



# Location Arbitrage: Gaining Competitive Advantage through an Effective Sourcing Strategy

By **Jeremy Smith**  
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Offshoring has long been viewed as a way to reduce costs and potentially deliver wider benefits such as increased productivity or new revenue opportunities that might be unprofitable if delivered onshore. Offshore locations such as China and India are well established but a number of new Asian and European centers are challenging the traditional offshore service locations. Placing of support services in highly educated, language capable, low cost locations has proved a widely publicized success story for many banks, but has it been as far-reaching as we have been led to believe?

This paper reviews the sourcing strategies of global U.S. and European financial institutions and focuses on the main infrastructure/support groups: IT, operations and finance, and poses the following questions:

- Where are infrastructure staff located?
- What do they do?
- How much are they paid?
- How is this changing?
- What is next?

Data has been sourced from our market leading benchmarking surveys conducted for hundreds of institutions. Our findings are based on 25 leading global banks to provide a fair picture of global trends.

### Where Are Infrastructure Staff Located?

The banking sector has experienced fundamental changes since 2000 with increased pressure to reduce costs. Headcount for 2011 is down year-on-year and the expectation is that it will remain depressed. This has also led to lower attrition rates. At the same time, there are still areas where banks struggle to attract staff in major locations, particularly those with technical or regulatory experience.

The graph below shows the overall split between “primary” (onshore - aligned to front-office), “secondary” (generally processing hubs and/or nearshore), and “tertiary” (offshore) locations. It is clear that while operations and finance groups have gained competitive advantage by an effective sourcing strategy, IT staff in banks are still mainly located in “primary” locations.



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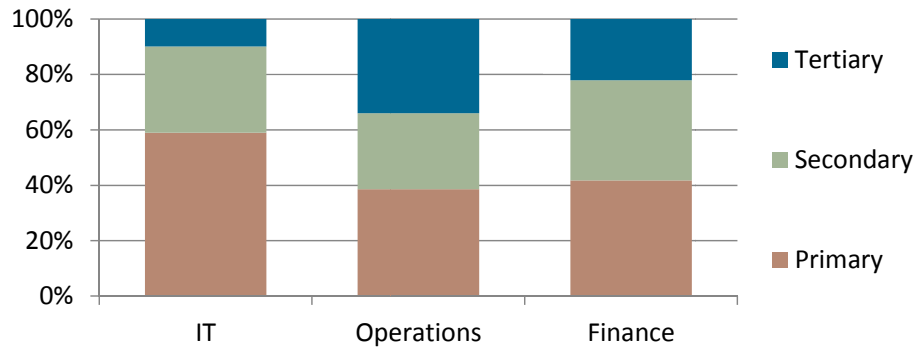
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**Location of Staff – Key Infrastructure Areas**



- **Primary:** US – NY metro, UK – London, France, Germany, Switzerland, Hong Kong, Japan, Australia
- **Secondary:** US other locations, UK – non-London, other European locations, Canada, Singapore
- **Tertiary:** Other Asian and Latin American locations

The pay balance is also changing. For example, pay in Singapore (considered “secondary” on a global basis) is now close to major hubs like London, New York and Hong Kong.

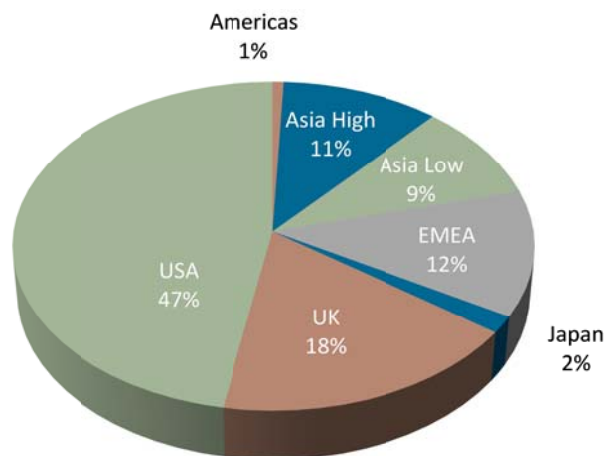
In India, while entry level pay is still low, management pay (MD & Director level) has also increased towards primary location levels. In addition, there is still a significant differential between BPO and local banking staff.

