

# China Sourcing

an Emerging  
Competitive Edge in  
Global Sourcing

Yin Guopeng and Chen Jin

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# Preface

The development of China services industry is a new major strategic issue facing our country in the new era. The building of China services industry is an important measure to achieve industrial upgrading, economic growth mode adjustment, and development of service economy; meanwhile it is also an effective means to improve China's economic competitiveness. "China Services" series of reports are co-conducted by China Service Industry Research Center of UIBE (University of International Business and Economics) and School of Information Technology & Management. This study report "ChinaSourcing: an Emerging Competitive Edge in Global Sourcing" reveals in depth dynamics and trends in the world's service outsourcing industry, analyzes key elements of the development of China service outsourcing economy, stresses the importance of building "ChinaSourcing" brand and proposes policy recommendations for the development of China's service outsourcing, thus contributes to the development of China's service industry and the building of "ChinaSourcing" brand.

## 1. The Rise of Service Outsourcing Industry

Fortune 500 companies and many U.S. software companies are delivering billions of dollars worth of software development tasks to India's Infosys, TCS and other emerging global IT service providers. IT service companies in Beijing are undertaking U.S. companies' software development business, and applications development and maintenance work for the Japanese financial industry. Procter &



Gamble, Motorola and other multinational companies are transferring their back-office functions such as financial accounting, human resources to India, China, the Philippines and other countries to varying degrees. These scenes, unimaginable a decade ago, are now becoming part of an important economic phenomenon—Services Outsourcing. “Service Outsourcing” is becoming a buzzword in China.

“Do what you do best, outsource the rest.” —This is the core concept of outsourcing. Outsourcing first appeared in the manufacturing sector. In 1913 American Ford Company revolutionarily introduced assembly lines to the T-car manufacturing process, marking the beginning of large-scale mechanized production period in the industrial production. Large-scale mechanized industrial production promotes the segmentation of production aspects and components standardization, hence manufacturing supply chain is gradually formed. For example, production process is broken down into product design, development, production of raw materials, parts manufacturing, packaging, assembly, machine testing, warehousing, sales and other links. Many manufacturers outsource parts of their products to reduce cost, which promotes the socialization professionalization and standardization of the production. In the 1980s, with the development of logistics industry and the reduction in transport costs, manufacturing supply chain began to relocate on a global scale. A large number of developing countries have begun to shift their manufacturing sector to low labor cost countries to take advantage of the cheap labor. “Asian Tigers” took off under the favorable circumstances created by the rise of manufacturing outsourcing. Since the 1990s, with the growing labor costs of “Asian Tigers”, manufacturing sector began to relocate to China’s Pearl River Delta and Yangtze River Delta. Currently foreign companies have built about 60,000 factories in China. China has become an important manufacturing outsourcing destination and the “World Factory”.

The development of service outsourcing industry started from the IT industry





labor division and segmentation. IT outsourcing emerged in the 1960s and 1970s, when computer is expensive and bulky. To avoid or to reduce the initial investment in hardware, a lot of companies outsourced their data processing functions to data processing agencies through signed contracts. In the 1970s expensive enterprise software development costs rose as the bulk of IT cost. Due to the surging demand on IT applications development added by the lack of internal IT professionals, management began to outsource software development via contracts. In the 1990s, more and more companies began to use services provided by professional IT service providers, which boosted the popularization of IT applications in major developed countries and resulted in the growing spending and refined segmentation of IT in the manufacturing and service industries.

## 2. The Value Chain of Service Outsourcing Industry

In 1989, Kodak and IBM signed the first global IT outsourcing contract, worthing \$1 billion. Prior to this, the majority of U.S. companies agreed that information technology and information systems are the core assets of companies and it would be risky to outsource these parts of business. However, following Kodak's successful outsourcing case, many Fortune 100 companies have begun to outsource their IT services to professional business service providers. Kodak's first IT outsourcing in 1989 became a milestone in the history of outsourcing. Afterwards the IT outsourcing market continues to expand into what it is today: a more than \$1 trillion-dollar global market. Information Technology Outsourcing (ITO) is increasingly specialized now, ranging from customer-facing areas including IT & business integration solutions, IT consulting and planning, requirements analysis, system design, technical implementation, and system testing, to research and development aspects of upstream suppliers, like application coding, product module development, technical architecture, conceptual product design, and product innovation. The entire value chain division



of labor is increasingly sophisticated.

The rapid development of aviation and information and communication technology (ICT) makes global service delivery of IT outsourcing possible. Under this circumstance, IBM, EDS, Accenture and other professional IT services multinational companies came into being. Meanwhile there has been more and more companies that allocate their resources on a global scale. Chinese enterprises are still in the low-end and low value-added sector of the service outsourcing value chain; whereas Indian firms gradually start to move to the middle and higher value-added part. American companies focus more on the high-end part of the whole value chain and are gradually outsourcing the lower part.

