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**Working Paper**

## Offshoring sector in Poland

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**Offshoring sector in Poland**

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## Offshoring sector in Poland

**JEL Classification:** L24, L80, M15

**Keywords:** *outsourcing, offshoring*, foreign direct investment

**Abstract:** Companies across industries gain the competitive advantage by outsourcing and offshoring. Developing countries are becoming the attractive locations for the BPO/SSC enterprises. The article reviews the definition of outsourcing and offshoring and presents the findings for the fast-growing BPO/SSC area in Poland. The study is based on detailed analysis of the literature on outsourcing and offshoring. The article presents a preliminary analysis of offshoring sector in Poland. The following considerations are taken into account: the number of companies and employees in this sector, foreign direct investment. The growing number of companies and employments in this sector. Subsequent growth of the offshoring business service sector in Poland is visible.

### Introduction

Contemporary management of a company is based on continuous changes, which bring both opportunities and threats. The market environment is highly influenced especially by two trends: globalization of the economy and the business management. Deindustrialization of the economy also leads to many changes in market systems.

In recent years, an increase in the importance of globalization of services can be noticed in the world economy, which is a relatively new phenomenon. More of a free flow of products, services, knowledge, ideas and capital across national borders can be seen. Companies must look for new solutions, because the global market is characterized by an increased competition (Kłos, 2010, p. 11-12).

The phenomenon of de-industrialization of the economy is the opposite of industrialization. This is a process in which traditional industries, particularly heavy industry and all related industrial branches, disappear. This phenomenon causes the decreasing importance of the processing industry, and – at the same time - the growing importance of services in creating GDP and employment. Technology is another important direction of changes in the business environment, since it affects the shortening of product life cycle and the development of information technology (Kopczyński, 2010, p. 17-18).

Between the business services and the process of globalization appear dependencies of bilateral nature. Growing globalization affects the internalization and evaluation of business services, which in turn are a source of further integration of markets and increased competition on them. One of the dominant views on the causes of the development of the business services is offshoring. The growing use of offshoring is becoming the dominant business practice in the global economy. The aim of the article is to present the theories associated with the outsourcing and offshoring. The article analyzes offshoring sector in Poland.

### Methodology of the research

Indicators such as position in the world rankings, such as A.T. Kearney, inflows and outflows of foreign direct investment, the number of centers, the level of employment in them, salary levels and the number of graduates were subjected to analysis. At the beginning, brief review of the theoretical

approach to outsourcing and offshoring was made, and preliminary analysis of offshoring sector in Poland has been applied.

The aim of the study is to present the future investment trends on the Polish market and the assessment of the current climate created for potential investors. Due to the fact that offshoring in Poland focuses mainly on specialized services, the following article is mostly devoted to the so-called captive offshoring and captive nearshoring.

### **The concept of outsourcing and offshoring**

The use of external resources for the dispensing of some of the core business of the company is called outsourcing. The name originates from the "outside - resource - using" and simply means the use of external resources. According to M. Trotsky outsourcing is associated with taking the problems of the company outside, and - more specifically - it is associated with commissioning of some work to the external contractors. It is assumed that this work will be completed more efficiently by external company than it would be possible in the ordering company, which may affect the achievement of pre-determined results (Trocki, 2001, p. 11). Chase et al. defined outsourcing as "the act of transferring some of the internal operations of the company and decision-making activities to an external provider." In contrast, Lankford and Parsa define outsourcing as a purchase of products and services from sources external to the organization (Schniederjans et al., 2005, p. 3).

One of the main motivations behind entrusting the completion of some activities to outsourced company is cost-saving, the second reason is focusing on the company's core business. The third motivating factor is the lack of technical capability or competence to perform the activities within the company (King et al. 2000: 323-334).

Smaller trade and investment barriers, as well as technological advances in communication occurring in recent years facilitate globalization of services. Technological changes that have occurred in the production and communication influence delegating the production processes of the companies to other firms around the world. This allows using of the differences in such factors as the cost of production factors without losing the benefits of specialization (Sethupathy, 2013, pp. 73-97). Increasingly, one can encounter the desire to minimize the costs and benefiting from the delegation of some activities and even their production by the companies to their foreign branches or to other companies that will accomplish the activities or produce things more efficiently. This is called offshoring.

