



To Develop Outsourcing: New Growth Point of Northeast China Using FDI

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Abstract

Outsourcing, as a new pattern of service industry in new century, has already become a hot spot of multinational corporations' FDI (foreign direct investment). The execution of the Northeast revitalization strategy creates chances for enlarging the openness of outsourcing and developing the outsourcing by FDI. This paper analyzes the problems in the Northeast developing outsourcing and advances policy suggestions for driving the development of Northeast outsourcing.

Keywords: Northeast China (the Northeast), Outsourcing, FDI

1. Introduction

At the background of international financial crisis, traditional industries grow slowly due to the impact of financial crisis. In contrast, outsourcing industry grows fast, becoming an important field for all countries' industrial competition. Since in 2004 China starts the Northeast revitalization strategy, the Northeast speeds up their opening-up. Its industrial structure and foreign investment environment continue to be optimized. All these facts offer basic conditions for the Northeast developing outsourcing industry. Outsourcing is a new pattern for international service transfer, in which multinational corporations serve as the subjects. Multinational corporations not only generate the great demands for international sourcing, but also serve as the main takers and drivers for international outsourcing. World Investment Report 2007 shows that the migrant of multinational corporations' R&D internationalization, outsourcing, and top manufacturing projects in China are the three opportunities for improving China's ability of absorbing foreign capitals in the future. To attract multinational corporations to develop outsourcing by FDI can help the Northeast to exert its competitive advantages, improve the specialization of service industry in the Northeast, optimize the investment environment, and enhance the world competitiveness of the Northeast, what are meaningful for the Northeast's economic revitalization and sustainable development.

2. Main problems in the development of outsourcing in the Northeast

In recent years, the Northeast regards the development of outsourcing as an important breakthrough for adjusting the industrial structure. The government supplies policy support. The patterns of outsourcing are enriched and the industrial size is larger. In front of world financial crisis, the Northeast's outsourcing industry has already achieved significant successes. However, compared with developed countries and the developed area in China, the Northeast's outsourcing is still at the starting stage.

2.1 The outsourcing develops fast but the size is still small

In Mar. 2007, the State Council issues *Opinions of Accelerating the Development of the Service Sector*, taking international outsourcing as the key for enlarging service trade, researching and constituting a series of policies for outsourcing, cultivating a batch of qualified outsourcing corporations, and forming several outsourcing bases. In Sep. 2009, the *Issues on Further Implement the Strategy of Northeastern Region and Other Old Industrial Bases Revitalization* emphasizes: speed up the development of outsourcing industry, especially the outsourcing in three demonstration cities, namely Dalian, Haerbin, and Daqing, and support relevant cities, such as Yanji, and Suifenhe, to develop the outsourcing industry based on special regional advantages. Take Dalian for example, where the outsourcing develops fast. From 1998 to 2008, the revenue from software outsourcing rises from 200,000,000 to 30,200,000,000, creating an annual growth rate of 68.2%. It explores a Dalian-characterized software development road, what makes Dalian turn into a leading city of China's software and outsourcing industry.

Though, the size of outsourcing industry in the Northeast needs to be improved in general. Compared with the world, in 2006 China's outsourcing industry realizes the revenue of 11,800,000,000 Yuan. Thereof, 7,560,000,000 Yuan are from software outsourcing, and 4,270,000,000 Yuan. It merely accounts for 10% of world market shares. In contrast, India has already accounts for 65% of world software outsourcing market shares, and 46% of global outsourcing market shares. It is estimated that the scale of world outsourcing market will reach 230 billion US dollars in 2009. At present, China has the market share of 10 billion US dollars, lagging far behind India's predicted 30 billion US dollars. From the

domestic market, Beijing and Shanghai's outsourcing accounts for 50% of the country. In contrast, the size of Northeast outsourcing is small, merely accounting for 20% of the total.

2.2 The outsourcing field is narrow, being the bottom of value chain.

Outsourcing is high-tech industry, with higher added value and lower resource consumption. It covers a wide fields, concerning IT service, finance, insurance, R&D, HR, accounting, customer service, and product design. However, China's outsourcing only relates with information technology, R&D, and finance. In the Northeast, the software outsourcing is dominating, seldom concerning other fields.

