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Country experience and business perspectives

ICT-ENABLED OUTSOURCING AND OFFSHORING ACTIVITIES IN HUNGARY AND ITS IMPACT ON THE INTERNATIONAL RELOCATION OF WORKING PLACES

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ICT-enabled outsourcing and offshoring activities in Hungary and its impact on the international relocation of working places[1]

The impact of increasing outsourceability of services

The outsourcing of business processes is an increasing tendency worldwide. The provision of a wide variety of services from a large distance away from the customer has been made possible by the standardization of services, by the availability of broadband telecommunication and by the reduction of information and communications technology costs.

Hungary is a low cost country with adequate infrastructure, political stability and safety. **The country has been the beneficiary of this process since the turn of the millennium**. The number of working places located to Hungary in the framework of offshoring amounts only to a few thousands, but the tendency is increasing. In 2005, the increase of service-exports and the thereby created workplaces still remain low in both fields of Business Process Outsourcing and of IT Outsourcing.

Operating export-oriented Shared Service Centres / International Call Centres

In Hungary the statistical enumeration of such establishments is difficult and is only possible via bottom-up methods. Only a few such service centres have settled in Hungary compared to Europe. However, **the size and number of planned investments and the main trends are promising**.

- The service exports generated by such establishments are not statistically measured, partly because subcontracting linkages are not covered by statistical assessment, and partly because most of these centres are embedded into larger organizations. However, their estimated **annual service export turnover lies between USD 400 million and USD 600 million**.
- The number of jobs so far established by export-oriented SSCs and Call Centres in Hungary since 2000 remain macro-economically insignificant. The estimated **number of employees falls between 4000 and 6000 persons**.
- There are case studies of minor business processes of subsidiaries of transnational companies being offshored from Hungary to other countries, but the number of job losses is insignificant.

According to the calculations of the Hungarian Investment and Trade Development Agency (ITDH), the Government agency specialized in investment promotion, between 2000-2004 altogether 11 accomplished foreign direct investment decisions resulted in the establishment of Shared Service Centres and international Call Centres in Hungary. Until now, the total investment value of these centres amounts to approximately EUR 200 Million.

- Firms investing into **the largest SSCs / Call Centres** have each created between **500 and 1000 jobs** respectively and are continuously expanding their range of services. Investing companies include trans-national firms such as EDS, IBM, Sykes, and GE EOS.

[1] Important notice: this paper is based on a study completed by ARIOSZ Kft., an independent consulting firm, the information presented in the paper is not necessarily represent the view of the Hungarian Government in each and every cases.

- Additionally, approximately a dozen of multinational companies have established **small and medium sized regional service centres** in Hungary, employing **50-500 persons**, such as DIAGEO, Avis Europe, and Exxon Mobil.

More than 80% of SSCs are located in Budapest. With regards to professional fields, investments include regional financial service centres, SSCs executing HR tasks and Call Centres dealing with customer services.

In 2004, UNCTAD surveyed the export oriented foreign direct investments established in Central and Eastern Europe aimed at such service institutions as Call Centres, Shared Service Centres, IT service centres and regional company headquarters. The total number of such institutions established in Central and Eastern Europe in 2002-2003 is 91, of which 26 were founded in Hungary. During the same period, 620 such establishments were created in Western Europe, and 799 were set up in developing countries.

Operating SSCs and international Call Centres in Hungary primarily provide services to the subsidiaries of their own holdings ("**insourcing**"). Their clients mostly comprise of firms outside Hungary, but located mainly within the Central European time-zone, and even within this region ("**nearshoring**"). Their services include an expanding range of strategic business service activities supporting basic company procedures, namely financial processes, back office services of HR Management, customer service, and to a smaller extent: IT processes outsourced to Hungary.

