KPMG

KPMG Pulse Survey: Shared Services and Outsourcing in China

ADVISORY

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Executive summary

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A strong majority of executives in our survey have a strategy involving outsourcing or shared services, or a combination of the two. This is irrespective of their size and sector.

Shared services are expanding rapidly in China. IT Outsourcing (ITO) has tended to precede Business Process Outsourcing (BPO) and Knowledge Process Outsourcing (KPO) in other markets, but our survey suggests executives are looking at all these functions simultaneously in China.

In the outsourcing space, China has still not reached the level of maturity seen in India. There is huge potential, but with so many locations vying for investment, executives have tough choices to make.

India and the Philippines are two of the leading destinations globally for both outsourcing and shared services. However, the survey shows that for executives based in the Asia Pacific region, China is now a strong and in many cases preferred destination.

The pulse survey shows that executives are not choosing China locations just on the basis of cost. Moreover, language is not seen as a deterring factor for China.

About the survey

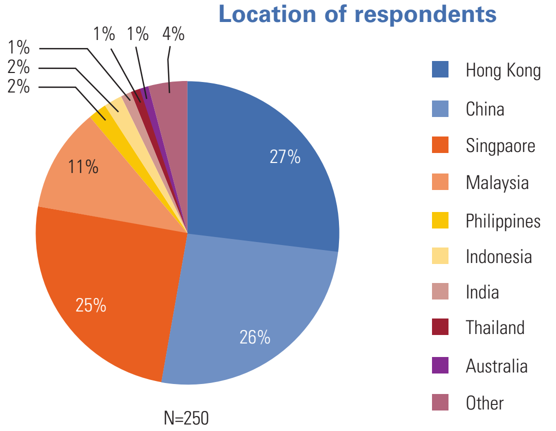
In May and June 2010, *CFO Innovation* conducted an online survey for KPMG China involving 286 CFOs, finance directors, financial controllers, CEOs and other senior executives based in Asia.

The survey takes the pulse of executives with regard to their use of shared services and outsourcing providers in Asia, the preferred location of those shared services centres and outsourcing providers, the services they are outsourcing, and other related issues. We have provided a succinct commentary on the responses to each question, drawing out what we believe to be the implications for executives in the region.

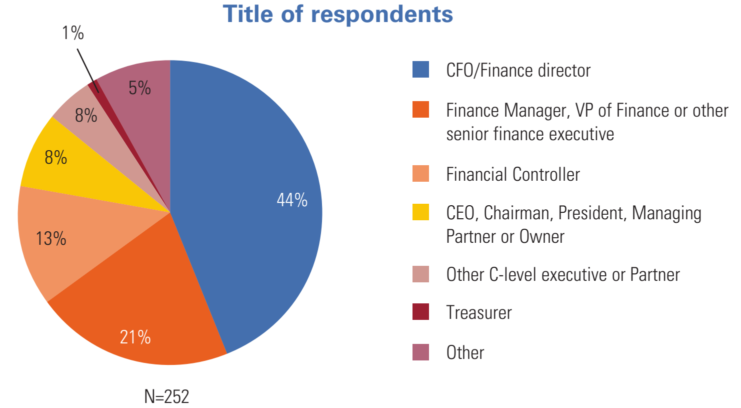
The respondents were mostly based in China (including Hong Kong) and in Singapore, with a smaller number based in Malaysia (11 percent) and other parts of the region (11 percent combined). The majority held a senior finance function such as CFO (44 percent) or Financial Controller (13 percent).

These executives represented a range of companies of different sizes, with 70 percent having turnover of over USD 50 million per annum and of those a further 32 percent having turnover exceeding USD 1 billion. All sectors were represented with the most prominent being financial services (16 percent) and electronics/software/technology (11 percent).

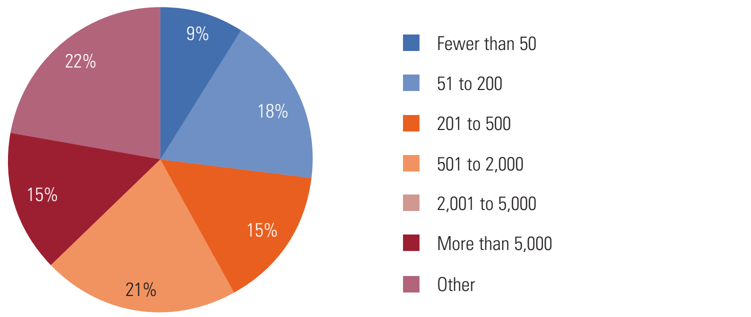
Location of respondents



Title of respondents

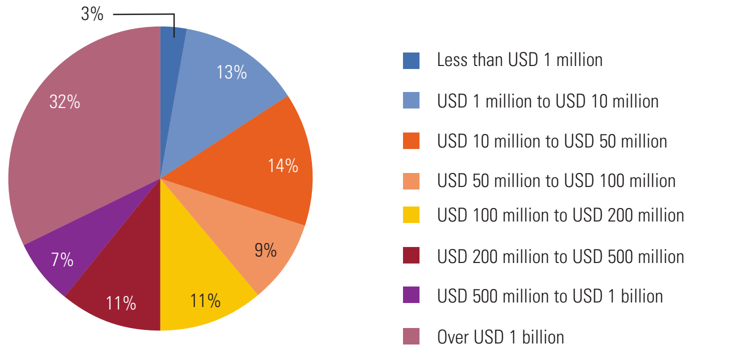


Size of organisation (employees)