A large number of “office works” can now be delivered through the Internet as information and communication technology application deepens, which facilitate the trade service. A large number of white-collar jobs in developed countries begin to move overseas, expediting the emerging of business process outsourcing (BPO). For example, in a firm located in North Third Ring Road in Beijing, more than 100 white-collar employees’ work time goes in line with the U.S. time as they provide online accounting and finance, supply chain management, and business process services to their U.S. customers. More and more businesses are outsourcing IT-enabled business processes, including data processing services, customer interaction services (e.g. call centers), human resource services, finance and accounting services, procurement and supply chain services to professional service providers. In recent years the high-end form of service outsourcing, namely Knowledge Process Outsourcing (KPO), such as bio-pharmaceutical research and development, industrial design and R&D, IC design, knowledge-based services (market research, data analysis, and financial research) has been expanding fast. R&D outsourcing, for example, is conducted through the use of the global partners’ network and formation to develop new products in large enterprises. Five out of IBM’s eight research centers locate



outside the United States. The research centers coordinate with each other smoothly through the management of the global R&D chain, thus speed up the new product development and increased efficiency dramatically.

### 3. The Scale and Employee Number of Service Outsourcing Industry Will Exceed Those of the Manufacturing Industry

The proportion of service sector in overall GDP is an important indicator to gauge whether an economy is developed or not. Currently the GDP of service sector amounts to more than 60% of the global GDP on global average. In the United States, Britain and other major developed countries, the number is more than 70%. Thanks to the international division of labor and trade, many developed countries seize the vast majority of benefits generated by the value chain though not involved in manufacturing and production directly. China now is a big manufacturing country in terms of output value, but still in the low-end of value chain in terms of industrial labor division. Compared to what has gained in the value chain, China has sacrificed too much. A lot of resources has been consumed and the environment being polluted during the production process. China's service sector now accounts for only 43% of overall GDP, lagging behind the major developed countries.

In 2009, the size of the global service outsourcing market is about \$1 trillion, of which 90% is onshore outsourcing. Offshore outsourcing constitutes only 10% of the total demand, which is about \$100 billion. Currently, the global outsourcing demand is growing at 20% annual growth rate. With the increasing demand for offshore outsourcing, offshore outsourcing will take a larger proportion of the total outsourcing demand. In the foreseeable future, offshore outsourcing industry will still be a vibrant sunrise industry.

Currently, the issuers of global service outsourcing contracts mainly locate in North America, Europe and Japan. The United States is the world's largest



offshore outsourcing contract-issuing market, whose contract-issuing volume answers for more than 50% of the total volume, while Japan accounts for nearly 10%. From the dimension of company size, major outsourcing contract-issuing parties are large companies, contributing to 2/3 of the outsourcing volume.

According to a study done by McKinsey, service outsourcing and offshore outsourcing has become an important means for multinational companies to execute global distribution strategy, to contend against competitors and to enhance their international competitiveness. Among Global Fortune 1000 companies, 95% has developed their offshore strategy. On average, weekly 5 –10 companies are conducting field trips in possible offshore destinations. The main outsourcing suppliers are India, Ireland, Israel and other countries. In recent years, China has become an important destination for global offshore outsourcing.

“Everything is service” has become an emerging trend. The proportion of service in manufacturing is increasing and manufacturing segmentation is transferring a lot of manufacturing components into service. The service outsourcing industry owns enormous development potential. The industrial scale and employment of service outsourcing industry exceed those of the manufacturing sector.

If China is to step into the ranks of developed countries, China must vigorously develop the service industries. The service outsourcing industry can promote the rapid development of modern service industry, industrial upgrading and enhance national competitiveness.

#### 4. ChinaSourcing: an Emerging Competitive Edge in Global Sourcing

China has become an important global service outsourcing destination. China's service outsourcing companies have grown to be important members of global service outsourcing industry. In the early 1990s, when India was known as the global software outsourcing leader, current Chinese top ten software outsourcing



companies like VanceInfo, HiSoft, and Beyondsoft had just been established. From 2003 to 2008 China's domestic service outsourcing enterprises has entered a period of rapid development. "A lot of companies of the size of two to three hundred people have experienced explosive growth into the scale of five or six thousand staff." Two giants employing over 10,000 personnel—VanceInfo and iSoftStone were set up in Beijing in 2010. Many China's service outsourcing enterprises have become increasingly favored by the capital market. Many service outsourcing companies have listed in Hong Kong and the United States stock exchanges.

The state and local governments have issued a series of policies to encourage the development of service outsourcing industry. Particularly after the initiation of "Thousand-Hundred-Ten" project by the Ministry of Commerce, service outsourcing, as a new industry, has received wide attention. State Council issued "Reply letter on promoting the service outsourcing industry" [State Council Letter (2009) No. 9] at the beginning of 2009, followed by the release of the "Reply by the State Council on encouraging and speeding up the development of service outsourcing industry" [State Council Letter (2010) No. 69] by the State Council in 2010. The State Council has also approved to entitle 21 "service outsourcing model cities" to promote service outsourcing industry. All these regulation and policy supports demonstrate the determination of the Chinese government to develop service outsourcing industry. Many regions have demonstrated an ardent scenario in service outsourcing industry development. China's service outsourcing industry has entered a new phase of development.