Compared with India, China's software outsourcing is lagged behind. The market share is small. And 65% of revenue from outsourcing is from low value-added application software development outsourcing offered by Japanese customers. According to a survey from the Localization Industry Standards Association (LISA), a Chinese firm has taken an international software outsourcing project valued 25 million US dollars. However, it has to pay 20 million US dollars as patent fees to foreign experts. Deleting kinds of R&D expenditure, the firm can get the profit no more than 500,000 US dollars. It indicates that Chinese corporations are at the bottom of value chain, lacking of core techniques, and low profit ratio. As a result, the whole industry does not possess a strong competitiveness. The Northeast is short of competitive large outsourcing corporations, which is originated from the general condition of outsourcing in China. The largest software outsourcing corporation in the Northeast---- Neusoft actualizes the revenue of 101,000,000 US dollars in 2006. The distance is considerable compared with foreign corporations whose business return can reach 1 billion US dollars. The smaller size of corporations is not helpful for corporations in the Northeast taking up top projects, which weakens the market competitiveness of these corporations.

2.3 The development of export market for outsourcing is unbalanced.

Viewing from the world, the contractees are mainly from America, Europe, and Japan's multinational corporations and international institutions. Thereof, two thirds are from America, and one third from EU and Japan. The contractors are mainly India and Ireland. And the American market is mainly for India. European market is monopolized by Ireland. Considering the market segmentation, Japan is still China's dominating target market. According to the Market Seasonal Monitoring on China's Software Offshore Outsourcing in the Second Season in 2007 issued by Analysys International, Japan is still the largest outsourcing market for China. It accounts for 51.8% of the market share. And Europe and America account for 29.4% of the market share. And Hong Kong is 10.0% of the market share.

In general, China's software outsourcing still at the starting stage as it enters the European and American market. Because of historical, cultural, and regional elements, the outsourcing corporations in the Northeast mainly take Japanese businesses. For example, Dalian, as the first outsourcing base in China, undertakes 80% of Japanese outsourcing business. Considering the limited shares of Japan in world outsourcing market, the Northeast corporations begin to step into a multiple road. They explore the European and American market actively. However, the fact of highly-intensive outsourcing market can not be changed in a short period.

3. Policy suggestions for speeding up the development of outsourcing industry in the Northeast

Global FDI starts to lay stresses on service industry, which serves as an ideal opportunity for the Northeast enlarging the openness of outsourcing, and developing the outsourcing industry by FDI. The Northeast should make up relevant active policies for driving the new development of outsourcing by following the tide of FDI.

3.1 Make best use of the Northeast's comprehensive advantage as the manufacturing base, and encourage multinational corporations to extend their business toward service

The transfer of world manufacturing center offers an excellent chance for China's manufacturing industry realizing a leap development. Develop the domestic outsourcing by extending the industrial chain of manufacturing. It can benefit the service industry. The giant manufacturing industry will generate a considerable market need for domestic outsourcing. By this way, it can improve contractees' core competitiveness on one hand. On the other hand, it can overcome the structural unbalance of China's manufacturing and service industry in a sense. In perspective the world, it is a tendency for manufacturing enterprises outsourcing the supportive activities in production value chain to specialized service suppliers. Furthermore, the manufacturing center becomes the outsourcing center. And the service center can turn into a manufacturing center. Especially, the manufacturing base has already possessed the matured investment environment and industrial integration effect, which supplies convenience for extending toward an outsourcing center. It can decrease investment costs significantly. Facts show that some multinational corporations are thinking about integrating the manufacturing center and the service center to achieve a higher synergy effect. Therefore, we should guide foreign investors to focus on the advanced and specialized service market.

At present, China is still at the middle age of industrialization. Economic growth mainly depends on manufacturing. Especially for the Northeast as the old manufacturing base, the service industry does not turn into the dominating strength for driving economic growth. The low proportion of service industry and the unbalanced structure greatly

restrict the development of outsourcing in the Northeast. In order to further speed up the development of outsourcing in the Northeast, we should not only make best use of domestic policies and sources, but also grasp the Northeast's advantage of developed equipment manufacturing, enlarging the size of outsourcing industry using foreign capitals, by guiding foreign investors transferring the investment from manufacturing base to advanced and specialized service market.