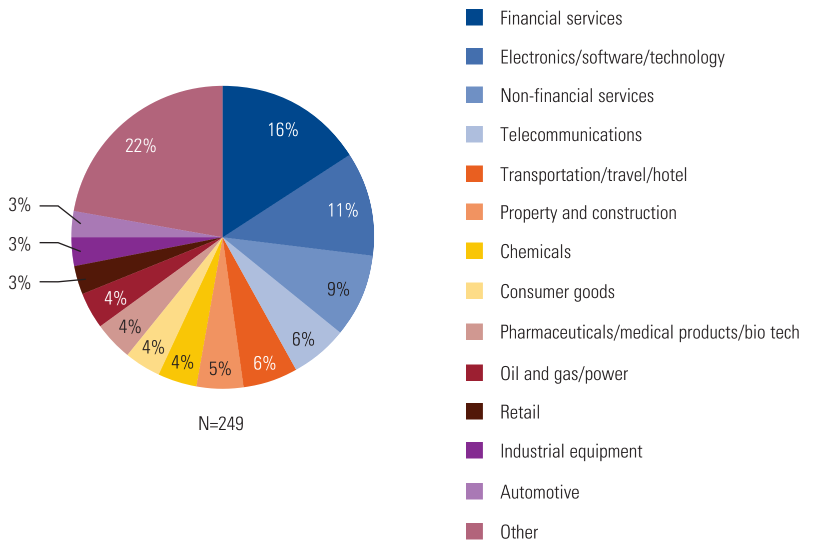
N=248

Size of organisation (turnover)



N=246

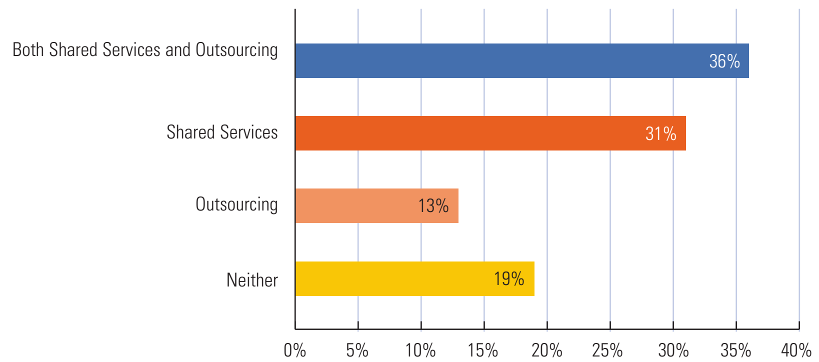
Sector



N=249

Pervasiveness of outsourcing and shared services

Q: Which of the following does your company practice?



N=286 respondents. Figures may not add up to 100% because of rounding.

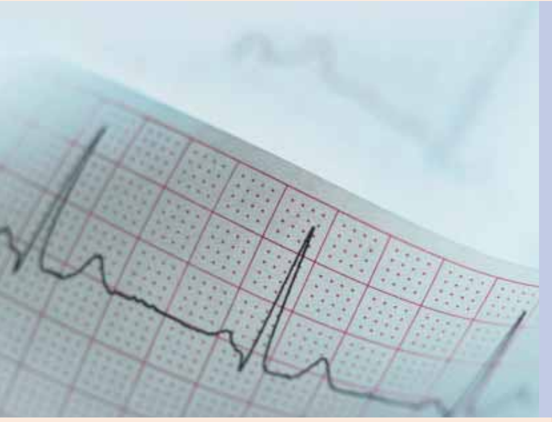
Shared services and outsourcing strategies are more prevalent among companies in Asia than many would assume. Only 19 percent of the respondents indicate that their company does not use a shared services centre or an outsourcing service provider. Many of the executives surveyed say their firm uses both shared services and outsourcing (36 percent), while some use just shared services (31 percent) or just outsourcing (13 percent).

KPMG comment

For the past two years, Asian companies have been outsourcing and offshoring as much as their western counterparts. It is significant that 81 percent of companies now employ a strategy involving outsourcing, shared services, or a combination of the two.

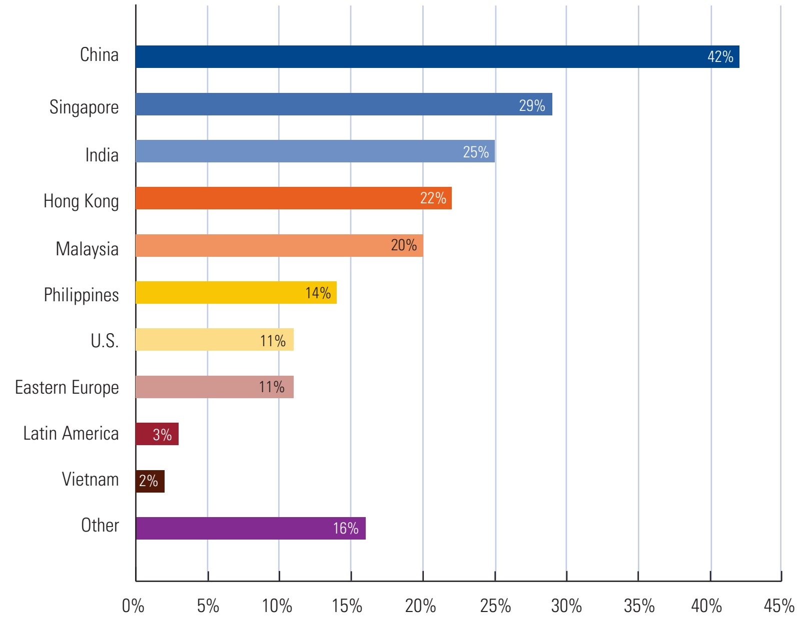
Executive implications

For the 19 percent that still don't have an outsourcing or shared services strategy, it may be time for a rethink. Most companies appear to have a "plus-two" strategy in Asia and executives need to consider how they make use of the talent pools and accompanying ecosystems that exist between different locations in the region.



