

Offshoring in Financial Services: Determinants and the Effect of a Changing Environment

A Switzerland to Poland Perspective

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Isabel Zimmer has been working in the financial services industry for almost 20 years, where she has held a broad range of functions, including roles within sales, credit risk control and legal in Basel, Zurich and New York. She was promoted to Executive Director in 2007 and is currently the head of UBS' Traded Products Legal Documentation Unit in Switzerland. After having been involved in previous offshoring initiatives, she became responsible for an offshoring project that led to the transfer of processes from various European booking centres into Poland in 2008. This professional background allowed her to gain first hand insight into the determinants and challenges of offshoring initiatives and into the factors shaping their long term success. Isabel Zimmer holds a Master's degree in Economics (lic. rer. pol.) from the University of Basel, Switzerland where she specialized in international trade and regional economic development.

Abstract

What is the rationale for moving processes offshore and for selecting a specific country? And what is the impact of the global economic downturn on the original determinants and, thus, on established offshore centres? The paper attempts to answer these questions with a focus on the financial services industry in general and the offshoring of processes to Poland in particular. Basis for the analysis are academic literature, professional experience of the author, information provided by consultancy firms and interviews with senior people in offshoring functions at leading Swiss financial institutions.

The conceptual framework encompasses three different theoretical perspectives: Transaction Cost Economics, Resource Based View and Institutional Theory. In the financial services industry, the major cost factor is human resources. Companies decide to offshore in order to lower costs and remain competitive. When determining whether to move processes abroad and when deciding on a specific country, they compare the cost savings of wage differentials against potential additional production and transaction costs. In addition, further (hidden) costs may arise from cultural differences, geographic distance as well as language barriers between the home and host countries. When cultural differences are large, miscommunication and misunderstandings cause additional friction that may translate into costs. However, offshore processes do not all incur hidden costs to the same extent: the simpler and more standardized processes, the lesser the negative effect of cultural differences and its implicit communication difficulties – and the other way around. Further, cultural aspects will have an a priori impact in that decision takers will tend to choose a location with which they feel at ease over one they do not. Other determinants that explain the rationale for moving processes offshore and for the selection of a specific destination are the need to tap on resources and specific skills that may not be sufficiently available elsewhere plus institutional pressures from external and internal sources. The uncertainty of a new environment - including infrastructure, political and regulatory risks – and time zone differences are also part of the assessment. In summary, companies decide on a particular country based on trade-offs between the attractiveness of financial aspects (comparative wages, additional production and transaction costs), labour pool availability, and the risks associated with the country. It is combination of all of these factors that guide the selection of the destination country and the success of the onshore-offshore relationship.

Poland and other Eastern European countries are situated between the richer countries in Western Europe and poorer countries in Asia, not only with regard to geographical location but also in terms of quality of the legal and regulatory context. Although these countries cannot compete with labour costs in less developed countries, a combination of other factors such as the availability of a large pool of graduates with foreign language skills, geographical and

cultural proximity to Western Europe and the institutional and regulatory stability provided by the EU membership provide comparative advantages over cheaper offshoring destinations. Poland's offshoring sector has benefited from EU membership and a stable government. Practically in the same time zone and culturally aligned, it is a preferred destination for the offer of services to clients in Western Europe. A case study of two offshore centres in Poland shows that the three theoretical perspectives of the conceptual framework - Transaction Cost Economics, Resource Based View and Institutional Theory - apply to actual projects. The multinational institutions decided on Poland as the destination for their offshoring captives based on a number of determinants and trade-offs – including relative wages and historical stability of salary increases, access to a large pool of university graduates with language skills, and institutional aspects such as political stability, legal environment and support by local authorities.

Poland's economy and political system have proven to be robust enough to master the recent global economic downturn, so that the main determinants that had led to the establishment of offshore centres were only mildly impacted or, if at all, in the 'right' direction. The crisis slowed the trend of growing wages and depreciated the Zloty against the Swiss Franc and other currencies, thus reducing costs of foreign investments. The crisis also caused professionals to repatriate and therefore increased the available labour pool by adding more experienced and language skilled people to the market. Other aspects like the cultural and geographical proximity to Western Europe were, by their nature, not impacted. Further, the risk profile of the country, much defined up to then by the EU membership and related political and structural developments, probably improved after having demonstrated the stability and capability to master a financial crisis. On the other hand side, multinational companies face institutional pressures not to move jobs abroad and to tap on domestic workforces, causing the growth in the offshoring and outsourcing sector to slow down. All together, the global economic crisis appears to have extended the time in which the country will remain attractive for offshoring and outsourcing.

In the long-term, the economic success of Poland (which supported the establishment of the offshoring and outsourcing sector in the first place) may, with its impact on increased costs for foreign investors, result in a major challenge for the sector. A possible strategy for the offshoring and outsourcing sector could be to concentrate on the countries' comparative advantages over less developed and cheaper locations, such as the reliable legal and political system and a motivated and well-educated workforce. Wage differentials between home and host countries are larger further up the value chain; on this basis, multinational companies may strive in the future to offshore tasks requiring highly skilled labour rather than routine work. Thus, rather than supporting the home organisation with data entry and low end value

chain type of tasks, offshore centres could aim at establishing themselves as alternative 'same-level' locations concentrating on specialised tasks.