



# Policy statement

## **ICC policy recommendations on global IT sourcing**

*Prepared by the Commission on E-Business, IT and Telecoms*

### **Background**

Modern business models around the world are increasingly organized across national boundaries. Global IT sourcing refers to the geographic distribution of different corporate activities. These activities can be performed either in-house or outsourced, and serve internal or external clients, or both.

Global IT sourcing business models occur in a broad range of industries and industry sectors such as human resources, financial services, and medical services. However, this paper focuses mainly on IT-enabled services (ITES).

Global ITES sourcing is expected to increase in the coming years. For example:

- ITES outsourcing is expected to grow from US\$1.3 billion in 2002 to US\$ 24.3 billion in 2007, and will represent 14 percent of the total ITES market by 2007<sup>1</sup>.
- Global ITES spending is estimated by India's National Association of Software and Services Companies at US\$712 billion. 63% of that is spent in the Americas, with Asia-Pacific accounting for merely 15%. But by 2006 Asia-Pacific will be the largest growth market in ITES, with annual growth of 14.7%.<sup>2</sup>

From the perspective of the location where the work is performed, global IT sourcing may also be viewed as an export market. While some locations may place a great deal of focus on export markets, the ICC believes that at least equal attention should be afforded to two other domestic markets: the domestic government market and the domestic private sector market.

Although the export market may help develop a local industry sector, it is just that – a single sector. A vibrant government market, on the other hand, can equally help jump-start a domestic industry, and is also effective in driving the use of Information and Communication Technologies (ICTs) into the local population. Encouraging the diffusion of ICTs into other industry sectors such as financial services, manufacturing, transportation and healthcare, makes local firms more effective and efficient, and thus has a positive effect on the entire economy of the country.

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<sup>1</sup> Scholl et al, 2003, India will generate \$13.8 Billion from Offshore Business Process Outsourcing (BPO) exports in 2007

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### **Drivers of global IT sourcing**

To compete in this new world, contemporary business models adopt a portfolio approach to flexibly access the best sources world-wide of products, services and talent to meet clients' needs. Just as manufactured goods are sourced from around the world, IT now enables services, business process operations and other knowledge work to be deployed and delivered almost anywhere.

For IT-enabled services, and its customers, there are many drivers of global IT sourcing such as:

- The ability to use operations in different time zones, allowing business to provide service and support customers 24 hours a day, 7 days a week.
- Competition for a large pool of skilled labor (including language skills) and the spectacular decline in telecommunication costs as a result of the introduction of competition in many parts of the world.
- By establishing an offshore presence, firms may gather additional insight into local markets, which can be used to customize the services offered and provided and improve their competitive positions in those markets.

Global IT sourcing creates employment and supports economic growth by strengthening national economies and helping companies to stay globally competitive. Many countries across the world are actively seeking to emulate the success of countries like Ireland, Korea and India in attracting foreign investment and fostering domestic economic development by investing in skills, infrastructure and business environments, which creates high value jobs that ultimately boosts GDP.

Many activities are conducted across borders, which is certainly not new. Technology developments have improved the ease with which certain types of services can now be provided at a distance – whether this distance is short or long. This is indeed a significant new benefit that many companies are increasingly maximizing, whether for their internal organization or as buyers or suppliers.

Increasingly in today's global economy, companies in all sectors and locations are looking around the world to determine how they can organize their activities globally, based on several factors. The location of all activities is based on a combination of both qualitative (skills, location of industry or knowledge clusters, physical proximity requirement, available infrastructure, etc) and quantitative investment criteria.

India, of course, is a well-known destination for global IT sourcing. Many developing countries in Asia and elsewhere are working to replicate India's success. The Philippines is already successful and other countries such as China, Vietnam, Malaysia, Bangladesh and Sri Lanka are making significant investments in education and infrastructure in an effort to improve their ability to attract and develop IT activities.

Eastern European countries are also looking to enter the IT-enabled services market. The Ukraine, for example, is attempting to leverage its considerable project management and high technology skills obtained through years of work for the Russian military.

### **Implications**

The global IT sourcing phenomenon may compound the existing evolutions in the global distribution of investment. A significant portion of the economic activity of companies in markets is a consequence of local market growth. The investment required in large, double-digit growth markets is significant and should not be underestimated.

Virtually all global firms have established significant ITES centers in India and other emerging markets, including China, Russia and the Philippines. Most experts seem to agree that global IT sourcing will grow. Major global companies in most industry sectors are moving to global IT sourcing policies, seeking best value services from any location.

