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Global Sourcing Trends in 2010

By David Skinner (London), Chris Ford (Washington, D.C.), and Nigel Stamp (Hong Kong)

At the beginning of each year, we survey Morrison & Foerster's Global Sourcing Group lawyers in Asia, Europe, and the United States regarding the current state of the world's outsourcing market and emerging trends likely to shape that market over the next twelve months. In this year's update, our lawyers comment on the impact on the global outsourcing market of the recession in 2009 and the anticipated recovery in 2010, and the rise of cloud computing. We also comment on the key business factors affecting current outsourcing projects and highlight outsourcing-related developments in the key markets across the world.

Our lawyers' views are based on what they have seen in their outsourcing projects during 2009, as well as on the views expressed by service providers, outsourcing consultants, and clients.

GLOBAL ECONOMIC PROBLEMS	
Recession and Recovery	In outsourcing terms, the verdict on 2009 was "it could have been so much worse." Cost cutting was the main driver and re-negotiation the main activity. The key questions for the outsourcing world in 2010 are: What sort of recovery in the world economy will we see? Will the recession return after cost-cutting outsourcing deals have already been done? Will the predictions of different shaped recovery curves in the U.S.A., Europe, and Asia cause splits in global outsourcing deals as economies move out of recession at different rates? Outsourcing is one way for organizations to position themselves to capitalize on the recovery and show that their overall strategy is about value creation, not merely cost containment.
It's All About Cost	Cost remains the key for 2010. Outsourcing prices dropped in 2009 and that trend seems likely to continue in 2010, although the rate of decline will slow. Service providers may not be prepared to be as accommodating as they were in 2009. Many outsourcing projects were put on hold in 2009, so market activity in 2010 should be busier overall, which should slowly cause prices to stabilize.
Flexibility: Doing More With Less	Shorter deal cycles will remain the norm. Companies want to close deals as soon as possible. The trend of DIY sourcing by internal teams will continue with less reliance on outside help. This will favor incumbent suppliers, and service providers will be keen to win contract renewals to boost revenues even if margins remain slim. We may even see a renewed emphasis on shared services across the entire sector with competitors willing to cooperate to reduce costs in their shared costs areas so that they can compete in their core competencies. So the example of Pepsi and Anheuser-Busch sharing procurement costs may be followed by other companies.
Particular Verticals	Financial services companies put more deals on hold in 2009 than other sectors. With many banks and insurance companies feeling more confident about 2010, expect an increase in financial services sector deals, especially offshoring. Also, as a result of the mergers resulting from the financial meltdown, financial institutions will seek to rationalize their sourcing contracts. Other sectors that we expect to see increased activity in 2010 are hospitality and healthcare.