This phenomenon raises a lot of controversy. On the one hand, it can help companies to improve their profitability and impact the creation of new jobs in the countries where the off-shoring companies are located. On the other hand, it may have negative consequences for macroeconomic of home countries, that is, for the so-called importers of offshoring. Offshoring may an increase productivity and development of skills. It may increase in the purchasing power of consumers through lower import prices and reduction of exchange rate fluctuations for exporters (Cheung & Rossiter, 2008, pp. 15-28).

In the subject literature we can meet two terms: offshoring and offshore outsourcing. Offshore outsourcing means that the location of business is transferred to another country and functions are outsourced to specialized suppliers (Hätönen, 2009, pp. 61-76). On the other hand, offshoring is a transfer of business activities from the home country to other countries, but within the same company. It is a strategy that is considered a managerial practice, which began in the late seventies. In addition to the desire to minimize costs, it is important for companies to also search for talent and technology resources for scalability purposes (Roza et al., 2011, pp. 314-323). The use of offshoring could improve the efficiency of the organization. Thus, the savings that can be obtained from offshoring the company can invest in research and innovation, which can lead to long-term increase in productivity.

The phenomenon of offshore outsourcing has become one of the cornerstones of the various disciplines, including international business, strategic management, supply chain management and information systems (Cheung & Rossiter, 2008: 15-28). This phenomenon can be seen in at least two concepts of business management. The first approach involves the possibility of recording the operations of companies in attractive tax jurisdictions or tax havens<sup>1</sup> Most frequently companies are transferred to tax havens to

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<sup>1</sup> According to the OECD, classic tax havens are currently located in Malaysia, Costa Rica, the Philippines and Uruguay. Tax haven is a jurisdiction that deliberately shapes its law contrary to the standards applicable in the Member States. OECD lists several factors that determine whether a jurisdiction is a tax haven: it does not impose any or imposes very low taxes; it is characterized by great discretion of activities; there is a lack of transparency of rules; there are no legal requirements of running a business in a tax haven.

significantly save money on taxes, protect assets, reduce risk, reduce costs, protect privacy and avoid bureaucracy. B. Spitz in his book says that the concept of offshore originally was connected with the activities of the American and British companies in the tax havens.

The second approach is to transfer the offshoring business activities due to the possibility of reducing the cost and competitive quality advantages that can be provided by contracting services in another country. This is an important approach from the standpoint of the global economy. This implies a competitive price and quality of resources, resulting in lower operating costs and access to knowledge and experience, which the company does not have (Próchniak, 2012, p. 362).

Increasingly, outsourcing companies outsource jobs to other countries culturally and geographically close - from Western Europe to Central and Eastern Europe. Such situation can be found in Poland, where service centers that work for clients mainly from Western Europe are located. This is influenced by the resources and the quality of the workforce, including training of staff, the cost of doing business, investment climate, the state of infrastructure and quality of life (Szukalski, 2013). Therefore, in recent years in Western Europe developed the concept of nearshoring (Bock, 2008, pp.490-508). Nearshoring means the transfer of operations to a closely located country separated only by the border (eg. For US and Canada it is Mexico, for Western Europe it is Poland). It may occur in the form of a branch or subsidiary company – co-called *captive nearshoring* or in the form of delegating activities to another independent company from its mother company – so-called *nearshore outsourcing*. The author of the forthcoming doctoral dissertation will explore enterprises operating in the offshoring and nearshoring. Table 1 shows the division of outsourcing based on the place of business delegation.

**Table 1.** Outsourcing division based on the location for moving the company's activities and the form of ownership

Ownership	Location with no changes	Location in a nearby country	Long distance location
Full	Captive Onshore	Captive Nearshoring	Captive Offshoring
None	Onshore Outsourcing	Nearshore Outsourcing	Offshore Outsourcing

Source: Own study based on K. Rybiński (2007, p. 31).