So, have these factors impacted where people are located globally?

**Information Technology**

For the banks surveyed, the United States and United Kingdom (47% and 18% of global headcount, respectively) remain the key locations for IT staff.

**Distribution of IT Staff**



- **Asia (Pacific) High** includes Australia, Hong Kong, Singapore (“Primary” & “Secondary”)
- **Asia (Pacific) Low** includes India, China, Taiwan, Malaysia, Philippines and other low cost locations (“Tertiary”)



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Existing system and product knowledge, the need for local support and for application developers to be close to the business units means that onshore and nearshore teams are still the largest geographic segment by far.

However, costs are high in primary locations with average total compensation of \$130k+ per person. Additionally, in the U.K., London has a higher percentage of global IT staff compared to the regions (12% vs. 6%). In the U.S., where skills are less clustered around New York, a majority are based outside the New York metro area (37% vs. 11%) thus benefitting firms with lower overheads and reduced compensation costs.

However, flexible hours and remote desktop support have enabled firms to more easily establish offshore support and development centers without compromising service quality. Network infrastructure improvements, most notably in fibre-optics, have meant that real-time lag is no longer an issue.

Singapore and China (6% and 1%, respectively) are large players in IT service provision to financial institutions. But India (9%), with its low-cost and highly educated labour force, leads the IT offshore market, offering firms the potential for substantial cost saving opportunities.

**Top and Growing Non-Hub Cities for IT Staff**

|                 |                  |                          |                  |
|-----------------|------------------|--------------------------|------------------|
| Charlotte, US   | Singapore        | Pune, India              | Shanghai         |
| Minneapolis, US | Moscow           | Mumbai, India            | Bangalore, India |
| Des Moines, US  | Pennington, US   | Manchester / Chester, UK | Chennai, India   |
| NCR, India      | Hyderabad, India |                          |                  |

**Note:** NCR, India is the *national capital region* including cities like Delhi, Gurgaon, Noda and Ghaziabad

With increased pressure on costs and competition for technology firms, it is likely that banks will start to grow IT development and support centers in offshore locations with several firms looking to China and Eastern Europe.



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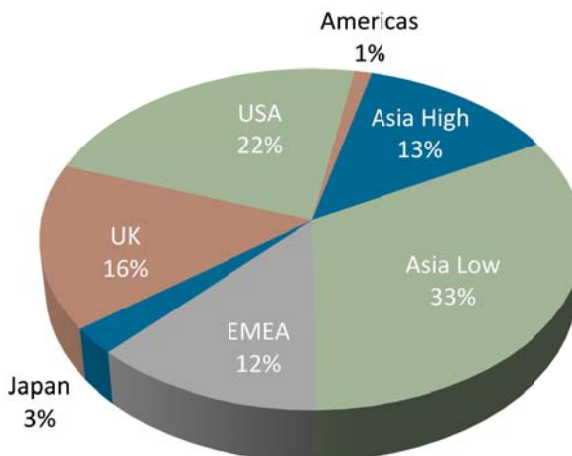
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**Operations**

Operations has long been favored as an area for extensive offshoring due to the high number of processes that can be automated and effectively monitored. Both retail and investment banks continue to make huge investments in offshoring operations to India (28%), Singapore (7%) and China (2%).

**Distribution of Operations Staff**



Emerging Asian and Latin American locations such as Malaysia, Thailand and Mexico (<1% but growing) are taking very early strides in shifting processes away from their head-office hub locations in Europe and the United States, but they are relatively small at present. The Philippines in particular has been an area of offshore employment growth in recent years, supporting both finance and operations.

New York now employs 7% of global operations staff, with a further 15% being based in other U.S. locations. London has 11% of global operations headcount with U.K. regions accounting for a further 5%.