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OTHER GLOBAL TRENDS	
Cloud Computing	The Cloud will become more important as companies realize that they can achieve significant cost savings by exploring this option. With major providers like IBM, Google and Microsoft offering desktop deals in the range of $35 - 75 per head, companies will find their existing deals of $300 - 1,000 per head difficult to defend. But the key question is: can anyone clearly define what "the cloud" means and provide a basis for comparison between cloud and traditional service provision routes? Banks may be slow to turn to the cloud until financial services regulators approve cloud-based deals or produce guidance on how to square away the particular risks of cloud computing with the control required of regulated entities' material outsourcings
BPO	The business process outsourcing (BPO) market has been the poor relation over the past 12 months. IT outsourcing deals offer much greater opportunity for immediately-realizable savings without the same scale of up-front investment. So the opportunity for a bounce-back in BPO deals is much greater.
Effect on Service Providers	The flight to quality will continue. Stronger providers are favored and counter-party risk is still an issue. Bigger service providers will continue to buy niche providers. However, that does not necessarily mean that well-structured niche suppliers with good market offerings will suffer, and the flight to quality will mean opportunities for both large and small providers.
Data Privacy and Security	Data issues will remain a key issue in outsourcing projects, and will be given even more prominence by cloud computing. Data breach notification requirements and more assertive regulation of data controllers by national regulators (as well as the threat of private litigation) will make security compliance a key differentiating factor between outsourcing providers.
EUROPE	
The "L" of LUV	By one key measure, Europe is now a bigger outsourcing market than North America. But the recession recovery is predicted to be slower in Europe than elsewhere. This may erode Europe's lead as new outsourcing deal signings are slow to come on-stream.
Slow-down in Public Sector	Uncertainty surrounding the UK general election will subdue one of the traditionally larger outsourcing markets in Europe: the UK public sector. UK central government spending will remain on a tight leash in 2010. It's possible that local government may fill some of the gap.
UNITED STATES	
The "U" of LUV	The recession heightened interest in the cost savings associated with outsourcing transactions, and many companies began their analysis to determine the feasibility of outsourcing. Those companies tended not to move forward, typically unwilling to spend the money on the transaction costs. The speed at which the U.S. recovery occurs may determine whether companies will be willing to move forward with those transactions.
Multisourcing	The typical outsourcing transactions in 2010 will likely be smaller in scale and not involve a large transformation. We see the continuation of the 2008 and 2009 trend toward selecting best-in-breed service providers. Governance will, therefore, be a crucial issue.
State and Local Government Activity	States and local governments have shifted focus from outsourcing toward a search for ways to achieve costs savings internally, such as server virtualization and data center consolidation. A slow recovery will maintain the financial pressure on the states and the local governments and may cause them to return to outsourcing.
ASIA	
The "V" of LUV	The "China factor" somewhat cushioned the effect of the recession in Asia, as predicted in our trends survey for 2009. The growth of outsourcing in China is likely to accelerate further in 2010 with the continued recovery of the economy and the Chinese government's attempts to foster the outsourcing industry through favorable tax policies and other financial support and subsidies.
ITO and BPO	The China outsourcing market will continue to comprise mainly IT outsourcing (ITO), with some increase in R&D sourcing, while the rest of Asia will remain a platform for BPO, with perhaps some gradual increase in ITO activity.
Outsourcing from High-Cost Jurisdictions	Outsourcing from Japan to China seems set to increase in 2010 as Japanese companies become more open to the concept of using low-cost offshore labor to save costs.
Outsourcing from Low-Cost Jurisdictions	2010 may see a shift in demand for outsourcing as Indian and Chinese companies begin to outsource themselves within their respective domestic markets. However, this is a longer term play.

GLOBAL ECONOMIC PROBLEMS

Recession and Recovery

At the end of 2008, most organizations throughout the world feared a deep global recession brought on by the banking and credit crisis. For outsourcing, this meant both risks and opportunities. The main risk was that budgets would be slashed and customers would require immediate cost savings; and if cost reduction were the only criterion, other important drivers of outsourcing best practice – such as quality and service transformation – would suffer. The upside opportunity was that companies would accelerate their outsourcing plans in order to move as much as possible of their cost base from fixed to variable.

In early 2010, many organizations are scratching their heads and wondering if 2009 was an illusion. For many, a recession of the scale originally predicted for 2009 did not happen, especially for Asia; whereas, for Europe and the USA, there remains the nagging suspicion that economic conditions could become much worse before they become better, especially as governments try to unwind the monetary stimulus that propped up the financial system after the fall of Lehman Brothers.

Some economists now talk about an "LUV" recovery from recession (with the letters representing the "shape of the recovery – *i.e.*, a very slow L-shaped recovery for western Europe; a slower U-shaped recovery for North America; and a quick V-shaped bounce-back for Brazil, Russia, India, China and other key emerging economies). As a result, the 3 major global regions would move further out of sync.

If this is true, the effects on outsourcing will be interesting. Until now, the effect of recession on companies' outsourcing activity has been generally fairly homogeneous: *i.e.*, companies looked at outsourcing as a pretty good way to save costs in the short-term. Going forward, if the massive but under-developed (in terms of outsourcing and access to consumer spending) markets of the BRIC countries bounce-back at a noticeably quicker rate than Western economies, that will cause companies to re-appraise their growth strategies and investment priorities. That may further encourage spending on offshore outsourcing (which is likely to remain a favorite anyway due to the cost/pricing benefits that still exist).

Service providers will need to respond to further customer demands in 2010 and will need to think carefully how to price new transactions given the twin threats of cloud computing and continuing labor cost arbitrage. Of course, if parts of the world economy move at different speeds over the next 12 months, service providers will need to consider more varied pricing strategies.

So, our experience in the last few months of 2009 indicates that outsourcing will continue to grow in 2010, but for different reasons depending on an organization's sector and geographic location.