### Factors influencing the placement of business services

In recent years, an interest in the phenomenon of offshore outsourcing increased. Despite the growing importance of this phenomenon of all the detailed aspects of making location decisions are still not explained. In the subject literature, the location is an important factor for foreign direct investment. Locational factors that influence the attraction of foreign investors include the most important features of the location. According to Jensen and Pedersen these factors can be grouped together (Table 2).

**Table 2.** The most important location factors

Localization factor	Description
<b>Labor costs</b>	It is one of the most important factors. The aim of the company is to reduce costs and consequently take advantage of the offer of countries where wages are lower. (Stringfellow et al., 2008, pp. 164-179). However, there may also be some additional costs that affect the volatility of costs, which often results in preventing the achievement of expected results (Bhalla et al., 2007, pp. 322-335). At the same time the subject literature also mentions, that the consequences of outsourcing go far beyond the direct cost reduction. (Ellram et al., 2007, pp.148-163; Mudambi & Venzin, 2010, pp. 1510-1533; Contractor et al., 2010, pp. 1417-1433)
<b>Resources availability</b>	The choice of the country where the offshoring activity is to be located is influenced by the availability of human and technological resources. (Lewin & Peeters, 2006, pp. 221-239; Luzzini & Ronchi, 2010, pp.7-21; Jensen & Pedersen, 2011, pp. 352-372). For example Doh (2005, pp.695-704) stresses that the quantity and quality of human resources is also important, while Roza et al. (2011, pp. 314-323) think that the availability of other service providers and access to talented individuals are equally important (Bunyaratavej et al., 2008, 227-242).
<b>Cultural proximity</b>	It refers to the geographical proximity (Stringfellow et al., 2008, 164-179), language and cultural factors (Doh, 2005, pp. 695-704; Bunyaratavej et al., 2007, pp. 7-21; Youngdahl et al., 2010, pp. 798-820; Clampit, 2015, p.79-93). In countries with similar culture, companies will be able to minimize the additional costs, such as costs of additional training. Cultural closeness also affects consumer perception of where the service is performed and whether it is completed close to home country. (Tate, 2014, pp.

	66-68)
<b>Business environment and local networks</b>	The company may decide to order the performance of its services to the country, which offers access to local markets (Kedia & Mukherjee, 2009, pp. 250-261; Jensen, 2009, pp. 181-193; Roza et al., 2011, pp. 314-323) or investment incentives (Bunyaratavej et al., 2008, pp.227-242). There is a high risk of theft of intellectual property, which affects the decision on the location of the company. Some countries do not have dealt with legislation on intellectual property theft, which affects their negative perception by potential foreign investors. (Tate, 2014, pp. 66-68)

Source: Own elaboration based on mentioned works.

### **The potential of Poland as a location of outsourcing of business services**

The field of Business Process Outsourcing / Offshoring (BPO) and Shared Services Center (SSC) is one of the fastest growing industries in the world. In recent years there has been a significant increase in interest in the problems of BPO / SSC in Poland, which is one of the fastest growing fields. Areas used by BPO / SSC, which include advanced solutions, new technologies and expertise, make this sector an efficient channel of exchange of information and know-how. The popularity of Poland and other countries in Central and Eastern Europe grows every year, because this geographic region currently provides the best possible offer of providing comprehensive and advanced BPO services in the world (ABSL, 2012).

At the beginning of 2011 the political and military turmoil in North Africa resulted in an increased risk of BPO companies operating there. The industry has been developed well there for many years. Egypt was considered one of the best locations for operating centers, with centers of some of the major international companies. Considering the lack of security and stability of the services provided, many companies decided to move their services to new, safer locations. This turns out to be a great opportunity for Poland and other Central and Eastern European countries. There is another important factor – the closeness. Increasingly, foreign investors are looking for a location for SSC and BPO, which would allow them the same or similar geographical area and faster air connection. (Colliers International & AT Kearney, 2008).