**Top and Growing Non-Hub Cities for Operations Staff**

|                    |                    |               |                  |
|--------------------|--------------------|---------------|------------------|
| Charlotte, US      | Jacksonville, US   | Singapore     | Shanghai         |
| Pennington, US     | Salt Lake City, US | Mumbai, India | Manila           |
| Raleigh/Durham, US | Bournemouth, UK    | NCR, India    | Bangalore, India |
| Dublin             | Glasgow, UK        | Moscow        |                  |



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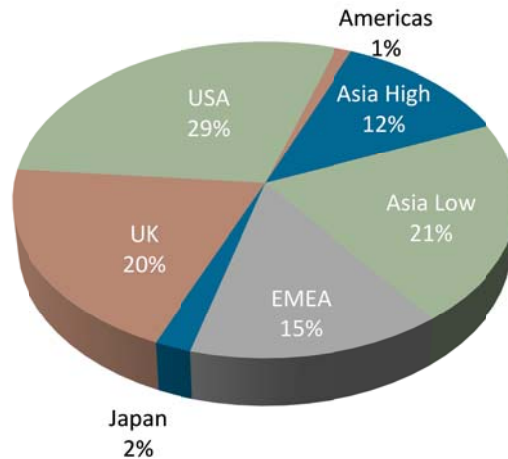
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**Finance**

Finance offshoring has also focused on the Asian hubs of India (16%), Singapore (6%), & China (2%). These countries have held unrivalled strength due to highly educated employees. However, they are now being challenged by emerging centers in Asia and Europe like the Philippines (2%), Russia (0.6%), Hungary (0.6%), and Korea (0.4%) where a highly motivated, educated and low-cost labor force is readily available.

**Distribution of Finance Staff**



Near-shore staff in the United Kingdom in locations such as Chester, Manchester, Birmingham and Bournemouth represent 5% of global headcount (London, 15%). In the U.S., Charlotte, Raleigh, Minneapolis, Tampa, SLC are popular near-shore locations to base finance staff whose roles do not require significant management access. Regional centers account for 18% of headcount (New York, 11%)

**Top and Growing Non-Hub Cities for Finance Staff**

|                   |                 |                  |            |
|-------------------|-----------------|------------------|------------|
| Charlotte, US     | Minneapolis, US | Singapore        | Shanghai   |
| San Francisco, US | Providence, US  | Mumbai, India    | NCR, India |
| Northampton, UK   | Manchester, UK  | Bangalore, India | Manila     |
| Moscow            |                 |                  |            |



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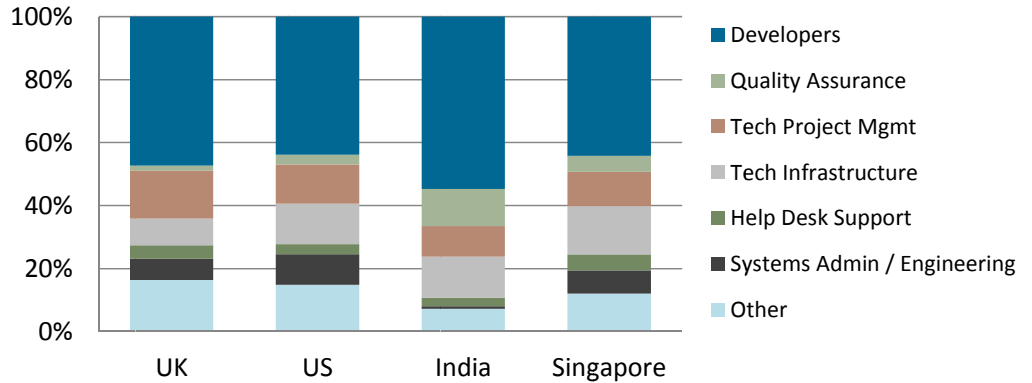
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**What Do They Do?**

