Possible Sources for Progress of the Shared Service Market in Hungary

RÓBERT MARCINIAK
ASSISTANT LECTURER

e-mail: szvmarci@uni-miskolc.hu

SUMMARY

The aim of a shared service model is improving processes and ensuring more cost-efficient operation. In this paper I focus on the Hungarian shared service market. In my research I analyzed a number of Hungarian shared service case studies to disclose the main characteristics of the market. To determine those drivers that contribute to the growth and those obstacles that hinder it, I interviewed some key experts from these service markets. In this paper I introduce the role of Central and Eastern Europe in the global market, the importance of this sector in the labor market and state budget and uncover the competition among the regional countries. I compared the positions of these countries in this competition and analyzed what could be the break point for Hungary.
Keywords: Shared Services, Hungarian Service Market, Source Strategy
Journal of Economic Literature (JEL) code: M19

INTRODUCTION

Background of the Research

In the area of global capital investments the service sector has taken on a more and more important role. While in the 1970s only 25% of foreign investment capital was put into the service sector, in 2002 it had reached 60% (Bilics 2005).

Earlier the service industry and the companies operating in service delivery were less international than manufacturing companies. But there was a dynamic progress and nowadays the proportion of foreign direct investment (FDI) in the service sector has moved to a higher level.

The big companies attempt to rationalize operational costs by standardization and deliver services over country's borders as well. Depending on the expected assets at the end of the process, either a shared service center is created or an outsourcing provider will get the delivery. The key lies in the reorganization of processes. If the function moves to an offshore location then this will mean further cost reduction.

Once a company has decided about the sourcing issue, it should deal with another question, the location. In particular, three factors could influence the location decision: the available competence (that is, the existence of labor required for performing the task), the investment incentives and the national tax system. Their equilibrium and the country's image will influence the country judgment (Sebök 2006).

Justification of the Research

In the countries of Central and Eastern Europe the shared service model appeared in the early 2000s. The previous lack of interest was caused by the fact that the countries in the area are too small as a market and had less advanced office technologies and information infrastructure, which was not very attractive for multinational companies. However, EU enlargement has changed the situation. It expanded and opened the market and it has accelerated growth and progress. This change has positively affected the market of service organizations and made Central and Eastern Europe increasingly favored. Contributing to this is the fact that West European companies laid claim for shared service centers that operate on the same European cultural and language base, have good local relations, and can be accessed easily.

For companies that considering this region there are four different strategies from the point of view of implementation (Thorniley 2003:14):

- ➢ Delivering to Central and Eastern Europe from a Pan-European center. Oracle, the U.S. software company chose this strategy. It is not very cost effective and caused language problems as well but the company could obtain a coherent picture of the whole European market.
- ➢ Moving the Pan-European center to a Central and Eastern European location. If the company detected a significant cost advantage, it could move the existing center to here. The U.S. aluminum industry giant Alcoa did this.

- Setting up a satellite center in this region: for those companies that operate shared service centers with low costs and success, there was no sense in changing them. These companies set up satellite centers in this region to test the market or prepare for a bigger change. The U.S. company IBM did so.
- Creating clusters in the region. More company leaders are thinking in terms of cluster strategy: creating regional centers that deliver not only back-office functions but could support more valuable areas such as marketing or business improvement.

Among these four different strategies, in the last ten years the setting up of satellite centers and relocation of service centers were the most favored.

Countries or even regions developed very attractive offers and incentives and created extra strategies for the industry, setting up a framework that fostered attraction and retention of investments. Hungary also recognized the value of this in the early 2000s and supported industry progress with incentives. As a result, numerous company leaders had chosen Hungary as a location for shared service investments.

The Purpose of the Research

The aim of this research is to explore the position of the Hungarian service market in Europe and globally. I want to discover the main drivers of and obstacles to market progress. Finally I collect the advantages and disadvantages of Hungarian market and make some forecasts.

Methodology

I summarized the most important points of the Hungarian shared service sector articles and statistics in the last three-to-five years. Besides the literate review I collected five Hungarian shared service case studies (BP, BT, IBM, Morgan Stanley, Sapa). I analyzed the case studies to draw some conclusions from the human resource exercise of companies. I had also three interviews with key experts from Hungarian service markets to disclose the market tendencies and the conditions for further growth. As consultants and real estate specialist they could create a real picture about the current changing on the market and forecast the future tendencies.