The events of early 2014 in Ukraine decreased the interest of foreign investors in operating there. The current unstable political situation and the danger of war with Russia effectively discourages potential investments. Also, poorly developed road infrastructure and ICT are another disadvantage. The political crisis and instability will result in a dramatic outflow of FDI from this country. Therefore, Poland has a chance to increase its competitive advantage among the countries of Central and Eastern Europe. Observing changes in the assessment of the potential attractiveness of Polish localization is an important source for the study of conditions of business services transfer. These observations are allowed, among others, by periodic surveys conducted by a company A.T. Kearney. They present three categories of location advantages:

- Financial Attractiveness, which includes, in particular: average wages, infrastructure costs, tax and regulatory costs;
- People skills and availability, describing the size of the IT and BPO sectors, the total workforce, university-educated workforce, scores and standardized education and language tests;
- Business environment, which includes the security of Intellectual property (IP), Cultural exposure, quality of infrastructure, country environment.

Table 3 shows the measurement of location of business services in Poland indicators in the various value categories on the basis of A.T. Kearney research, conducted between 2009 and 2014.

**Table 3.** Location attractiveness of Polish economy in terms of transferring of business services according to the research by A.T. Kearney (2009-2014)

<b>Years</b>	<b>Financial attractiveness (max. 4)</b>	<b>People skills and availability (max. 3)</b>	<b>Business environment (max. 3)</b>	<b>Totality</b>	<b>Rank</b>
<b>2009</b>	1,82	1,22	1,73	4,77	38
<b>2011</b>	2,14	1,27	1,81	5,23	24
<b>2014</b>	2,28	1,39	1,87	5,54	11

Source: Own elaboration based on A.T. Kearney, Global Services Location Index 2009, 2011 and 2014.

Based on the provided data it can be seen that the overall assessment of the Polish economy value for business services continues to grow. From 2011 the assessment of all the indicators of location have improved. The biggest change in 2014 (compared to 2009), was reached by a financial attractiveness

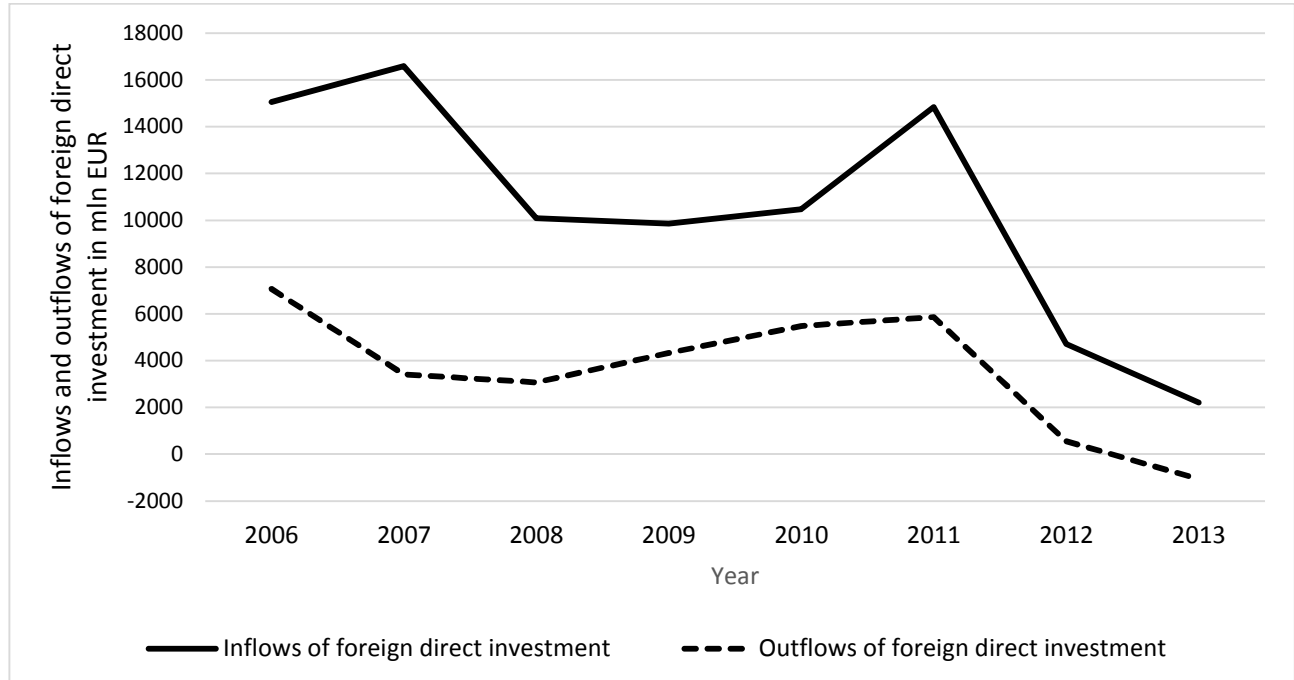
indicator. The increase in the assessment of the cost attractiveness can be associated with the fact that, although the cost profile is slowly approaching the value observed in Western Europe, it is still several times lower. Relatively low and competitive wages in this sector in Poland in comparison to other countries of Central and Eastern Europe influenced this the most. An increase in the assessment of human capital is also noticeable. This is due to rising of the quality of education and knowledge of foreign languages, and thus greater access to skilled labor. Specialized skills are offered not only in English.