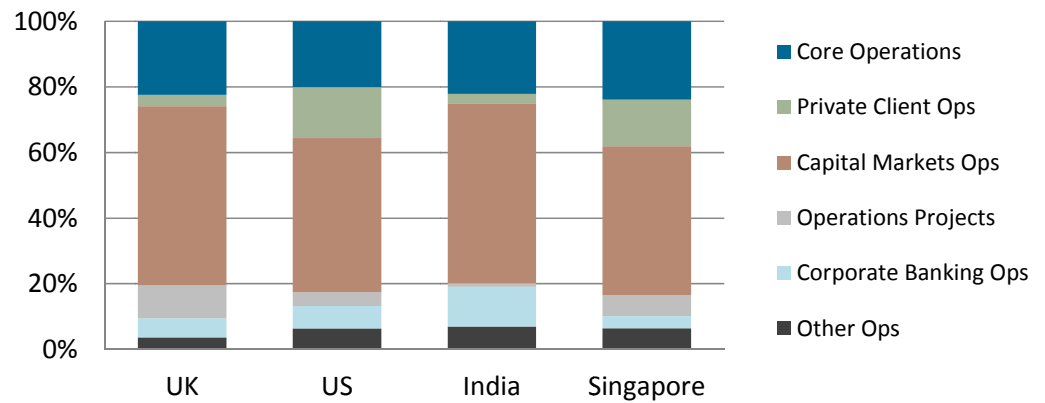
Is the functional mix at offshore locations any different from onshore? While offshored IT generally tracks onshore roles, there is a greater emphasis on developers and quality assurance jobs in India than project mgt. and supervisory positions.

**IT Functions**



Developer roles in India are popular due to high technical expertise in programming languages. In addition to development, IT infrastructure and support roles are also being outsourced, sometimes globally.

**Operations Functions**



Both core and business-line operations have been the areas where the most offshoring has occurred while operations projects are predominately managed onshore.

Capital markets is also an area where significant offshoring has occurred due to high staff cost and aggressive cost-saving initiatives by the investment banks in recent years.



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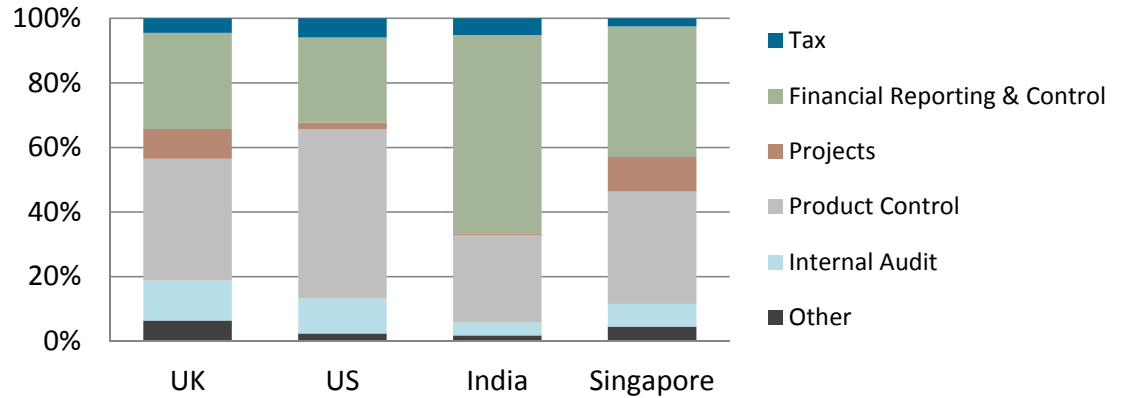
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**Finance Functions**



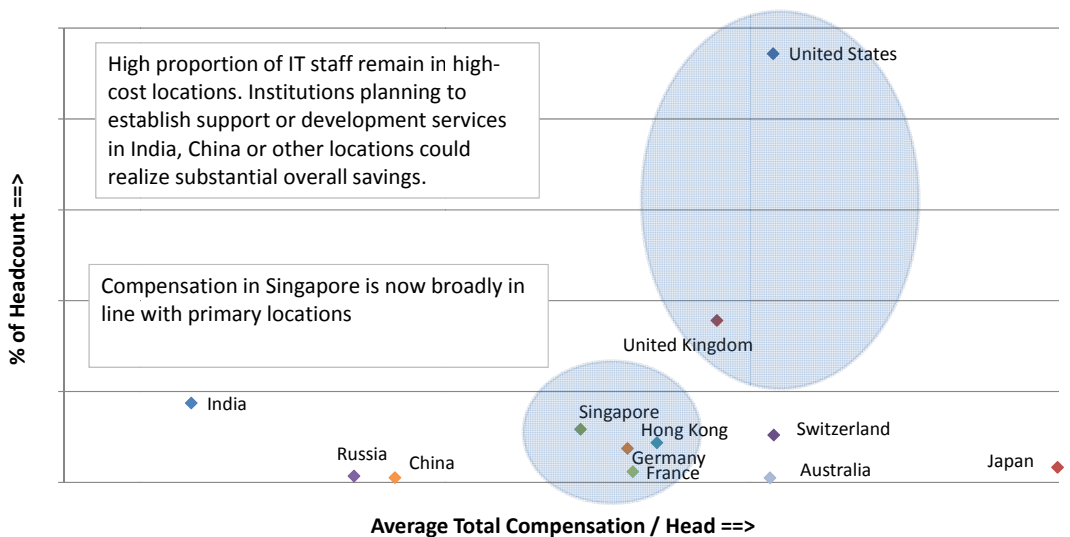
Initially, finance groups offshored process-driven roles such as financial reporting and control. More recently, product control has seen a large increase in roles being offshored to Singapore and China.