IT'S ALL ABOUT COST

One of the dominant features of the outsourcing market over the last 12-15 months has been the emphasis on cost above all else. We have always believed that cost was (and remains) the primary driver in most outsourcing transactions. The difference is that during the boom years of 2002-2008, cost was often down-played by customers and, instead, emphasis was placed on other business benefits such as transformation, concentrating on core competencies, and speed to market. 2009 saw cost and, more particularly, immediate cost savings, take center stage when customers engaged with existing suppliers or contemplated new sourcing projects.

That is why so many outsourcing contracts were re-negotiated in 2009, with suppliers being asked to share some of the pain experienced by their customers. Re-negotiations have been the mainstay of the outsourcing market in 2009. This often took the form of reductions in pricing, relaxation of volume commitments on one hand and service levels on the other hand, and bringing forward the financial benefits of transformation projects. Service providers often felt they had no choice but to agree to these changes and, often, it was better to keep an existing customer happy even at the cost of margin dilution. The main other benefits for service providers came in the form of contract extensions and renewals and the ability to show investors that the service provider's revenues were secure despite the overall financial turmoil in the markets.

But the problem with cost-cutting is that costs can only be cut once, and the re-negotiations suffer the law of diminishing returns. So some companies are thinking more laterally about ways to use outsourcing or joint shared services relationships to drive out savings – and none more so than Pepsi and Anheuser-Busch, who announced in 2009 that they have agreed jointly to purchase goods and services, from computers to travel, in the United States. The deal applies to goods and services not directly related to making the beverages that each company sells, such as information technology hardware. Though that deal is unusual, other companies in different but related sectors will study the outcome closely for evidence of success.

FLEXIBILITY: DOING MORE WITH LESS

Flexibility will be a key word in outsourcing deals over the next 12 months. Companies are seeking to implement much more flexible commercial arrangements with their service providers that reflect the different stages of the economic cycle.

In 2010, we see a continuation of the trend for shorter deals, shorter procurement processes, and an emphasis on making things work rather than engaging in complex strategies.

Many customers believe that they have enough in-house expertise to buy outsourcing services – so-called DIY sourcing. Although this is often only true of bigger organizations with experienced sourcing professionals, this will not deter many procurement departments and CEOs from pursuing this approach. While the DIY approach will often result in short-term transactional cost savings, inexperienced purchasers of outsourcing services usually suffer longer-term losses because they often fail to identify many of the key components for long-term success. For example, with the increased focus on costs, buyers will try and save on governance costs and overlook necessary governance functions. Particularly when customers engage in multi-sourcing transactions, heightened attention to governance processes is critical. As a result, we believe that many of the raft of 2009/10 deals will run into problems because they have not been properly managed by customers. Short-term cost savings do not always fix long-term service delivery problems and customers should not overlook governance.

PARTICULAR VERTICALS

Financial services companies put more deals on hold in 2009 than other sectors. With many banks and insurance companies feeling more confident about 2010, we are seeing an increase in financial services sector deals, especially offshoring.

The financial crisis of 2008 resulted in a number of U.S. financial institution mergers. The merged companies continue to maintain many overlapping sourcing relationships. As these institutions attempted to regain financial footing in 2009, they also began to investigate methods of rationalizing these sourcing contracts (many of which are at the stage of expiration from the major wave of outsourcing in financial services sector in 2002 and 2003). We expect this investigation to continue in 2010, and to result in increased outsourcing activity in the second half of 2010.

Other sectors in which we expect to see increased activity in 2010 are hospitality and healthcare. We began to see a number of hotel groups become active in the outsourcing of their information technology in the second half of 2009. Also, as the U.S. redefines its healthcare laws, healthcare companies (hospitals, insurance companies, and pharmaceuticals companies) will likely increase their sourcing activity. Much of this activity will likely involve the digitizing of healthcare information.

OTHER GLOBAL TRENDS

Cloud Computing

Cloud computing – the return to centralized processing, but using the Internet to distribute services to multiple customers instead of mainframes or midrange servers providing services to individual customers over local WANs and intranets, may be the biggest development to affect outsourcing since the rise of offshoring. 2010 will be the first year in which cloud computing will have a real role in procurement decisions. To be sure, cloud providers must deal with the key issues of data security, privacy compliance and service level guarantees, but the market potential is too great for solutions to these problems not to be forthcoming.

In 2010, we expect the outsourcing industry to begin seriously to address many of these issues, so that cloud solutions become not just economically tantalizing, but within the bounds of acceptable risk for customers. If nothing else, the dramatically lower costs on offer from cloud providers will push customers to question charges by traditional sourcing providers, and the cloud will be used as a lever in negotiations.