Systematic improvement of business environment evaluation can be observed. The increase was caused by the improvement in the perception of country risk and increase in the availability and quality of information technology. The improvement in this indicator could also be affected by the political crisis in Ukraine, which began in November of 2013.

An improvement in the assessment of the competence and the availability of resources and reduction in transaction costs is also noticeable. Foreign investors assess Poland positively also because of a stable business environment. This in turn helps in keeping a relatively high attractiveness of the location for the transfer of offshoring services. The importance of qualified human resources is increasing, and considering these qualities we can notice a good direction of adapting of the Polish economy to the new market conditions in the offshoring area. Further development of social capital, knowledge, innovation and the development of the business environment can be one of the Polish competitive advantages on the European market. Increased activity of the local government units towards foreign investors in this sector can contribute to greater absorption of investments related to the relocation of business services. (Malik, 2013, pp.203-223)

Political changes in the late 80's and 90's of the twentieth century influenced the attractiveness in terms of moving services to Poland. Also, lower labor costs than in other EU countries and accession to the EU in 2004, provoked more positive perception of the country in the eyes of investors. An important role was also played by transnational corporations that brought in direct foreign investment. According to the World Investment Report 2006 developed by UNCTAD, Poland is one of the largest recipients of offshoring investment among the countries of Central and Eastern Europe. (UNCTAD, 2006)

**Figure 1.** The value of inflows and outflows of foreign direct investment (in millions of dollars, 2006-2013)



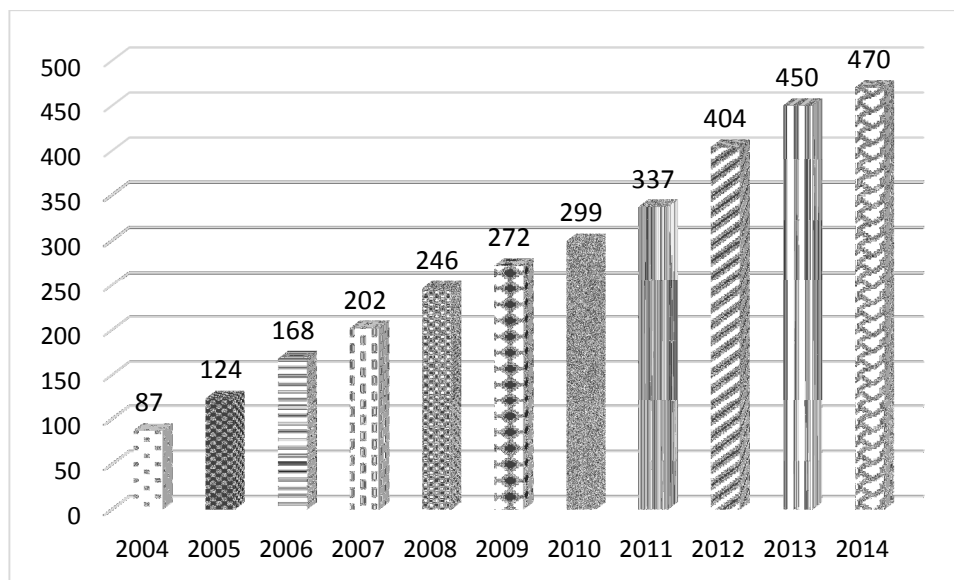
Source: Own elaboration based on the data of Polish National Bank <http://www.nbp.pl> (13.03.2015).