ROLE OF HUNGARY ON THE CEE SERVICE MARKET

Within the region, the most important period of establishing shared service centers (SSCs) in Hungary was 2000-2004.

In Table 1 you can see that Hungary was competitive only for a short time and after this Romania and Poland won stronger positions in this contest.

Compared to the regional competitor countries, Hungary had no advantage in foreign language skills. According to research of the EU public research agency, the Eurobarometer, released in its 2001 study, Hungary is quite weak in foreign language knowledge (EC 2002:35).

Table 1
Number of Shared Service Centers by the Date of Establishment

	2004	2005	2006	Total
Hungary	6	0	4	10
Romania	5	7	20	32
Poland	15	10	18	53
Czech Rep.	2	8	1	11
Slovakia	4	0	1	5
Bulgaria	4	3	2	9

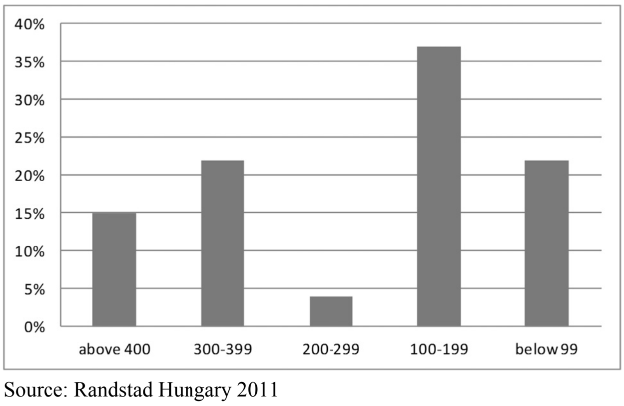
Source: Wéber 2008

The attraction was rather the good regional conditions, the close geographical position to the West European countries, and almost unlimited amounts of skilled labor whose cost was half than in the West (but twice as much as in India) (Erdős 2005). Since then the cost of labor has been increasing year-by-year in the region. This catching up to the level of West Europe’s costs stimulates the leaders of service centers to improve their efficiency indices (Thorniley 2003:17).

After the last decade’s rapid growth the business service industry – and within it the shared service sector – had became one of the key segments of service industries and an important employment sector of the country.

Today, there are more than 80 shared service centers in Hungary, that primarily employ an educated workforce that speaks foreign languages, with about 40,000 employees. The leased office space by shared service centers is 200,000 square meters, which is approximately one-tenth of the total A-list office space in Hungary. According to the experiences of real estate developers, the technology of these centers becomes outdated in 3-5 years and after this point centers move to Asia, where the operational costs are lower. But today there is a tendency not only for these centers to remain, but for some companies to move their service centers from cheap countries like India to Central and Eastern Europe (Sütő 2012). The cause of this trend is that companies recognized advantages of CEE region in language skills, educational level, technological advancement on the contrary of offshore countries.

According to Randstad Hungary’s research (see Figure 1), 37% of the Hungarian shared service centers have between 100 and 199 employees.



Source: Randstad Hungary 2011

Figure 1. Number of Employees in Hungarian Shared Service Centers in 2011

The shared service centers provide a range of business services – most notably in finance, accounting, procurement, logistics, information technology and human resources area – mostly regional and sometimes globally. According to PwC consultant, Mr. Bunna, this sector is a major employer, with around 1.2% of the state budget coming from taxes on it in 2010. (Bunna 2010)

The key question is why a parent company would choose Hungary when looking for an investment location to establish a new service center. To win this competition Hungary has to prove that its society is cosmopolitan and capable of operating on an international level, and that its young people speak several languages and are well-educated. But there is a serious responsibility placed on government and the leaders of local government. If cities have conveniently located, well-equipped offices and public transport infrastructure then this could mean a high attraction value. About 40-50 countries are on the list and competing against each other for such a decision.

Several consulting firms make rankings that can help in choosing an investment location. Perhaps one of the most famous lists is the Global Services Location Index (GSLI), annually compiled by A.T. Kearney, which ranks the most favorable 50 countries on the base of service sourcing. Three aspects are taken into account in the methodology of ranking: financial attraction of the county (40%), the availability of adequate human resources and training (30%), and the business environment (30%). The first ranking was in 2004 and since then the first three countries have been India, China and Malaysia. The position of Hungary is continuously changing but it has been constantly in the first 40 countries. Unfortunately within Central and Eastern Europe Hungary is not very competitive.