Typically, these positions focus on vanilla products rather than structured/exotics where closer risk and managerial oversight is required. Projects and strategic planning have remained onshore because they require closer interaction with end-users and decision-makers.

**How Much Are They Paid?**

Information Technology staff are compensated highly in primary locations. Total Compensation (TComp) in primary locations is \$130-150k. Compensation in Singapore and Hong Kong is catching up at \$100-120k but overall there is still less offshoring beyond a presence in India where TComp is \$20-30k.

**IT – Compensation & Headcount**





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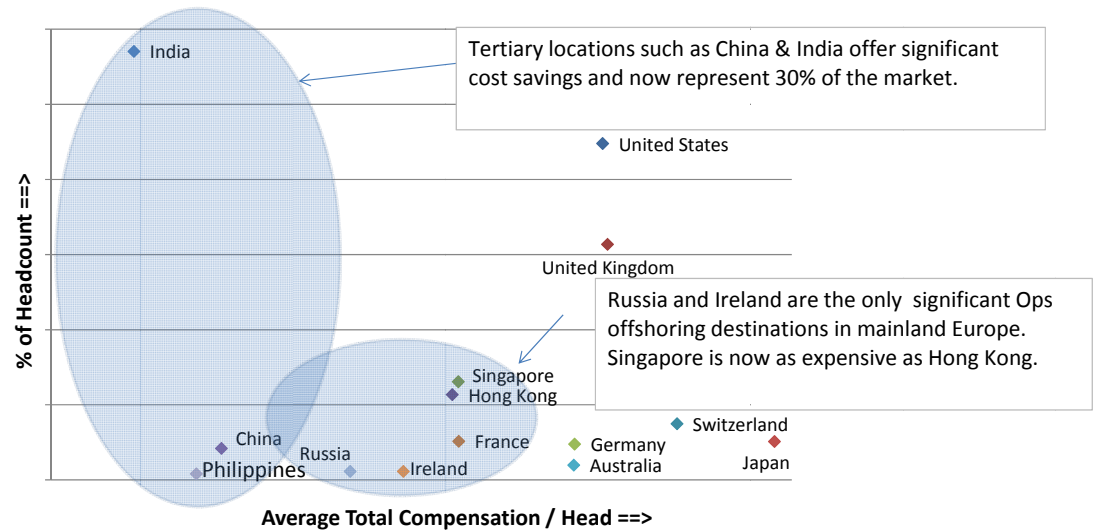
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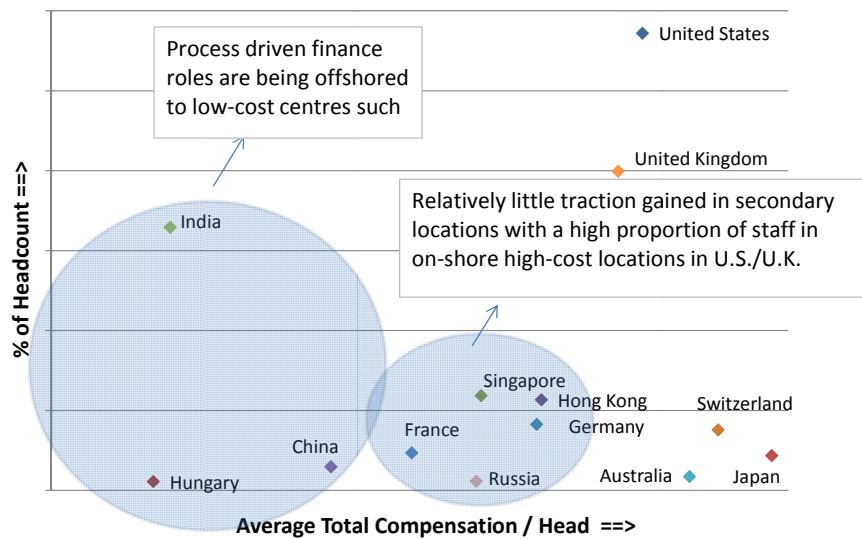
**Operations – Compensation & Headcount**