Statistical data presented in Figure 1 illustrate the decrease in inflow and outflow of foreign direct investment in Poland. It is especially visible in recent years. Until 2011, an increase in the inflows and outflows of foreign direct investment in Poland was a visible. 2013 was another year of decline in foreign direct investment into Poland. Net inflow of these investments amounted to 2,208 million Euro, and it was more than twice lower than the inflow of investments in 2012. It was the year with the lowest direct

investment inflows into Poland since 2006. This situation could be affected by the elimination of special purpose entities and the withdrawal of capital in transit, the sale of equity interests in the banking sector to foreign portfolio investors and the reduction of activities by some financial holding companies and the withdrawal of the equity interests of foreign investors. Also the global trends, such as the slowdown in the economies of the European Union and the impact of the phenomenon of capital in transit, could cause a drop in direct investment inflows into Poland. Still, there was an influx of new investments into Poland, which included both greenfield investments and capital for business development of existing companies. According to the Polish National Bank data the largest inflow of foreign direct investment came from the United Kingdom (3343 million Euro) and Germany (1910 million Euro), a major investor from outside the European Union was Switzerland (955 million) (the Polish National Bank, 2013). On the other hand, Polish investors withdrew more than 1 billion Euro of foreign investment. Active policy of the state would be able to help build new location advantages, which could be based on a highly skilled workforce, innovation and technological progress.

Figure 2 shows the number of offshoring centers in Poland between 2004 and April 2014. Number of offshoring centers with the participation of foreign capital in Poland is growing continuously since 2004. The change in the number of existing service centers could be affected by the number of new foreign companies that are just entering the Polish market of business services and did not have their centers in Poland before.

**Figure 2.** Number of business service centers in Poland (2004-04.2014)



Source: Own elaboration based on the data presented by Association of Business Service Leaders in Poland (2014), Sektor nowoczesnych usług biznesowych w Polsce, ABSL, s.14, <http://www.paiz.gov.pl/> (14.10.2014)

Currently, a phenomenon of reshoring in business services is not noticeable. This phenomenon involves delocalization of business to the home country. The largest rate of growth in the number of centers over 30% is noticeable in 2005 (43%) and 2006 (35%). Inhibition of growth is noticeable in the following years. Since 2010, the growth rate does not exceed 20% per annum. In 2012, the number of service centers exceeded 400 types of entities. At the end of April 2014 as many as 470 companies in this sector were located in Poland.