Responses for users of shared services

Q: Where is/are your shared services centre/s located?



N=199 respondents. Figures do not add up to 100% because multiple responses are allowed.

The preferred location for shared services centres is, perhaps surprisingly, China. Four out of ten respondents (42 percent) who say their company has set up shared services centres (SSCs) report that one of those locations is in China. (Respondents were allowed to give multiple answers and on average selected more than two locations). Singapore stands second as a popular location (29 percent of respondents say their SSC is in this country), followed by India (25 percent), Hong Kong (22 percent) and Malaysia (20 percent). The Philippines, which is regarded as a major base for outsourcing providers, hosts the SSCs of only 14 percent of the companies surveyed.

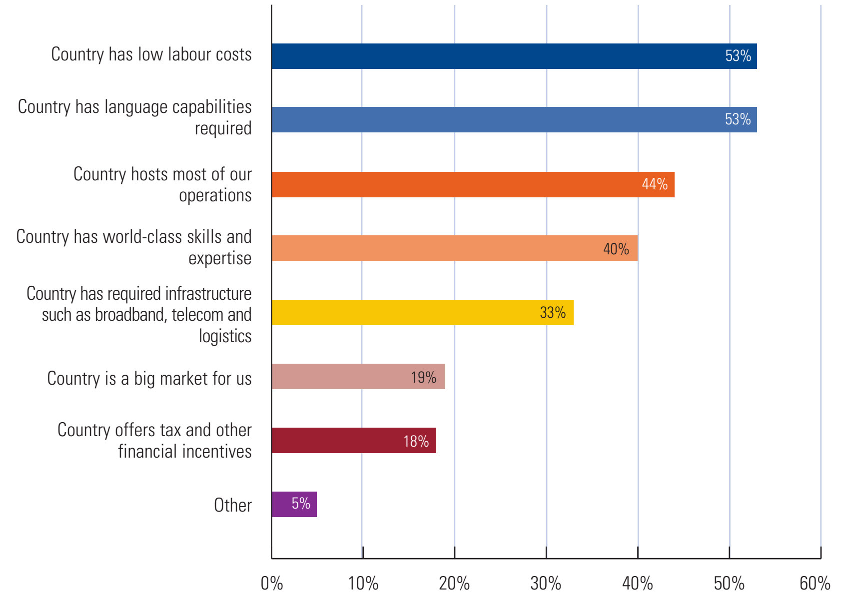
KPMG comment

The speed with which China has emerged as a shared services destination will no doubt be a surprise to some observers. China, the Philippines and Vietnam are the lowest cost locations in Asia Pacific. Regional hubs such as Hong Kong and Singapore still have an important role to play for certain high-value functions that senior management want to keep closer to their regional headquarters.

Executive implications

For executives based in the region, China is now a strong and preferred destination. The Philippines, Malaysia and India all have an advantage in certain respects such as language, but in Asia Pacific, language means more than just English. It also means Japanese, Korean and Chinese.

Q: Why was that shared services location selected?



N=189 respondents. Figures do not add up to 100% because multiple responses are allowed.

Low labour costs and language capabilities are the two key reasons cited in choosing the location for the shared services centre. The majority of respondents (53 percent each) cite these two factors. Two other important reasons are the fact that the country hosts most of the company's functions (44 percent) and the country having world-class skills and expertise.

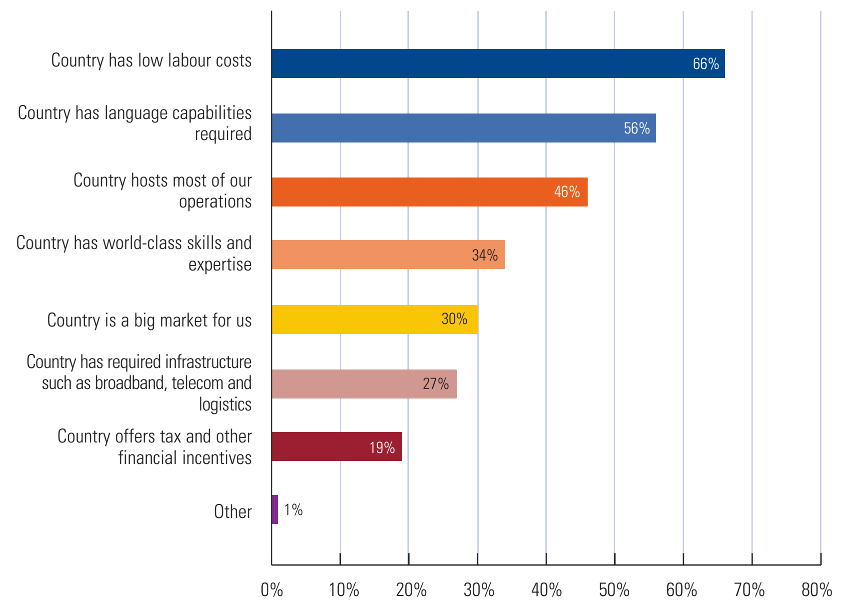
KPMG comment

Organisations are, quite rightly, not choosing locations on cost alone. Language, skills and infrastructure are all critical. Given how many people choose China and India, it is surprising that more do not cite domestic market potential as a factor (only 19 percent do so). We believe that figure is likely to rise.

Executive implications

Executives should be careful about making choices based on cost. They should also think about the long term needs of their business and how their outsourcing and shared services approach aligns with their wider growth strategy.

