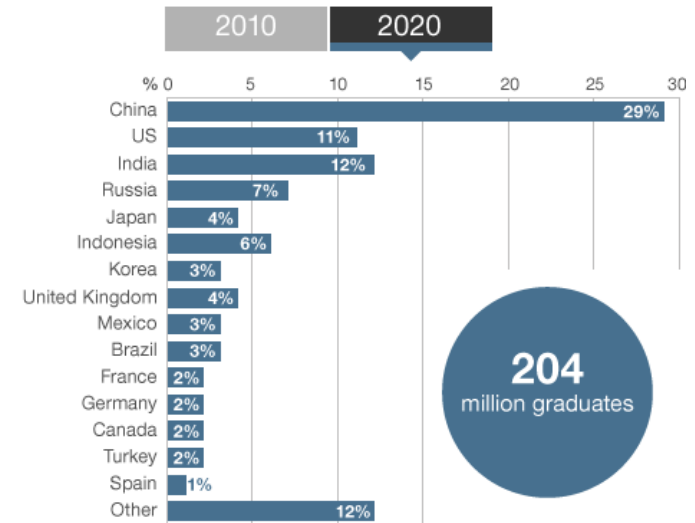
25-34 year-olds with a degree in OECD and G20 countries



Source: OECD

**The changing share of the world's young graduates**

25-34 year-olds with a degree in OECD and G20 countries



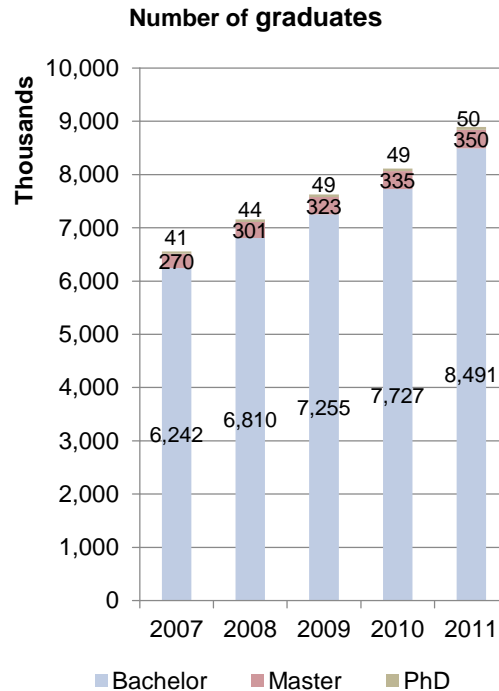
Source: OECD

Source: BBC News, "End of empire for Western universities?", 10 July 2012

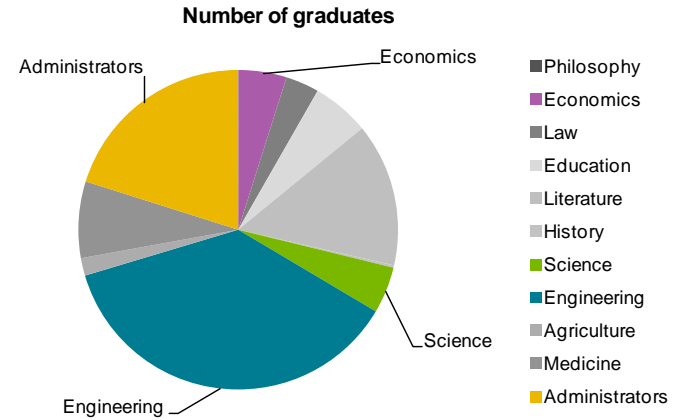
# China's talent pool is diverse

## Talent

*Adding to the graduate talent pool is the growing high-end research talent with post-graduate qualifications*



Source: National Bureau of Statistics 2011 statistics, KPMG research



Source: Ministry of Education – 2010 Statistics

*Large number of engineering / science graduates provide a strong pipeline for IT services, while graduates in economics, commerce and administration would become a rich source for delivering business process and knowledge services*

# English proficiency is improving in China

## Talent

### About EF English Proficiency Index

The EF English Proficiency Index (EPI) is a standardised measurement of adult English proficiency, comparable between countries and over time.

The index uses a unique set of test data from over two million adults who took free online English tests over a period of three years. Because this group of test takers is so diverse and the entry barrier to taking an online English test is so low, the resulting scores are reasonably representative of the average English level of adults.

*English proficiency has been one of the key constraints to China's offshore services capability, but China is attempting a remarkable linguistic feat to its English-speaking rivals*

- According to EF English Proficiency Index (EPI) in year 2011, China ranks 29 out of 44 countries around the world, gaining a score slightly higher than its major competitor, India
- According to a report published by Cambridge University Press, more people are learning English in China than in any other country – it is estimated that there are 250 to 350 million English learners in China, compared to 55 to 350 million in India
- The score and ranking shows that China still has a long way to go before it can be considered as adequately proficient in English. But the government has shown great motivation in training children and retraining adults, especially those in the public sector
- With continuing efforts of Chinese Government and the citizens on English proficiency, more international business opportunities will flow into the country in future

Rank	Country	Score	Level
9	Malaysia	55.54	High Proficiency
12	Hong Kong	54.44	Moderate Proficiency
13	South Korea	54.19	Moderate Proficiency
14	Japan	54.17	Moderate Proficiency
25	Taiwan	48.93	Low Proficiency
26	Saudi Arabia	48.06	Low Proficiency
<b>29</b>	<b>China</b>	<b>47.62</b>	<b>Low Proficiency</b>
30	India	47.35	Low Proficiency
32	Russia	45.79	Low Proficiency
34	Indonesia	44.78	Very Low Proficiency
39	Vietnam	44.32	Very Low Proficiency
42	Thailand	39.41	Very Low Proficiency
44	Kazakhstan	31.74	Very Low Proficiency

Source: EF EPI 2011



# What's next.....

## SSC EcoSystem

### Key considerations:

- Industry
- Technology
- Innovation
- Demand generation
- Talent
- Government
- Service Provider
- Regulation



How can innovation drive the success of SSC?

With all the government support in China, can we overcome the challenges on talent retention?

How can we combine the best use of technology like Cloud and Social Media in our SSC

What is our SSC business case besides cost savings?

How can we leverage SSC to create value and improve efficiency?

Can our SSC support our future growth in China and in the region?

What does the best SSC look like?

# Thank you

Ning Wright  
China Leader  
Shared Services and Outsourcing Advisory



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