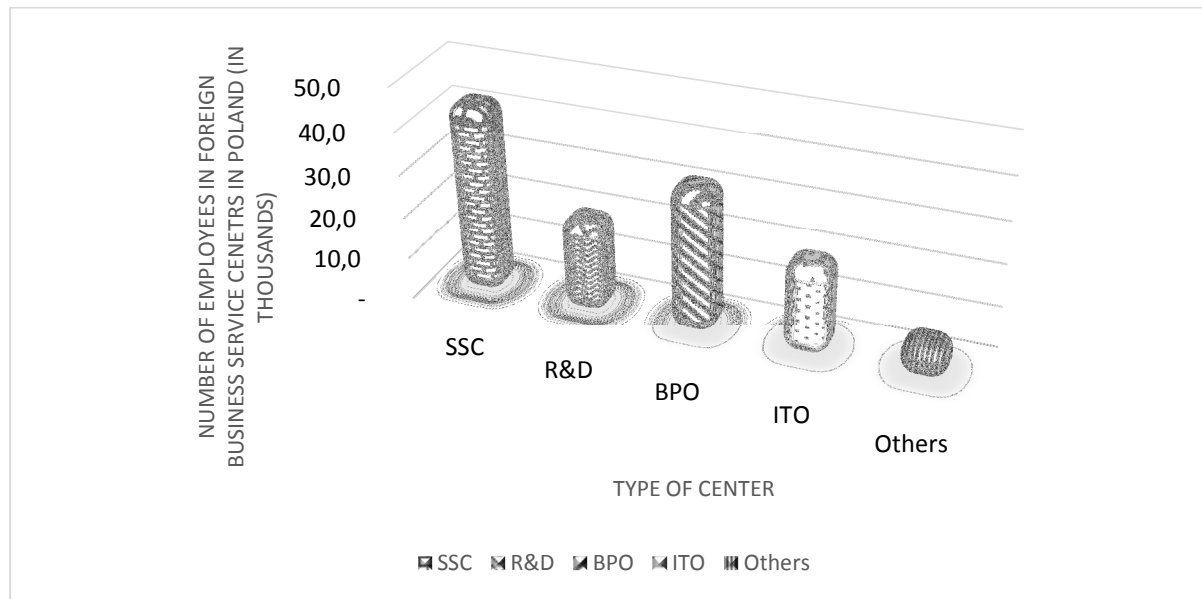
Most centers with the participation of foreign capital in Poland are Shared Services Center (SSC) -165, 113 are R & D centers, 109 are Business Process Outsourcing / Offshoring (BPO), 73 entities are Information (ITO) and 10 which are difficult to qualify for any specific type.

Employment in the business service centers with the participation of foreign capital in Poland is steadily growing. In 2013 there was an increase in employment of approx. 27,000 people compared to 2012 (Figure 3). The average annual growth in the country in a few years (from 2009 to 2013) stood at about 15 000 a year. As many as 95% of all workers BPO / SSC / ITO in Poland are employed in the ten largest business service centers: Krakow, Warsaw, Wrocław, Trojmiasto, Łódź, Katowice Agglomeration, Poznan, Bydgoszcz, Szczecin and Lublin. The largest number of employees are in the SSC-type entities (44,1 thousand people), in the BPO it is 33,7 thousand people, in R & D centers 21.6 thousand people are employed, while in the ITO 21.1 thousand people work. In other centers, which are difficult to qualify for a particular type 7,7 thousand people find employment.



The average service center in Poland employs 272 people. For SSC this value stands at 267 people, BPO - 309, R & D - 191, ITO - 289. In Poland 28 service centers that employ at least 1,000 people are located. Most people working in service centers are employed full-time (contract). The largest number of people employed in the business service centers in 2014, worked in Krakow (30.6 thousand people), Warsaw (21.8 thousand people), Wroclaw (20.5 thousand people), with about 128 thousand employed in Poland. Analyzing the employment in this sector it can be seen that Krakow, Warsaw and Wroclaw have the largest number of employees in this sector, a total of about 57%.

**Figure 3.** Number of employees in foreign business service centers in Poland, broken down by type of center (in thousands, 2014)