3.2 Take offshore outsourcing

According to the geological distribution of suppliers, outsourcing is sorted into two types: onshore outsourcing and offshore outsourcing. The onshore outsourcing means the contractee and the contractor are from the same country. And the business is done in one country. The offshore outsourcing means the contractee and the contractor are from different country. And the business is done in not only one country. In recent years, the size of offshore outsourcing is larger. The contractors are from various countries in the world. The scale of global offshore outsourcing rises from 19.2 billion US dollars in 2004 to 50 billion US dollars in 2007. Mckinsey Global Institute says that the workers in offshore outsourcing will be 4.1 million in 2008. Considering the fast development of offshore outsourcing, Ministry of Commerce of China has already listed the offshore outsourcing as one of key industries since 2006. To take international offshore outsourcing can help to enlarge the openness of the Northeast, which can pull the development of offshore outsourcing by FDI. Make best use of rich human resources of the Northeast and cultivate a large batch of qualified service suppliers. Strengthen the competitiveness in ITO (information technology outsourcing) and cultivate the ability of BPO (business process outsourcing). Accept the transfer of world services, such as computer center, call center, data process, R&D, financial accounting, and after-sale services. Drive world famous outsourcing corporations to enter the Northeast. Introduce a series of world famous outsourcing corporations to set up investment firms and R&D centers in the Northeast. In the process of driving the development of outsourcing in the Northeast, absorb the rich experiences of multinational corporations in information technology consultation and services. Improve the top service ability. It can attract multinational corporations to transfer their business to the Northeast.

3.3 Continue to open the service market and broaden the FDI market entrance

With the basis of defining the outsourcing concept, make up specific policies for encouraging FDI to pull the outsourcing development. Under certain conditions, list the outsourcing in the direction for foreign investors. Besides, list the outsourcing items in the direction that needs official supports. Apply different opening policies to different industries. Open the accounting and telecom thoroughly. Open the urban infrastructure construction, medical care, culture, and education step by step based on summarized experiences. Open the banking sector, securities, and insurance carefully, considering the financial monitoring level and national economy in the Northeast.

In recent years, favorable macro economic situation, significant market advantage, and giant manufacturing create large demands for services, which make China more attractive for multinational corporations. More and more international institutions take China as a newly-developed market and important R&D base for multinational corporations' services transfer and outsourcing. The Northeast should grasp the chance, continuing to improve the quality and level of FDI, attracting more multinational corporations to set up R&D centers, operation centers, and regional headquarters, introducing advanced ideas, techniques, and management experiences of international outsourcing, and driving the improvement of the outsourcing in the Northeast.

3.4 Speed up the construction of regional outsourcing base and create preconditions for multinational corporations' agglomeration.

The outsourcing cluster is a new concept based on world experiences. The cluster is originated from industrial association effect and social network effect. It has the characteristics of resource share, service network system, and brand effect. Objectively, it builds a nice industrial ecological environment for the development of outsourcing. The brand effect can help service firms to obtain higher market acceptance and occupation ratio, further improving the market needs for regional services. The competition and cooperation between enterprises can improve the effective supply of services, exploring new market spaces for outsourcing development. To build outsourcing clusters is meaningful for the Northeast using FDI to develop outsourcing, which directly affects the technological level of outsourcing enterprises. The technological overflow effect, as the inner function of multinational corporations' direct investment, is inevitable. However, it is uncertain for whether it can improve the technological level of host country or not. The effectiveness of overflow is determined by whether the host country creates the environment and conditions for technological overflow. The outsourcing cluster is a favorable try for driving the technological overflow. The reason is: the closer the host country's industry is to the industry invested by multinational corporations, the stronger the overflow effect of advanced technology is. If the association of multinational corporations and host country's economy is weak, the multinational corporations' economic activities will seldom generate technological effect on local economy. Build an outsourcing cluster and achieve the agglomeration of outsourcing enterprises. Strengthen the association of international outsourcing corporations and local enterprises. Enhance the synergy and cooperation. And further improve the enterprises' ability of absorbing advanced technologies in the Northeast.

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