Although China owns obvious advantages in terms of policy environment, infrastructure and low-cost high-skilled personnel and the service outsourcing industry has grown rapidly in recent years with rising influence on the international market, China's outsourcing industry is still lagging in an early stage as a whole. Currently, China's outsourcing industry makes up less than 10% in the global



market ( India about 45% ). Besides, in the global market, China's service outsourcing industry has not yet grasped a strategic position. Therefore, the urgent task for China is to build the brand of "ChinaSourcing", clarifying our value orientation in global service outsourcing industry, and study in-depth and develop promotional strategies and investment guidelines targeting at global outsourcing customers and service providers.

"ChinaSourcing: an Emerging Competitive Edge in Global Sourcing" research report is produced under this context. The research goal is to provide strategic guide and reference for multinational companies who plan to implement outsourcing business strategy in China. Concurrently the demonstration of industrial leading and landmark cases will promote the "ChinaSourcing" international brand, and help multinational clients to better understand China's service outsourcing industry's environment, layout, strengths, abilities, success cases and preferential policies, thus establish the good image of China's service outsourcing industry.

Shi Jianjun

# Introduction

The research and writing of this report consists of three parts: Part I “ChinaSourcing: Macro Level Study” compares the advantage and gap of ChinaSourcing with other major outsourcing destination countries through global service outsourcing market analysis, vision of China’s service outsourcing industry, China’s service outsourcing industry scenario analysis, and China’s service outsourcing industry development policy examination. Part II “ChinaSourcing: from a Regional Perspective” analyzes and compares the 21 service outsourcing model cities through matrixes, including service outsourcing industry basic situation, human resources and skills, infrastructure, life and social environment, business environment, operating costs, government and policy support. The 21 model cities are analyzed mainly in a geographical framework and are grouped into four major geographical regions, namely, Bohai Rim, Yangtze River Delta, Pearl River Delta, and central and western regions. Then we provide future development orientation suggestions to these cities’ outsourcing industry utilizing location advantage theory and empirical analysis. Part III “ChinaSourcing: the Study on Vendors” examines the types of service outsourcing business model and evolution trend, defines high-middle-low end outsourcing services, and evaluates China’s service outsourcing companies through case analysis. This part introduces the evaluation criteria of outsourcing providers and strengths and weaknesses of China’s service outsourcing industry. Then the future opportunities and development orientation of China’s service outsourcing companies are



investigates through case study. Lastly, this part explores the importance of outsourcing relationship management and partnership trends.

Core members of UIBE School of Information Technology & Management Engineering and China Service Industry Research Center of UIBE modern service industry and service outsourcing team conducted and composed this study report. Professor Chen Jin leads the overall planning and framework of the report. Yin Guopeng, Yang Bo, Cui Jinhong, Liu Mingzhu, Bao Lu, and Jing Qing are mainly responsible for Part I ; Chen Jin, Yin Guopeng, Liu Yiming, Liu Mingzhu and Jing Qing for Part II ; Yin Guopeng and Yangbo for Part III. Hereby we would like to deliver our thanks to the Department of Foreign Investment of Ministry of Commerce of the People's Republic of China, Department of Electronic Commerce and Informatization of Ministry of Commerce of the People's Republic of China, China Service Outsourcing Research Center of Ministry of Commerce of the People's Republic of China, Service Trade Office of Beijing Municipal Commission of Commerce, Beijing Association of Sourcing Service, Discipline Development Office of UIBE, Department of Scientific Research Administration of UIBE, many outsourcing companies and also the help of domestic and overseas experts for their dedication to the field of outsourcing.

Yin Guopeng



# Contents

## Part I ChinaSourcing: Macro Level Study

Chapter 1	Analysis of Global Service Outsourcing Market .....	3
1.1	Service Globalization and Outsourcing .....	3
1.2	Global Outsourcing Market and Forecast .....	5
1.3	R&D Globalization and Opportunities in China .....	8
1.4	IT Services Market of United States and Japan .....	12
1.5	Major Outsourcing Destinations Overview .....	19
Chapter 2	From “Made in China” to “ChinaSourcing” .....	32
2.1	Economic Globalization Promotes the Transformation of Manufacturing Industry .....	33
2.2	Technology Development Drives Service Transfer .....	34
2.3	The National Vision of Service Outsourcing Industry .....	35
2.4	Service Outsourcing Promotes Economic Transformation .....	38
Chapter 3	Comparative Analysis of China and Other Major Service Outsourcing Destinations .....	40
3.1	Overall Analysis and Comparison .....	41
3.2	Human Resources Comparison .....	43