Q: Why was that shared services location in China selected?



N=79 respondents who say their SSC is in China. Figures do not add up to 100% because multiple responses are allowed.

Respondents whose company has located its shared services centres in China cite the same reasons as the total sample, although more of them point to low labour costs. Two-thirds (66 percent) of these respondents say the key reason for locating the SSC to China is the low cost of labour, with 56 percent citing China's language capabilities – presumably English and, of course, Mandarin as well as other Asian languages.

Looking ahead, it will be interesting to see whether China's costs will continue to be regarded as affordable given signs of a tightening supply of labour and its accompanying move up the value chain.

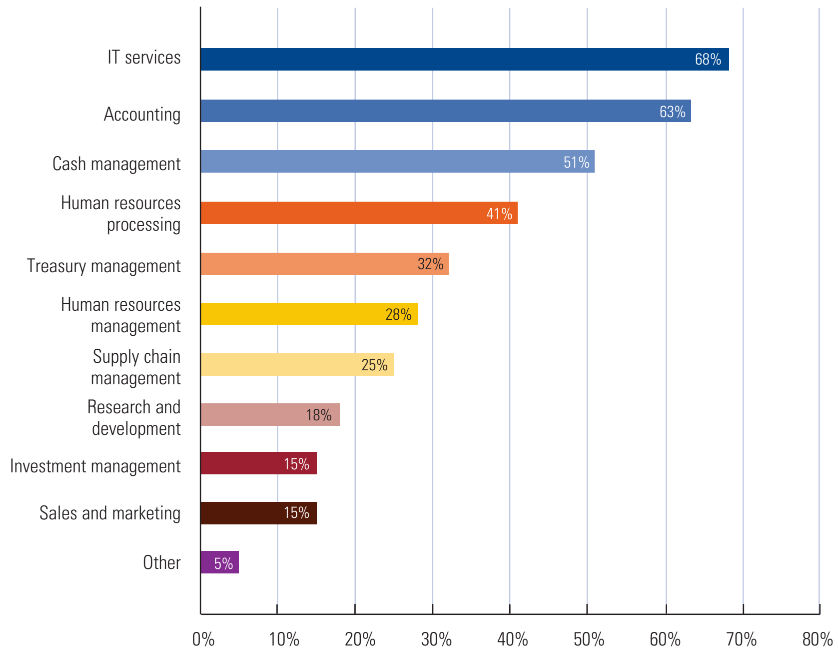
KPMG comment

There are some interesting comparisons between the factors chosen overall and the factors behind choice of location in China. China is not at a disadvantage with regard to language. In fact it scored higher as a factor in China (56 percent) compared to overall (53 percent).

Executive implications

Executives need to look at the opportunities for shared services facilities with an open mind. The risks and drawbacks of China may not be in the areas they had imagined. An example of this is that language is not seen as a hindrance. More of those who are setting up in China cite the domestic market potential as a decisive factor (30 percent) compared to those choosing other locations (19 percent for all respondents).

Q: What services are undertaken by your Shared Services Centre/s?



N=186 respondents. Figures do not add up to 100% because multiple responses are allowed.

Regardless of where located, the SSC is most often tasked with providing IT services and accounting services. Nearly seven out of ten (68 percent) say the SSC provides IT services, including help desks, while 63 percent say the SSC's role extends to accounting services, including general ledger, monthly closing, financial reporting, debt collection and tax processing.

The majority of the executives surveyed (51 percent) also cite cash management, which includes collecting accounts receivable, processing accounts payable and taking charge of working capital management.

Research and development is a less common activity among SSCs (18 percent), along with investment management and sales and marketing (15 percent each).

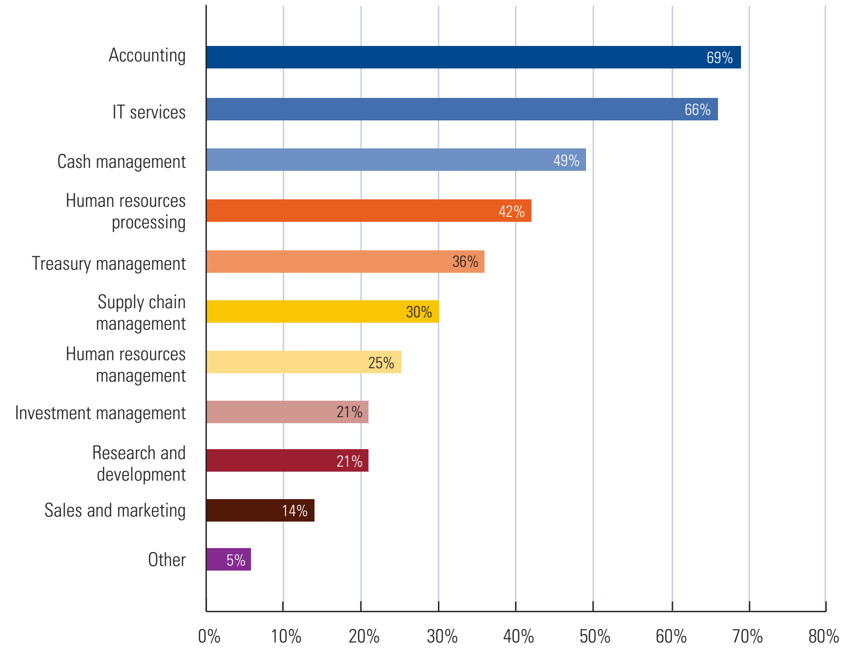
KPMG comment

While IT is leading the way, accounting and finance are growth areas for shared services. Functions such as supply chain management, investment management and R&D remain more niche areas for shared services or are confined primarily to certain sectors.