Tertiary locations such as India and China with average compensation under \$35k offer significant cost savings.

While operations staff in Singapore and Hong Kong are still paid below most U.S./European markets, the differential has narrowed.

**Finance – Compensation & Headcount**



Finance staff in primary locations average TComp of \$140-180k+. The more process driven finance roles are being offshored to low-cost centres such as China/India (TComp \$35k-80k).

Secondary locations, where TComp is in the region of \$100k-\$140k, have not gained significant ground with the possible exception of Singapore.





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**Has This Been Changing?**

**Major Hub Locations: U.S., U.K., Europe**

There has been an overall infrastructure headcount trend decline in New York and London based staff.

- U.S. - New York and regional centers have seen an overall decline in headcount across operations and finance. For IT, regional staff levels have increased to compensate for reductions in the New York metro area.
- The U.K. has seen a decline in IT headcount in London, most of which has been picked up by regional centers. The burden of U.K. regulatory, government and financial oversight has resulted in a 4% increase in finance headcount.
- There has been a decline in headcount in other major European locations.

**Established Offshore Locations: Singapore, China, India**

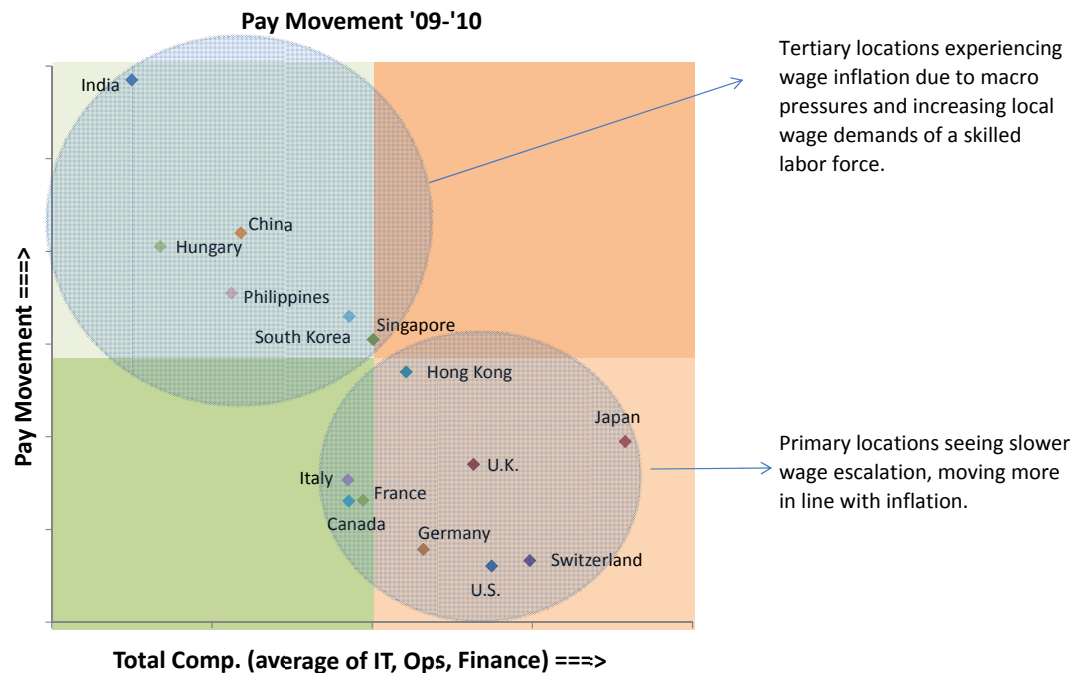
These major offshore locations have continued to see across the board increases in infrastructure support for the last two years by picking up workloads from primary locations in EMEA (in particular, France and Switzerland) and the U.K./U.S.