Cloud computing may change the transactional environment as well. Eventually, cloud computing should simplify the contracting process by relying heavily on the provider's service specifications rather than custom-built documents. For example, instead of a "Statement of Work" with extraordinary detail of which party is responsible for which function, most of the providers' detailed functions will be done "in the cloud" without detailed description. Accordingly, the focus will be on due diligence regarding the provider's solution rather than the development of detailed contractual language.

Cloud computing will also not only revise strategies regarding IT outsourcing, but also will create many options for combining process, software and hardware in newly launched BPO solutions that are scalable and truly "on demand," and offer enough flexibility to do the job while assuring compliance. In 2009, Salesforce.com surpassed US$1 billion in revenue. The trend for 2010 will be for more providers to bundle BPO solutions in an IT cloud, so that eventually – and it will take a few years – IT infrastructure is no different from the enterprise than network infrastructure has become.

We do not expect to see banks and other financial services organisations being the first ones to rush into cloud computing. Despite the fact that, in relation to many sophisticated IT systems, financial services organisations have been at the forefront of investment in new systems, we expect that, given the degree of virtualisation which cloud computing involves, they are more likely to wait to have other organisations test the water in relation to the successful use of cloud computing. Financial services organisations are also more wedded to control over their systems and less traditionally willing than companies in other sectors to surrender their own ways of operating for a standardised platform or approach. Banks will also want to wait and see what the financial services regulators in key global markets make of the extra risks inherent in cloud computing before investing in it: will the regulators conclude that the risks of cloud computing are incompatible with the control required of a regulated entity's material outsourcing?

Cloud computing may be the biggest development to affect outsourcing since the rise of offshoring.

Business Process Outsourcing

The business process outsourcing (BPO) market has been the poor relation over the past 12 months. IT outsourcing deals offer much greater opportunity for immediately-realizable savings without the same scale of upfront investment. So the opportunity for a bounce-back in BPO deals is much greater.

Effect on Service Providers

If economists are right and the economic recovery in both Europe and the U.S. is fragile and uneven, service providers will continue to be under pressure to ensure that revenues are stable and margin dilution is kept to a minimum.

One of the key stories of 2009 was service provider consolidation – especially in the form of large technology-based companies seeking to buy market share of wider services-based business (*e.g.,* Dell buying Perot Systems and Xerox buying ACS).

These mergers (along with the 2008 merger of HP and EDS) appear to be an endorsement of the outsourcing model. Because of the higher margins, the technology-based companies seem to view having services-based offerings as a necessary part of their revenue strategy. In fact, in at least one quarter of 2009, HP would have suffered huge losses but for its outsourcing business (formerly EDS). For the service providers, the mergers are attractive because of the depth of the marketing organizations of their acquirers. For example, Perot Systems can now take advantage of the vast marketing arm of Dell, with the expectation that Perot Systems will be better able to penetrate the outsourcing market. Many service providers have believed that IBM's model of having an integrated technology and services company has given IBM an advantage in the outsourcing marketplace because the outsourcing arm could take advantage of the vast relationships that IBM, the technology company, has created. It will be interesting to see in 2010 and beyond whether these merged companies can increase their market share using the integrated model.

Service providers will also be looking to the financial markets for any opportunities to raise capital as well as to buy niche players. So we expect attempts by Tier 1 providers both globally and in specific markets such as India to try to differentiate themselves from smaller providers. Tier 1 providers will therefore emphasize their creditworthiness and seek to justify any cost arbitrage by pointing to lower counter-party risk, financial stability, longevity, and commitment to the market. This will present a challenge to smaller or niche service providers who will not only have to overcome the counter-party risk issues, but also provide greater cost savings in order to persuade customers to choose them instead of Tier 1 providers. Sometimes it will be possible to sell domain expertise and other delivery qualities, but we expect to see an element of Tier 2 providers having to buy market share in 2010.

One area where smaller providers may thrive, however, is in the market for smaller outsourcing contracts. For some time now, the average size of outsourcing projects has been falling as multi-billion dollar mega-deals fell out of favor; companies broke up deals into components and selected providers based on niche skills. This trend is continuing and presents an opportunity for smaller providers who are able to compete effectively for contracts that fall below the level at which larger providers are able to compete effectively.