Table 2 represents the changes in the ranking of Central and Eastern European countries. In brackets the global rankings could be seen. The rankings of 2004 and 2005 do not include Latvia, Lithuania, Estonia and Ukraine, Bulgaria and Romania were not in the first 50 countries. The comparative table shows that a few years ago Hungary could prove relatively easily its benefits to the potential SSC investors, but now the situation has changed.

Table 2
Changes in Global Services Location Index Ranking of Central and Eastern European Countries

2004	2005	2007	2009	2011
Czech Republic (4).	Czech Republic (7).	Bulgaria (9).	Bulgaria (13).	Estonia (11).
Poland (10).	Bulgaria (15).	Slovakia (12).	Estonia (18).	Latvia (13).
Hungary (11.)	Slovakia (16).	Estonia (15).	Romania (19).	Lithuania (14).
-	Poland (18).	Czech Republic (16).	Lithuania (21).	Bulgaria (17).
-	**Hungary (19.)**	Latvia (17).	Latvia (22).	Poland (24).
-	Romania (24).	Poland (18).	Czech Republic (32).	Romania (25).
-	-	**Hungary (24.)**	**Hungary (37.)**	**Hungary (31.)**
-	-	Lithuania (28).	Poland (38).	Czech Republic (35).
-	-	Romania (33).	Slovakia (40).	Ukraine (38).
-	-	Ukraine (47).	Ukraine (42).	Slovakia (40).

Source: own edition based on The A.T. Kearney Global Services Location Index (2004, 2005, 2007, 2009, 2011)

Unfortunately, in the past five years Hungary has become completely sidelined from the first 10-20 positions, as has also happened with the Czech Republic, Poland and Slovakia, although the business service sector was growing during this period. However, the position of the Baltic countries (Latvia, Lithuania and Estonia) has significantly strengthened, while the ranking of Romania and Bulgaria also improved considerably. So these countries are now the major competitors of Hungary. It is true that several Asian countries have overtaken Hungary on the global service market, but for example the world-leader India is not a competitor because companies choose India for one purpose and Central and Eastern Europe for another. In India there are services similar to mass production that do not need special skills. On the global service market the position loss of Central and Eastern European countries can be attributed also to the fact that the Middle East and North Africa have also appeared among the most popular locations. The reason for their rise in the rankings is based on their large and educated populations and the proximity of Europe.

The year of 2011 was not a good one for the Hungarian service market. Although many investors were thinking of locating in Central and Eastern Europe, and Hungary was also on the list, last year Hungary was rarely the winner. In 2011 Poland was the favorite country. There are two arguments against Poland. One is the even scarcer workforce than in Hungary. The other is better international political image, which is not very lucky for Hungary now. But these are short term influencing factors that will diminish in the medium term. It is sure that more shared service centers will come to Hungary – the only question is how many. Government regulations and incentives have also a key role in this. Now Hungary supports the high value-added, research-based service centers like BT, Morgan Stanleys, BP. Nowadays there is a tendency in Hungary to turn to outsourcing and the shared service market. There is a demand for process optimization and automation, i.e., those services that reduce operational costs and increase productivity (Berta 2011).

Hungary's biggest competitive edge is that labor costs is still lower than in Western Europe. This is reinforced by the fact that low labor costs are coupled with higher expertise and the investor company can get access to a workforce similar to that of a Western European nation but at a lower price. In addition not only the labor costs are lower, but also the other incremental costs (training, office space, etc.) are lower (Nagy 2010).

Further competitive benefits are the high working hours per year, the big consumer markets around Hungary (about 150 million people) and the high unemployment rate. This is good for the Shared Service Centers because they can get cheap and educated labor quite simply.