Executive implications

Any executive concerned about costs rising, or the efficiency of their finance function, should take a look at what others are doing in this space. They should look at all their functions, across every part of the business, and understand what capabilities exist in each area.

Q: What services are undertaken by your Shared Services Centre/s in China?



N=77 respondents who say their SSC is in China. Figures do not add up to 100% because multiple responses are allowed.

As with the total sample, SSCs located in China are most often tasked with providing IT services and accounting services. Nearly seven out of ten companies with an SSC in China (69 percent) say that the centre provides accounting services, while 66 percent say it provides IT services. Forty-nine percent of respondents also cite cash management.

Research and development is also a less common activity among SSCs in China (21 percent), along with investment management (21 percent), and sales and marketing (14 percent).

KPMG comment

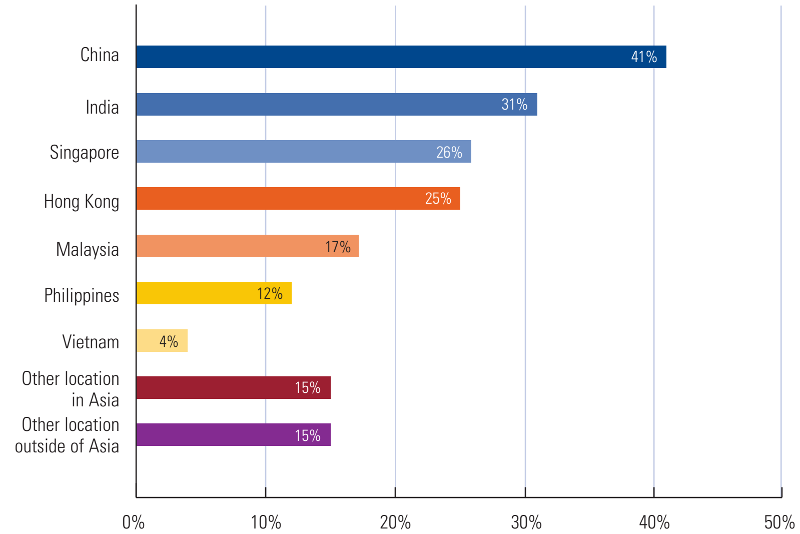
China, as a shared services destination, is not at a disadvantage relative to other countries in the region. The fact that accounting ranks higher than IT as a function provided by shared services centres indicates that BPO has overtaken ITO, while in China, ITO, BPO and KPO are all occurring simultaneously.

Executive implications

Shared services are growing across the board in China. Many people will not want to commit all their resources into China, so hub-spoke or "plus-two" models will continue to be important. But for any executive looking at China, there is the genesis of an ecosystem that will be very powerful in the future.

Responses of those using outsourcing providers

Q: Where is/are your outsourcing service provider/s located?



N=138 respondents. Figures do not add up to 100% because multiple responses are allowed.

China is the preferred location for third-party outsourcing providers, more so than India. Four out of ten executives surveyed (41 percent) say their third-party outsourcing provider is in China, compared with 31 percent who point to India. Singapore (26 percent) and Hong Kong (25 percent) come next, ahead of lower cost Malaysia (17 percent) and Philippines (12 percent).

KPMG comment

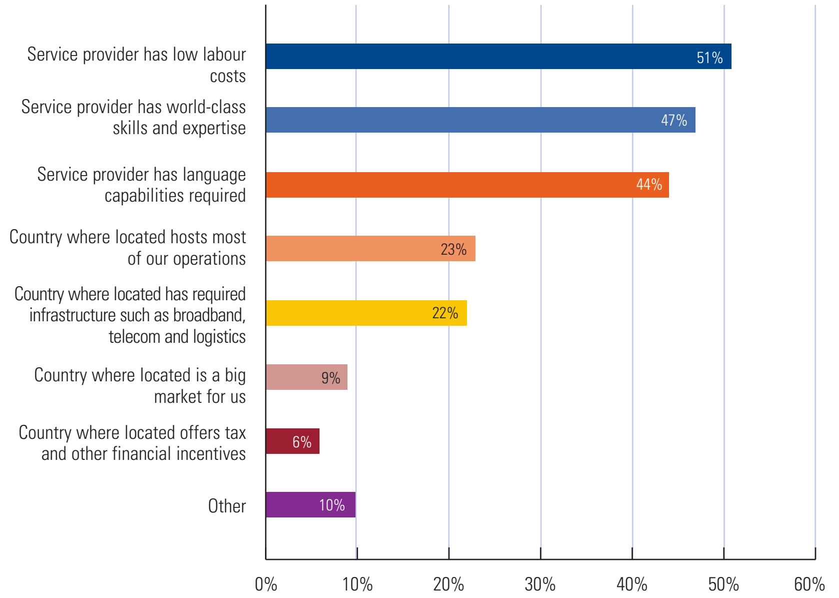
India commands a strong position in the outsourcing arena, but among Asian companies it is clear that many will choose China as one of their main hubs. Singapore is still seen as a strong location for high quality BPO and KPO capabilities – and in particular sectors.

Hong Kong also remains a regional centre. It continues to be a strong service-based economy. The Philippines has proved to be an excellent location for many western companies and can potentially rise higher up the list as a location for Asian companies.

Executive implications

There is plenty of upside for CFOs in Asia Pacific looking to outsource as the vendor footprint is growing and getting more diverse. The potential for hub and spoke models is expanding.

Q: Why did you choose your third-party outsourcing service provider/s?



N=131 respondents. Figures do not add up to 100% because multiple responses are allowed.