A growing world economy may also prompt more companies to sell their captive offshore entities following in the footsteps of companies such as GE, Aviva, and British Airways. An exit strategy for captives was always an issue for companies that set up captives in the first place, so any opportunities to sell captives to traditional service providers or to tap the market via an IPO will be seized upon by captive owners to release cash to their core business.

Data Privacy and Security

Data issues will remain a key issue in outsourcing projects, and will be given even more prominence by cloud computing. Data breach notification requirements and more assertive regulation of data controllers by national regulators (as well as the threat of private litigation) will make security compliance a key differentiating factor between outsourcing providers. Privacy and data security are likely to become a proxy for other political and environmental issues. Put another way, customers may focus on the lack of clear data security standards when the real issue is lack of a viable court system or the failure to have a stable infrastructure. The potential impact of a data security breach has never been higher. Outsourcing customers continue to focus extensively on the risk of data loss presented by their service providers. Encryption, secure data transfer, and enhanced loss notification, insurance and liability provisions are increasingly common negotiation topics. Data privacy and security is an issue that is sure to be high on the list of concerns and potential risks of all outsourcing customers in 2010.

EUROPE

The "L" of LUV

Leading outsourcing advisory firm TPI reports that, at the end of Q3 2009, the volume of outsourcing spending by international firms headquartered in Europe exceeded the value of deals awarded by firms headquartered in North America. This is a reversal of the position at the end of 2008, suggesting that the outsourcing market has fared better in Europe than in North America during 2009.

However, the economic outlook is far from certain for most countries both within and outside the euro zone. In the UK, which remains the largest outsourcing market in Europe, economic growth is likely to be weak until 2011 and beyond. For UK private sector outsourcing, the trends of 2009 are likely to continue. Cost savings will continue to drive outsourcing deals; companies will seek to complete deals more quickly and to shorten the procurement and negotiation process. There will, however, be more financial services sector deals than 2009 as the effects of banking mergers, including Lloyds and RBS, require that cost savings are driven through on the IT and business process side as well, and as delayed 2009 projects are given the green light for 2010.

Elsewhere in Europe, we see a continued demand for outsourcing although the constraints on reducing employment costs in many European countries will continue to limit the depth of services that are outsourced. The shared services model will continue to be pursued and companies will only outsource services in the traditional sense where the impact on employees is minimized. The anti-offshoring rhetoric of many European politicians will also make European companies reluctant to be accused of exporting jobs offshore.

Slow-down in Public Sector

The looming UK general election (expected in May 2010, but it could be as early as March) means that there is no coherent plan to sort out the public finances. Yet everyone expects that drastic measures (akin to those which Ireland and Greece have started to implement) will follow in the second half of 2010 regardless of who wins the election. The effect on public sector outsourcing, which has traditionally been a very active sector in the UK and also a source of high-margin business for many suppliers, will be that, for the first half of 2010, many projects will be stalled.

Post-election, some service providers think there will be a surge in deals in Q3 and Q4, but this can only be speculation. Instead, many existing deals may come under the spotlight especially since there are considerable opportunities for central government to reduce costs by following both shared services and cloud computing. Outsourcing will remain on the public sector agenda as a means of saving money.

Interestingly, in the second half of 2009 a few key local government deals were announced. Cardiff Council announced that it had hired TCS to undertake a transformation of its IT platforms, and Essex County Council signed a deal with IBM in which it would hand over as much as £5 billion in public spending across a range of citizen-facing services if IBM can demonstrate that it can make substantial savings through transformation. The element of transformation in both of these projects may prompt other local authorities to consider whether partnerships with private sector outsourcing providers might help to improve their ability to manage shrinking budgets.

UNITED STATES

The "U" of LUV

The U.S. outsourcing market is the most mature of the three main global regions in outsourcing terms. Accordingly, outsourcing activity continued in the U.S. in 2009 in the form of renegotiations and other adjustments to existing deals. Like the other regions, we saw the commencement of relatively few new outsourcing deals in 2009.

However, the economic slowdown did stimulate many companies to consider outsourcing for the first time, resulting in significant evaluation activity. These companies were seeking ways quickly to reduce their internal costs, converting certain of their fixed costs to a variable basis. Even if these studies indicated that cost savings were quickly achievable, the studies also often showed that capital investments were necessary to achieve those savings. Furthermore, these companies realized that, to consummate an outsourcing transaction, significant transaction costs would be incurred. A tension therefore arose, between achieving savings and expending capital up-front to achieve the savings. The result of that tension was a reluctance to engage in new outsourcing activity. Instead, companies that had existing deals chose to modify their agreements — often opting to do so quickly and without the help of outside assistance (*i.e.*, external outsourcing consultants).