It could be an important point of view that Hungary possesses the conditions – infrastructure, regulation, etc. – that are needed to stimulate investments. The quite high standard of living is also an asset of Hungary. Hungary holds the 20th position on the global ranking of International Living. (Figyelőnet 2011)

However, the risk of continuous growth in labor costs is modulated by the fact that Central and Eastern Europe should not compete with the Far East. Countries that contend in this competition only with the cheapness of their workforce cannot win in the longer term. If countries want to stimulate investments, they have to aspire to added-value creation because an educated, skilled, foreign-language-speaking workforce is more valuable. So those countries will be successful in the attraction and retention of service centers that undertake not low added-value, transactional work but that focus on more difficult, knowledge-based tasks. To achieve this, countries and regions have to invest in developing education and training.

On the Hungarian service market the vast majority of shared service centers are in Budapest. According to key experts, however, this should be changed in the future because without it the growth will be unsustainable. If the change to non-Budapest locations was successful the current number of employees could grow by 5-10% annually, because 80% of shared service centers are still in the expansion phase. This growth potential is clearly visible in the expansion of functions in certain centers. While in Hungary there is neither a shortage of workforce nor oversupply on this segment, in Czech Republic or in Slovakia the shortage could be sensible. In Hungary the labor supply of provincial cities, especially cities where universities are based, is still unused. However, major infrastructure investments are necessary, since service centers need large and technologically advanced offices. These could be the source of growth because there are a number of EU subsidies for these purposes (Mártonffy 2010). For now, Budapest has an unbeatable advantage with its young, foreign-language-speaking workforce in comparison with the other cities of Hungary, but hopefully this disadvantages will decline in the future (Szilágyi 2011).

The most important expectation for the young, educated workforce of shared service centers is the ability to learn quickly and decision-making skills. In service centers there are higher attrition rates than in other sectors. The reason for the manpower exchange is the high expectations in these centers that require a higher education diploma or degree. While this job could be interesting initially, it could become very monotonous for these highly educated employees after a little while. Because of this, in the service centers the attrition rate could reach 20-30% annually. It is also typical for an employee to change jobs between two service centers, naturally for a higher position (SSC Recruitment 2010).

The “job-hopping” phenomenon in which the young workforce migrates from one center to another has long existed in India. It has become a well-known problem in Hungary as well. There is even a company that does not let any visitors into the center because of its fear of competitors. Other companies apply incentives to retain their workforces (Sebök 2006).

Of the Hungarian shared service staff, 80% are highly educated and speak foreign languages excellently, and about 20% have only a secondary education. This ratio is reversed in the West, because intermediate level skilled workers also speak a foreign language that is necessary in those centers. This is the reason why shared service centers recruit mainly among highly educated people, but it is also true that there are some centers that need really qualified experts, for example from the fields of engineering or IT. The competitiveness of Hungary depends also on maintaining its labor cost on a low level (Mártonffy 2010b).

CONCLUSION

To attract new service investment in Hungary the national and the local government has to act consciously. Budapest, along with Prague, Krakow, and Warsaw, was one of the most favored investment cities at the beginning of the 2000s. But now the growth has been stopped. All of the countries in the neighborhood have recognized that they need to encourage the investment in shared service centers because this sector has become an important player for the domestic labor market and the national budget as well.

To get more investments the national government should create a better country image abroad, politically as well as economically. This could be very important because the investors need a feeling of security. It creates trust that the investment will yield its benefits. Central and Eastern Europe does not yet play so large a role in the global service market because a notable proportion of Western companies do not know the region.

Improving foreign language skills is also a national issue. In Hungary the society speaks foreign languages very poorly and speakers are few in number. It is necessary to improve this situation because all foreign investments need foreign language skills, and the service sector especially. Now only the higher educated people speak foreign language well but the government should start education programs for the secondary-school graduates as well. The national government and the education are responsible for regulations of language education.

In Hungary the provincial cities have not as developed an office infrastructure as the service sector investors need, but there are a lot of possibilities to change this situation. According to a Deloitte survey (Wéber 2008) there is a shift in the country. Several provincial cities like Szeged, Debrecen, Pécs, Kecskemét, and Székesfehérvár could be attractive enough in cost/quality that these cities would have a competitive edge not only over Budapest but over other capitals as well. But for the sake of evolving their competetiveness, the local governments of these cities have to do more than they have done so far.

In addition, the national government should improve the IT and financial regulation that influences international operations and supports internal movement on the labor market.

Acknowledgement

The described work was carried out as part of the TÁMOP-4.2.2/B-10/1-2010-0008 project in the framework of the New Hungarian Development Plan. The realization of this project is supported by the European Union, co-financed by the European Social Fund.