Outsourcing firms whose orders are primarily received from companies outside their own holding constitute in Hungary represent a minority in this group. (E.g. EDS, Sykes)

Export oriented IT services

The Hungarian IT sector is traditionally open to the world market but **the foreign trade balance of IT services remains negative**. Despite spectacular success stories (e.g. Graphisoft, Synergon) currently only a handful of Hungarian companies are able to sizeably export. The basic facts are as follows:

- The turnover of the IT service market in Hungary is USD 750 Million.
- Of this, USD 150 Million accounts for IT-outsourcing. IT-outsourcing services are provided by numerous IT firms. Market competition is very high. The majority of companies purchasing IT services are large Hungarian enterprises, the export in this business line is not significant.
- Hungarian software and IT service export annually amounts to USD 150 Million. This turnover is generated at approximately 1500 to 2500 IT-related working places.
- Hungary has a 20% market share of all Central and Eastern European IT outsourcing services.

Shared Service Centres / international Call Centres investments in preparation

In addition to the already operating service centres, further investments of specialized enterprises are expected to materialize in Hungary. The existing service centres today primarily providing services to subsidiaries of their own holdings are anticipated to grow and to serve the needs of a gradually increasing amount of extra-holding customers. **The sector will increasingly benefit from the domestic market as well**, because it is expected that various Government offices and public health establishments are planning to outsource sizeable administrative activities and processes.

In the spring of 2005, the preparation of 20 further Shared Service Centres are underway in Hungary. Characteristics of the **20 currently proceeding investment incentives** are as follows. The homeland of the investing companies: Germany, the Netherlands, Belgium and the United States of America. Their planned investment value falls between EUR 700.000 and EUR 4 Million each. Their planned number of employees lies between 25 and 1000. Target locations: mainly Budapest, but many are planning to take advantage of the tax allowances offered if the selected location is in a less developed region.

Foreign Direct Investment and the Service Sector

During the last fifteen years, Hungary has become **one of the most important targets of foreign investors in the Central and Eastern European region**. Large foreign companies operating here play an important role in the economic life of the country. As a result of foreign investments taking place since 1990 the stock of foreign direct investments exceeded EUR 400 Billion in 2004.

Since 2000 somewhat **more than half of FDI flowing into the country is invested into the service sector**. The service sector provides 62% of Hungary’s GDP and 60% of the country’s jobs. More specifically, business services account for 20% of the GDP and 9% of the jobs. The volume of service export in Hungary is USD 7,7 Billion, which is a quarter of the Austrian value. Hungarian service export is 22% of all exported goods (44% in Austria).

In comparison with other regional locations, the following factors play a role in the fact that Hungary attracts a growing number of investments:

- Central geographical location, local attitudes and customs are similar to Western European ones, high quality of life, high prestige of Budapest
- Still cheap, motivated, well educated and trainable workforce. E.g. the salaries of Hungarian, foreign language speaking customer care service employees with university diploma amounts to a one-fourth of the corresponding value in Germany, while the salary of an IT expert amounts to one-third of a comparable IT expert in Germany. However, it has to be mentioned that one of the biggest challenges for Hungary is to move upward on the value-chain and focus on high value-added products and services.
- Favourable investment environment in Hungary, European Union membership, stabile political situation, ripe institutional system of market economy, high safety records, excellent investment security regulations.
- Favourable transportation and ICT infrastructure, low office rental costs, communications costs a little higher than in Western Europe, yet on a continuous decline.

State Incentives Supporting Foreign Investment

- ***Tax allowances***. Exceptionally low corporate tax rates in international comparison (16%), that is further decreased by tax allowance in the case of large investments as well as a further allowance in case of retraining employees or employing jobless people.
- ***Individual subsidies for large scale investors****.* Large allocations to large scale investors depending on the number of created jobs.
- ***Tender-based subsidies****.* The Economic Competitiveness Operational Program (Gazdasági Versenyképesség Operatív Program - GVOP) is the sub-program of the National Development Plan, which is the master document of subsidies co-financed by the EU and the Hungarian Government. Provision 1.1.2. of the GVOP explicitly supports the establishment of regional enterprise headquarters. Foreign investment is also supported by the SMART Hungary economic development program, administered by the Ministry of Economy and Transport.
- ***The one-stop system****.* The governmental agency, ITDH serves as the contact institution between the investors and all government offices in for the sake of more effective production of information to investors and faster administration processes.