As with SSCs, low labour cost is the key reason for signing up an outsourcing provider, but world-class skills and expertise come a close second. The majority (51 percent) say the outsourcing service provider was chosen because of its low labour costs, with 47 percent saying it is because the provider has world-class skills and expertise. The provider's language capabilities are also a key reason (44 percent).

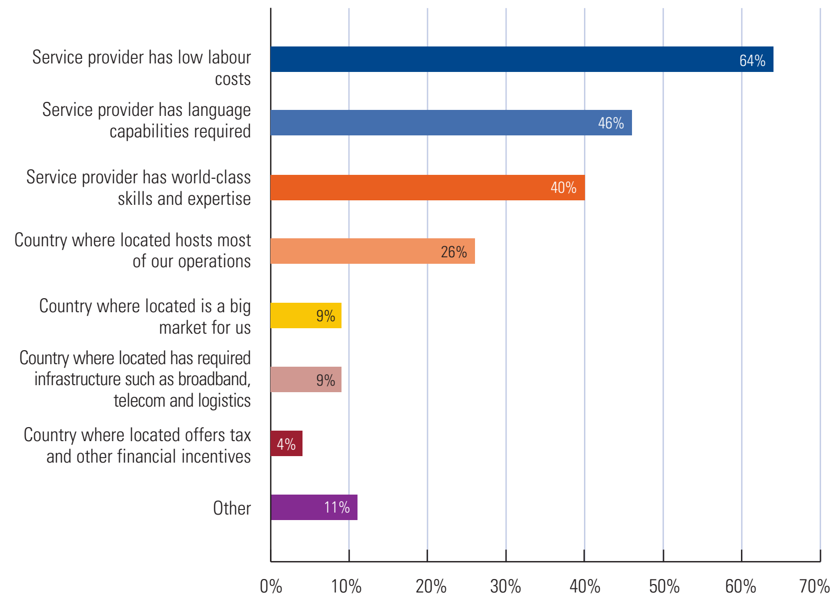
KPMG comment

Purchasers of outsourcing services are choosing on low prices, but also very demanding on quality and skills. It is perhaps surprising that more people did not cite low costs as a factor in their choice of service provider. These buyers are not compromising.

Executive implications

Executives can look for opportunities that give them a cost advantage, without compromising on quality. Asia will become an even more competitive market with vendors offering high quality at favourable prices. CFOs need to check that they are not compromising value and quality for low cost, because there should be no need to do so.

Q: Why did you choose this outsourcing service provider/s in China?



N=55 respondents who say their outsourcing service provider is in China. Figures do not add up to 100% because multiple responses are allowed.

Companies that chose outsourcing service providers in China cite low labour costs as the main reason for the decision. A significant 64 percent point to this, higher than the 51 percent of the total sample. Fewer respondents cite language capabilities (46 percent) and world-class skills and expertise (40 percent) as reasons for hiring an outsourcing provider in China, the same proportion as the total sample.

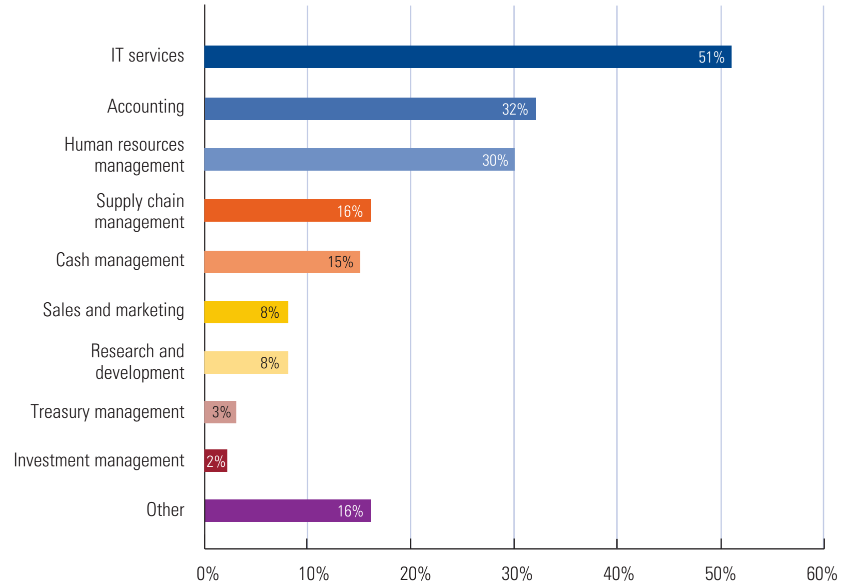
KPMG comment

Low cost is a draw card at this point, but it cannot be expected to remain so and China will likely become less cost-competitive in coming years.

Executive implications

China still has many vendors at a lower scale of capability than India. The gap is wider for outsourcing than it is for shared services. However, the survey result does not reveal any one factor to be singular disadvantage in choosing a vendor in China.

Q: What are the services entrusted to your outsourcing provider?



N=129 respondents. Figures do not add up to 100% because multiple responses are allowed.

Companies use third-party outsourcing service providers mainly to handle IT services. This is what the majority of respondents (51 percent) indicate. Interestingly, only a third (32 percent) say the outsourcing provider serves their accounting needs (versus 63 percent who say their SSC extends accounting services), while just 15 percent say their company entrusts the outsourcing provider with the cash management function (versus 51 percent who say cash management is done by an SSC).

The difference is starker when it comes to treasury management, which only 3 percent of companies entrust to a third-party outsourcing provider, compared with the 32 percent that have turned this function over to a shared services centre. It seems that accounting, cash management and treasury management are regarded as core functions that should remain in-house.