**Emerging Countries**

Hungary remains relatively static across functions, but Russia has seen an increase in operations and finance while South Korea has seen increases across the board.

**How Has Pay Changed?**

While average TComp has increased for all countries between 2009 and 2010, the biggest rises have been in countries with the lowest starting point, i.e., low-cost locations are catching up. In addition, significant inflationary pay increases have also been seen in some countries, most notably Brazil and Russia (not shown here). These rises reflect the global competition for support staff talent and GDP inflation.



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[www.mclagan.com](http://www.mclagan.com)**What Has Happened in the Other Infrastructure Areas?**

This paper has mainly focused on IT, operations and finance. But, has there also been location change in the other infrastructure roles?

**Human Resources**

HR is a function that is generally outsourced, rather than offshored. Offshore hubs have appeared in India, China, Singapore, which largely support the local presence. Otherwise, the primary focus for offshoring has been data reporting, benefits/rewards and payroll administration

**Risk Management**

Risk Management has a large presence in Singapore supporting local businesses. Additionally in recent years, some services have been offshored to China, India, Korea in Asia or to Poland in Europe.

**Treasury + ALM, Legal & Compliance, Communications & Marketing**

- Treasury remains almost exclusively in high-cost locations with no real offshoring beyond Singapore.
- There is very little offshoring for legal and compliance. In the U.K. over 80% of legal staff are in London.
- Communications and marketing remain almost exclusively in high-cost locations.

**What's Next?**

While it is not possible to predict the strategies of leading banks, there are wider factors in the offshoring market which will influence these decisions.

- **In the Americas:** We are seeing growth of operations in Latin American countries such as Mexico, which is able to support the U.S in both language skills and time-zones.
- **In Asia:** Indonesia, Taiwan, Thailand and Malaysia are experiencing offshoring growth, though still significantly behind the penetration of the Philippines.
- **In India and China:** There are a number of other cities with staff costs significantly less than the established centers of Mumbai, Bangalore and Shanghai. These are opening up as competition for graduates rises and some major banks already have operations centers in these locations.
- **In Europe:** Poland, Hungary and the Czech Republic remain a choice for European due to their highly educated workforce in the same timezone.

Nearshoring is growing. While the cost savings on headcount are not as high, there are significant advantages in language, timezone and reduced T&E costs. While compensation levels may only be 20% - 30% below hub locations, additional savings may be made due to lower cost of premises and a greater proportion of junior staff.

Offshoring itself is changing too. Suppliers are moving services up the value chain:

- **1990-2000:** Basic tasks such as invoice processing, retail processing, payments
- **2001-2010:** More advanced tasks such as financial control, modelling, client analysis, research
- **2010-Present:** Complex product processing, front office roles



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India is likely to retain its dominance in operations offshoring due to its very large, educated workforce, low-costs and relative safety compared to other destinations. India itself now offshores: leveraging its expertise to other lower-cost locations to maintain its market leading position. Additionally, banks are now beginning to use non-captives and some organizations have sold their captives to save cost and focus on core banking activities.

The big opportunity is IT, where banks have not yet focused their efforts on finding lower cost locations. In the wider technology market, locations like Lund in Sweden and Cluj-Napoca in Romania have grown as development centers for technology firms. It is likely that these will attract financial services firms in the near future. In addition, technically advanced locations like China, South Korea and Taiwan are also likely to see growth in offshoring.

In a globalized workplace, the competition will escalate as language skills improve, and costs will escalate in many tertiary destinations. We are already seeing salary inflation in Brazil, China, India and Russia as a result of GDP growth and the demands of intellectual, educated workers in these BRIC economies. Other emerging economies will take market share as they begin to expand.

**Will This Affect the Financial Services Pay Premium?**

One difference that has surfaced in recent years is that in offshore locations, there is less differential between pay levels for staff supporting financial services and those supporting other industries. Many banks are now looking to see whether the financial services premium remains justifiable onshore for those jobs which are based on skills that are transferable between sectors.

In our next Alert, we will review the pay premium associated with financial services over technology and industry peers. We will discuss whether compensation will converge and result in more competition between industries for infrastructure staff.

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