Actions to be taken by the Government in order to gain future benefits of international sourcing

The establishment of export oriented SSCs, Call Centres, IT service centres and regional headquarters in Hungary is a top priority of the economic policy. The government has to **coordinate** those currently dispersedly operating processes that play a role in incentive. Slowly and gradually **increasing labour costs need to be counter-balanced by measures boosting productiveness**.

In particular, the Government should consider the following measures:

- Continuous adaptation of **investment stimulating measures**: regulations, tax breaks subsidies, and institutional spheres of authority. Extension and **further development of the one-stop system**.
- **Harmonization of the bureaucratic processes** of the Central Government, of line ministries and of the local administrations.
- Consumer protection regulations related to business services should be continuously adapted to international law, with special respect to ICT-enabled services.
- Development of a **sufficient educational-training strategy** aiming at the harmonization of the training provided by governmental – private- and non-profit institutions. The number of students attending institutions related to financial, administration, customer service and IT education should be increased.
- **Further steps of competition policy** should be made in order to further reduce communications and IT costs.
- The **legal and institutional framework** as the basis of standardized and safe electronic networks should be continuously developed.

- The **dissemination of digital literacy and the spreading of telework** should be supported within the framework of the Information Society Programmes. Telework working places should be supported to introduce the quality standards of ICT-enabled service provision, and the usage of Service Level Agreement (SLA) type contracts.
- **Small and medium sized service companies** that are potential knowledge-based subcontractors of SSC-s to be supported by means of tender-based subsidies in order to acquire **ISO quality assurance systems**.
- International cooperation concerning the issues of the standardization of business services.
- Development of services statistics and services foreign trade statistics in order to quantitatively follow the rapid transformation of the services sector.

Examples for international outsourcing in Hungary

Large SSCs and Call Centers in decreasing order of the number of employees:

- ***EDS Magyarország Kft.*** 900 employees at 20 Hungarian locations. Business processes conducted within the framework of outsourcing: IT type supports, customer services, back office processes (data processing, archiving, payroll management). 80% of employees have a degree in higher education. Mainly domestic clients, of which many are local subsidiaries of transnational companies.
- ***IBM ISSC Hungary Kft.*** The ISSC International Shared Service Center has 700 employees in Budapest. Only foreign clients, mainly other IBM subsidiaries in the region. Divisions: Procurement, HR related back office processes, financial processes (Account Payable Center), Consumer Care.
- ***General Electrics, GE European Operations Services*** SSC employing 600 persons since 2002. Main task is the centralized coordination of the business processes of GE's other European subsidiaries. Provides marketing, logistic, accounting, IT and customer care services in 18 languages.
- ***Sykes Közép-Európa Kft.*** International Call Center, 600 employees. Provides outsourced customer care services for domestic and foreign clients. Sykes was awarded the "Best Employer in Hungary" Prize by Fortune Magazine in 2001.
- ***Diageo Üzletviteli Szolgáltatások Kft.*** Multinational company producing and distributing alcoholic beverages. Regional Shared Service Centre with 450 employees.

Examples of the **small and medium sized Hungarian regional service and customer care centres of certain transnational companies**:

- ***ExxonMobil:*** 10 languages, SSC, 300 employees.
- ***ING Group***'s European regional trade and data processing center, 250 employees.
- ***Alcoa***, USA-based aluminium production company, SSC in Szekesfehervar, Hungary, 150 employees.
- and General Motors, Flextronics, British American Tobacco Company.

Examples of **export oriented IT-outsourcing firms**:

- ***Getronics Magyarország*** Kft. International IT enterprise. Its international branch recently created in Hungary provides IT outsourcing, Help Desk and BPO with 60 employees in 10 languages.

- ***Synergon Atos Origin Information Technology*** Kft. Subsidiary of large Hungarian IT company Synergon, with foreign affiliations in various Central and Eastern European countries. Offering classic IT services with special emphasis on IT outsourcing.

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