It's also interesting to note that companies are not yet farming out research and development (8 percent outsourcing; 18 percent shared services), sales and marketing (8 percent outsourcing; 15 percent shared services) and investment management (2 percent outsourcing; 15 percent shared services). It may be that these functions, too, are seen as core competencies that should be kept in-house at the operating unit level, not necessarily at the SSC.

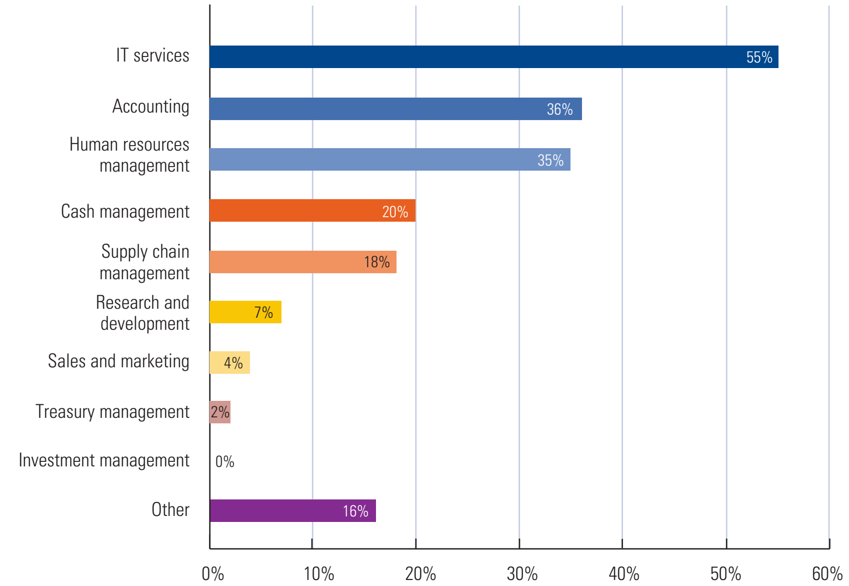
KPMG comment

IT is still the most common function to outsource, although HR is also rising. Higher-end KPO services are not as yet widely outsourced, and in general vendors in Asia have yet to build their skills around these areas.

Executive implications

KPO is still in its infancy. This is an area where shared services is already quite advanced with many companies having established their own captives.

Q: What are the services entrusted to your outsourcing provider in China?



N=55 respondents who say their outsourcing service provider is in China. Figures do not add up to 100% because multiple responses are allowed.

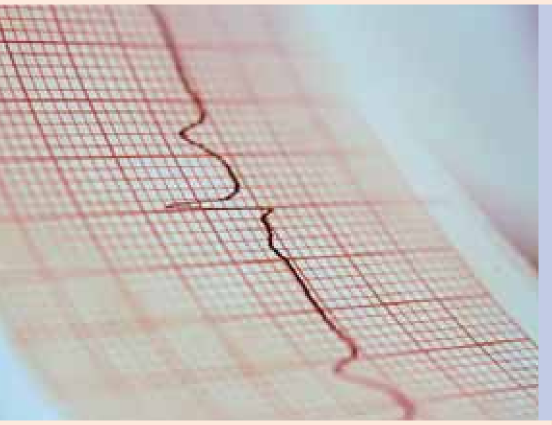
As with the total sample, companies that use third-party outsourcing service providers in China do so mainly for IT services. This is what the majority of respondents (55 percent) say. Coming second are accounting (36 percent) and human resources management (35 percent).

KPMG comment

Outsourcing vendors are still primarily providing IT services, with BPO gaining ground. In shared services, the transformation is across the board and there are captives providing services such as R&D. In the outsourcing space KPO functions are still less developed.

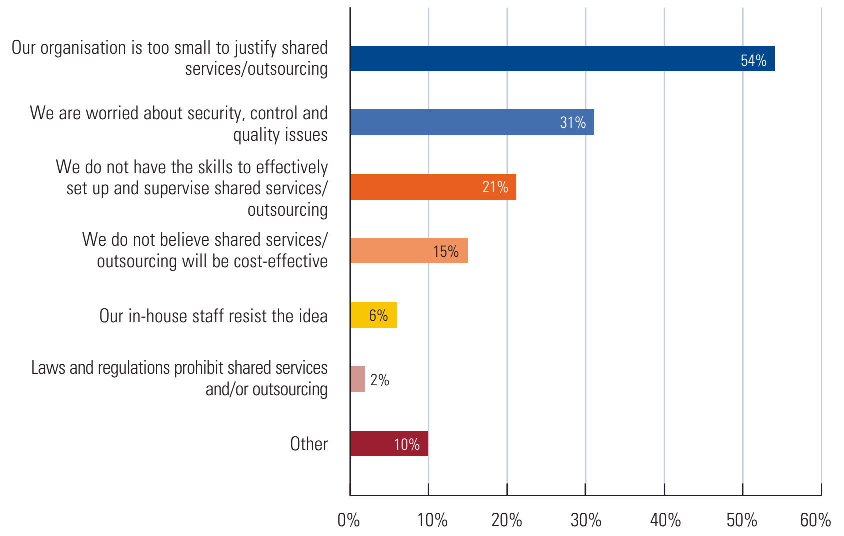
Executive implications

China is at an early stage in the development of BPO vendors. Executives should recognise that it is still early days but that this space is likely to develop rapidly over the next two to three years.



Responses for those with no shared services or outsourcing strategy

Q: Why has your organisation not pursued a shared services or outsourcing strategy?



N=48 respondents who say their company has no shared services centre or outsourcing service provider. Figures do not add up to 100% because multiple responses are allowed.