REFERENCES

BERTA, László (2011), "Áll az outsourcing piac: miért nem jönnek a beruházások?", HR portál, Retrieved: 20.12.2011 http://www.hrportal.hu/hr/all-az-outsourcing-piac-miert-nem-jonnek-a-beruhazasok-20110902.html

BILICS, Brigitta (2005), "Regionális üzleti központok Magyarországon", Budapesti Gazdasági Főiskola, Külkereskedelmi Főiskolai Kar, Szakdolgozat, Budapest

BUNNA, Gyula (2010), "A szolgáltató központok országa lettünk", PricewaterhouseCoopers, Innoportál, Retrieved: 22.11.2011 http://www.innoportal.hu/a-szolgaltato-kozpontok-orszaga-lehetunk

CSÉFALVAY, Zoltán (2005), "Mit tanulhat Magyarország Indiától?", HVG, Retrieved: 22.02.2012 http://img8.hvg.hu/velemeny/20050901csefalvay2

Ecoline (2009), "Outsourcing világranglista – Szlovákia nagyobbat zuhant, mint Magyarország", Retrieved: 19.11.2011: http://ecoline.hu/ecoline/2009/5/19/20090519_outsourcing

ERDŐS, Gabriella (2005), "Szolgáltató-központok", IT Business Online, Retrieved: 20.02.2012 http://www.itbusiness.hu/Fooldal/hetilap/Focus/Szolgaltato_kozpontok.html

European Commission (EC) (2002), "Candidate Countries Eurobarometer 2001", Directorate-General Press and Communication, pp. 35-37

Figyelőnet (2009), "A szolgáltató központok hazája lehetünk", Retrieved: 11.10.2011 http://fn.hir24.hu/ceghirek/2009/05/11/szolgaltato_kozpontok_hazaja_lehetunk

Figyelőnet (2011), "Megrettentek a szolgáltató központok", Retrieved: 16.05.2012 http://fn.hir24.hu/karrier/2011/11/09/megrettentek-a-szolgaltato-kozpontok/

GYIMÓTHY, Éva (2011a), "Miért nem szerveznek ki a magyar cégek?", HR portál, Retrieved: 19.11.2011 http://www.hrportal.hu/hr/miert-nem-szerveznek-ki-a-magyar-cegek-20110606.html

GYIMÓTHY, Éva (2011b), "A szolgáltató szektor lehet hazánk kitörési pontja", HR portál, Retrieved: 25.01.2012 http://www.hrportal.hu/hr/a-szolgaltato-szektor-lehet-hazank-kitoresi-pontja-20111111.html

MÁRTONFFY, Attila (2010a), "Fővárosközpontúak a szolgáltató központok", IT Business, Budapest, Vol. 8., No. 17. pp. 60.

MÁRTONFFY, Attila (2010b), "Töretlen szolgáltatók", IT Business, Vol. 8., No. 18.

NAGY, Bálint (2010), "Interjú Vass Tiborral az E.On kelet-európai szolgáltatási igazgatójával", IT Business Online, Budapest, Retrieved: 22.10.2011: http://www.itbusiness.hu/Fooldal/hetilap/vipstafeta/Vass_Tibor.html

SEBÖK, Orsolya (2006), "Középről az élre", Piac&Profit Magazin, Vol. 10., No. 5, pp. 56-58.

SSC Recruitment (2010), "Az átlagnál magasabb munkaerő mozgás okai", Retrieved: 20.11.2011: http://sscguide.hu/news.php?extend.1

SZILÁGYI, Katalin (2011), "Hogyan működhetnek hatékonyabban a szolgáltató központok?", HR portál, Retrieved: 21.01.2012 http://www.hrportal.hu/hr/hogyan-mukodhetnek-hatekonyabban-a-szolgaltato-kozpontok-20111114.html

THORNILEY, Daniel (2003) "Shared Services - Moving into Central and Eastern Europe", The Economist, White Paper, pp. 14-18.

WÉBER, Balázs (2008), "A vidéki városok is vonzhatják a szolgáltató központokat", Menedzsment Fórum, 2008. január 29., Retrieved: 10.04.2012 http://www.iir-hungary.hu/!site/downloads/sajto/beszeres_mfor_01_29.pdf