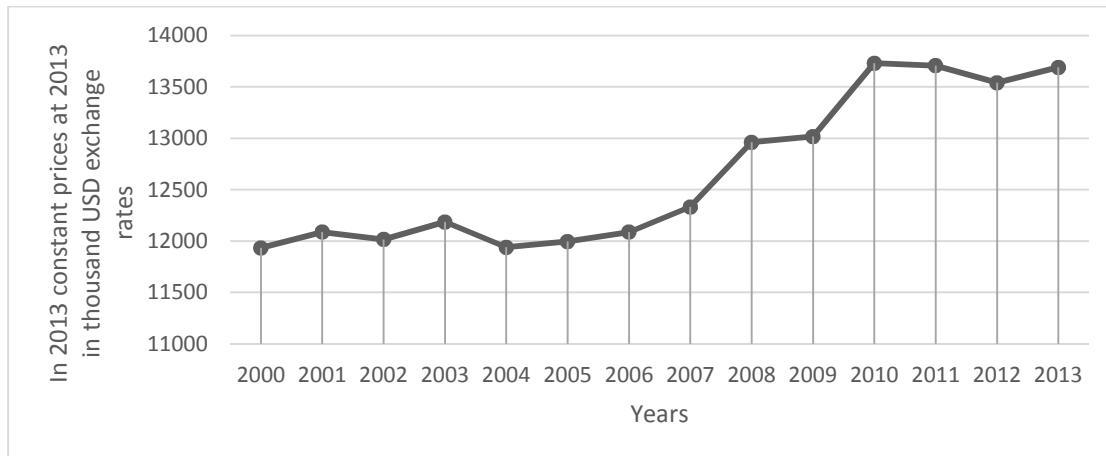


Source: Own elaboration based on the data presented by Association of Business Service Leaders in Poland, Sektor nowoczesnych usług biznesowych w Polsce, ABSL, s.14, <http://www.paiz.gov.pl/> (14.10.2014).

Since the beginning of 2012, the highest increase was recorded in Wroclaw (68%), Krakow (59%) and Lodz (57%). In contrast, the largest number of jobs was created in Krakow (11.4 thousand) and Wroclaw (8.3 thousand). Medium-sized centers of employment between ten thousand and twelve thousand people we may include Trojmiasto, Łódź and Katowice. Based on these data it can be seen that the concentration of service centers coincides largely with the location of the largest academic centers in Poland. Of all the service centers with foreign capital the largest share were US companies (38%), followed by France (18%), UK (9%) and Germany (8%). US companies chose large urban centers for its location, which are traditionally associated with the business services sector. (ABSL 2014)

Poland has not experienced the crisis and recession, to an extend similar to many other countries in Europe. The average real wage in 2013 increased by 1.1% (Figure 4). The main reason for this was deflation and an improvement of economic conditions.

**Figure 4.** The average annual salary in Poland in 2013 with constant prices at 2013 USD and exchange rates in the years 2000-2013



Source: Own elaboration based on the data presented at <http://www.oecd-ilibrary.org> (13.03.2015)

It should also be noted that the increase in demand for the selected experience in the region can have a direct impact on the increase in the level of wages in a given specialty. Workers in this sector are the most mobile group of professionals, therefore interesting job offers in one region can attract experienced workforce from other centres, both domestic and foreign. The level of remuneration in the processes of customer service, finance and accounting, and IT support is affected by: years of experience and the level of position taken in the organization.

## Conclusions

Poland is an attractive location for investors from BPO / SSC. For Poland the most competitive markets in the world in terms of locating business service centers are China and India. On the European market, Poland loses often with Slovakia, the Czech Republic, Hungary, Bulgaria and Romania. Despite this, Poland stands out from its competitors because it is centrally located in Europe, has access to qualified and multilingual staff and has a relatively low cost of labor.

Based on the available data it can be concluded that the phenomenon of offshoring in Poland in the first decade of the twenty-first century was a significant economic process. This was influenced, among others, by economic changes, technological development and the evolution of the operation and activities of transnational corporations.

The development of offshoring in Poland led to increased employment and development of new professional specialization in the sector. The development of this sector was caused mainly by enterprises with foreign capital. The further development of this sector in Poland may indicate an increase in employment, the number of business service centers and improved availability of human resources. An important factor which affects the development of the phenomenon of offshoring in Poland is the location. Poland is located close to the major European economies. Polish EU membership is also very beneficial, due to the political and economic unity. One of the advantages is the ability to make use of an easy and quick travel between countries in the same time zone. There is also a greater availability of low-cost airlines, which support all major European cities. EU member states have simplified administrative procedures.

If Poland wants to seek a greater inflows of FDI, the country should strive to remove existing barriers that hamper economic activity in our country. This is necessary also due to the fact that the cost attractiveness, which is one of the main advantages for foreign investors may be significantly reduced in the future. This is not only because of the increase in salaries, but also because of a decline in the importance of labor costs factor in comparison to such other factors as: an access to a skilled workforce, access to well-developed technical infrastructure and the level of labor

productivity. That is why it is important to invest in human capital and modernization of the infrastructure, which is one of the priorities of the Polish economic policy.

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