Size is cited as the main reason why companies have not pursued a shared services or outsourcing strategy. The majority (54 percent) of respondents who say their firm do not have a shared services centre or an outsourcing service provider cite as reason the fact that their organisation is still too small to justify such an undertaking. Nearly one-third (31 percent) are worried about security, control and quality issues.

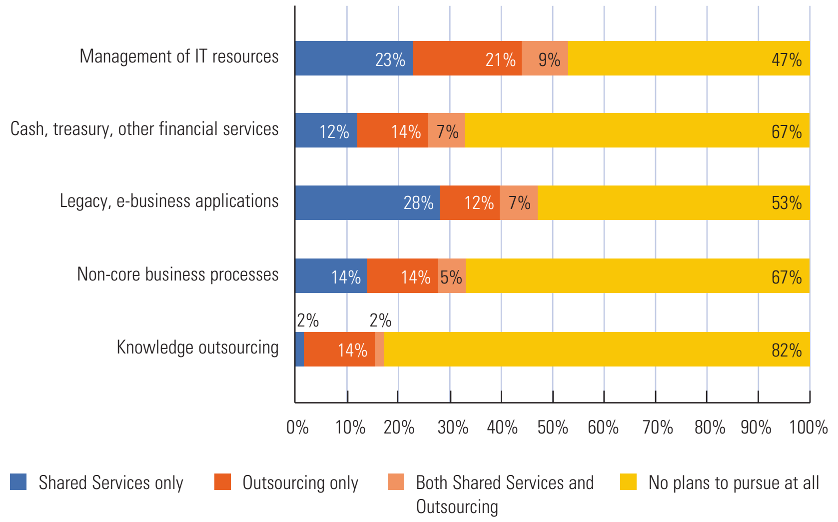
KPMG comment

Among those who have yet to develop an outsourcing or shared services strategy, scale is an issue. However, there are many boutique companies that can support small and medium-sized organisations.

Executive implications

Many executives may feel there are still too many hurdles to overcome, but for those who are serious about it, these hurdles can be overcome and the accompanying risks appropriately managed. Offshoring and outsourcing can provide value to smaller organisations as well.

Q: Which of the following initiatives will your company pursue in the next 3-5 years?



N=43 respondents who say their company has no shared services centre or outsourcing service provider.

A bare majority intend to have management of IT resources done by a shared services centre (33 percent) or an outsourcing service provider (30 percent). However, most companies that currently do not have an SSC or an outsourcing service provider do not plan to let go of knowledge management and R&D in the next three to five years (81 percent), cash, treasury and other financial services (67 percent), non-core business processes (67 percent) and legacy and e-business transactions (53 percent).

It seems that the relatively few companies that have yet to get caught up in the shared services or outsourcing wave are really resistant to the idea.

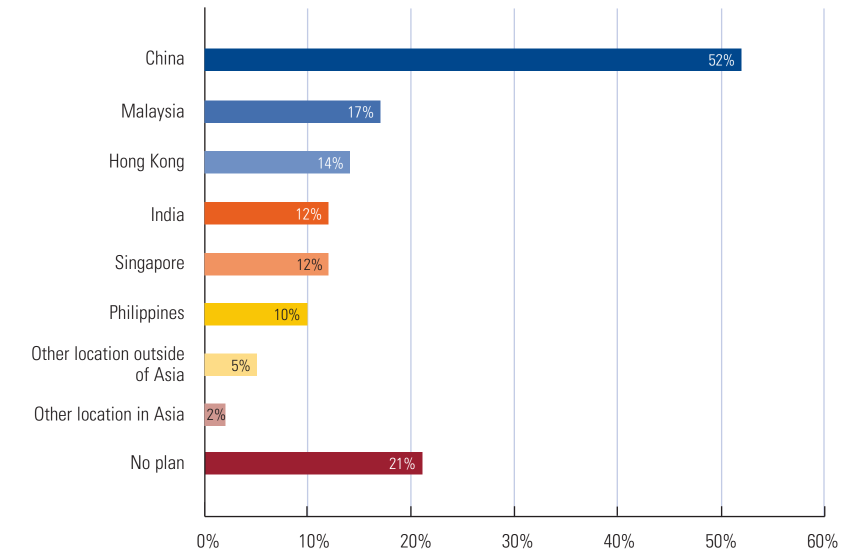
KPMG comment

Some entities may believe they are taking a unique path in choosing not to outsource, believing that they may even have a competitive advantage in not doing so.

Executive implications

While this may be true in some cases, every executive needs to test the boundaries of his or her business model and one aspect of this is to continue to assess opportunities to outsource or use shared services functions and understand how these can support long-term strategic objectives.

Q: Where do you plan to locate your shared services/outsourcing functions?



N=42 respondents who say their company has no shared services centre or outsourcing service provider. Figures do not add up to 100% because multiple responses are allowed.

Asked where they plan to set up a shared services centre or sign up with an outsourcing service provider, the majority say it will be in China. Other locations cited include Malaysia (17 percent), Hong Kong (14 percent), India (12 percent) and the Philippines (10 percent). However, China is the overwhelming favourite, an indication that despite its low profile in the media, which tend to focus on India, China is fast becoming the SSC/outsourcing choice for Asia's companies.

KPMG comment

Executives are continuing to look at a range of locations for shared services or outsourced functions. Most respondents indicated that they were only looking at one, or a handful, of locations.

Executive implications

Executives need to have a view about the merits of locations in China and elsewhere, even if they choose not to pursue opportunities there. Further understanding the diverse range of location options in Asia can be beneficial in developing a competitive advantage.

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