One aspect of global IT sourcing that is just beginning to be explored is its potentially positive impact on a country's economy as a whole. Catherine L. Mann, Senior Fellow at the Institute for International Economics reported that:

*Globalization of IT hardware production is a model for the global evolution of IT services and software. Although technological change is the most important driver of IT price declines, globalized production and international trade made IT hardware some 10 to 30 percent less expensive than it otherwise would have been. These lower prices translated into higher productivity growth and an accumulated \$230 billion in additional GDP (1995-2002). Real GDP growth might have averaged 0.3 percentage points less per year from 1995 to 2002, if globalized production of IT hardware had not occurred.<sup>3</sup>*

A more definitive study conducted for the Information Technology Association of America by Global Insight in 2004 confirmed the above conclusions. According to that report:

*For reasons cited earlier in this report, offshore IT software and services outsourcing (ITO) spending increased rapidly over the last five years from \$2.5 billion to \$10 billion. The cost savings associated with this increasing level of ITO spending reached \$6.7 billion in 2003. This represents a 40% savings versus what would have been spent if domestic resources had been used instead of offshore resources. Over the forecast period, offshore ITO is expected to grow to \$31 billion in 2008. This represents total savings of \$21 billion in that year.<sup>4</sup>*

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<sup>3</sup> Mann, Globalization of IT Services and White Collar Jobs: The Next Wave of Productivity Growth, International Economics Policy Briefs, December 2003, Institute for International Economics

<sup>4</sup> *The Impact of Offshore IT Software and Services Outsourcing on the U.S. Economy and the IT Industry*, Global Insight, March 2004, Page 14.

Further, the report continues:

*Offshore ITO has a positive, cumulative effect on total employment in the U.S. economy. This implies that more jobs are created in the Offshore IT Simulation than are displaced as offshore ITO continues. While offshore ITO displaces workers in the IT profession, the benefits stimulate job creation throughout the economy. The overall employment gain is positive: an estimated 193,900 new jobs were estimated to have been created through 2003 due to the cumulative benefits of offshore ITO. In the Offshore ITO Simulation, over 589,000 new jobs are expected to be created by 2008 if offshore ITO continues. These estimates include both IT and non-IT jobs.<sup>5</sup>*

While the above findings were applicable specifically to the U.S. economy, they may be generalized to global IT sourcing elsewhere.

Technological changes, trade and investment liberalization allows for resources to be shifted to locations where worker productivity and returns on investment are higher, enabling IT software and services to move to more efficient locations. Freed-up domestic resources will eventually be reallocated to more efficient, more competitive sectors or sub-sectors.

The efficiency enhancements lead to economic gains through lower prices since companies no longer need to pass on higher cost of production to consumers through product price increases. This limits the upward pressure on inflation. Slower inflation growth not only keeps borrowing costs for investment activity by businesses and consumers alike at favorable rates, but also provides stability that is crucial for business activities, ultimately leading to the creation of new employment opportunities.

However, the economy performing the global IT sourcing is not the only beneficiary in this model. The countries providing the global IT sourcing services experience improvements in overall economic activity as foreign investment increases, technology transfers occur and rapid growth in exports continue. In the case of India, total exports of IT software and services increased 30.5% from 2003-04 to 2004-05.<sup>6</sup>

With time, as economies evolve, both activities and locations evolve as well. Locations can improve their business environment by investing in skills, open markets, infrastructure and innovation. Locations can also worsen by increasing taxes, adopting restrictive social policies, or because of corruption and political instability. These combined changes affect companies' global IT sourcing strategies on a continuous basis.

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<sup>5</sup> Ibid, Page 22.

<sup>6</sup> "Indian Software and Services Exports Exceed Expectations." NASSCOM. [www.nasscom.org](http://www.nasscom.org) June 2, 2005.

### **Policy recommendations**

ICC urges governments to develop policies that support a vibrant government ICT market as well as the diffusion of ICTs into the domestic private sector rather than having a single focus on the export market. Such policies capture the efficiencies and effectiveness of ICT use in the economy in a broad and sustainable manner.

ICC opposes restrictive measures imposed by governments to restrict global IT sourcing and instead recommends that:

1. companies maintain flexibility to source globally to meet the needs of their own particular business models; and
2. governments embrace global IT sourcing as a means to improve economies by taking constructive actions to encourage innovation, foster an enabling business environment, and create an educated and skill-based workforce.

### **About ICC**

ICC is the world business organization, a representative body that speaks with authority on behalf of enterprises from all sectors in every part of the world. ICC promotes an open international trade and investment system and the market economy. Business leaders and experts drawn from the ICC membership establish the business stance on broad issues of trade and investment, e-business, IT and telecoms policy, as well as on vital technical and sectoral subjects. ICC was founded in 1919 and today it groups thousands of member companies and associations from over 130 countries.

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