Multisourcing

Even as the recession loosens its grip on the U.S. economy, the outsourcing transactions that we see in 2010 will likely be smaller in scale and will not involve large transformations. We will likely see the continuation of the 2008 and 2009 trend toward selecting best-in-breed service providers. These multi-sourced deals will necessarily require outsourcing buyers to focus on their internal governance structures as they cannot rely upon a single service provider to integrate the activities of their subcontractors. Instead, the companies will have direct relationships with many providers, which will cause them to create and maintain processes that will cause these providers not only to work together effectively, but also to avoid the opportunity to blame each other for failures. Such structures will involve the creation of complex operating level agreement structures. These buyers will be wise to hire third parties expert in governance processes to assist them in creating and maintaining these internal governance organizations.

State and Local Government Activity

After the consummation of the transformational deal whereby the State of Georgia outsourced its information technology platform in 2008, it appeared that many state and local governments were on the verge of following suit. The financial burdens that these state governments faced seemed to dictate that this would be a logical course of events. However, as 2009 progressed negative press began to emerge regarding outsourcing deals that pre-dated Georgia (*i.e.*, Virginia, Texas and Indiana). As a result, states and local governments have seemingly strengthened their resolve against outsourcing. Instead, they seem to be searching for ways to achieve costs savings internally. Such methods include server virtualization and data center consolidation (although some of the states have been mandated to do so on a cost-neutral basis). It will be interesting to see whether the financial burden on the states and the local governments continues (and there is no indication that it will subside) and, if so, whether these governments will re-visit their view on outsourcing. We will continue to monitor this activity.

This growth is being aided to a large extent by the Chinese government's investment in infrastructure, education, training, and tax incentives at 20 designated outsourcing cities across China.

ASIA

The "V" of LUV

As we predicted in last year's version of this report (*Global Sourcing Trends in 2009*), the overall effect of the recession has been somewhat softened by the "China factor." At worst, there was a slow-down in growth, but the negative impacts were by no means anywhere near the extent experienced in the United States and Europe. Some companies in China, such as BT Frontline, have even reported a marked growth in business during 2009. Growth in the last quarter of 2009 particularly accelerated and the widely-held view is that the outsourcing industry will continue to grow in China during the course of 2010. This growth is being aided to a large extent by the Chinese government's investment in infrastructure, education, training, and tax incentives at 20 designated outsourcing cities across China.

ITO and BPO

The outsourcing industry in China consists largely of ITO, but mostly AD&M outsourcing, and will remain focused on those areas in the near future, although there has been a relatively recent increase in the volume of R&D sourcing as well, and there are now over 1,200 R&D centers established by multinationals across China. The rest of Asia will continue to offer a platform for BPO, with the Philippines a particularly attractive destination due to its strong English-language skills. There are indications, however, that ITO activity may be increasing in Asia generally with low-cost countries like Vietnam emerging as IT outsourcing services destinations.

Outsourcing from High-Cost Jurisdictions

In last year's *Global Sourcing Trends in 2009*, we anticipated that outsourcing within Asia from high-cost to low-cost jurisdictions would increase and perhaps have the greatest mid-to long-term growth potential due to the fact that it starts from a relatively low baseline. In hindsight, this analysis is particularly true of outsourcing from Japan to China (although outsourcing from Hong Kong, and Singapore to a lesser extent, has also increased across the region).

Japanese companies have traditionally shunned outsourcing in favor of contract manufacturing or limited services agreements, partly due to differences in corporate culture. However, with the re-emergence of the Chinese economy and a rise in outsourcing by competitors, Japanese companies are also looking to save costs by taking advantage of the China outsourcing market. The language barrier is still an issue, but with an estimated 2 million Japanese and Korean speakers in China, particularly in northeastern hubs such as Dalian, and the geographical and time zone proximity, the continued economic recovery should bring further growth in the Japan-China outsourcing market.

Outsourcing from Low-Cost Jurisdictions

Looking further ahead, another factor we see is that Chinese companies will need to tap the outsourcing market themselves to reduce costs, improve performance and concentrate instead on their core competencies. Outsourcing by Chinese companies, however, is unlikely to involve offshoring in the short term to any degree, since the domestic market is already established and can offer cost reductions without the inconvenience of language or cultural barriers. ■