






World Watch, Low cost country sourcing

In an increasingly globalised world, outsourcing operations to and sourcing products from a low cost country has become common practice and often delivers significant benefits. European and US companies plan to increase the sourcing of goods and services from low-cost countries, including India, by 85 percent within the next 2-3 years. They are attracted by lower costs for labour and infrastructure.

It pays to first gather thorough information about possible target destinations. Companies often fail to take account of the risks and challenges associated with outsourcing. Markets are growing and developing fast, especially after China's entry into the WTO and the Eastern European block's addition to the EU. Outsourcing to, sourcing from as well as investing in any of the low cost countries needs to be well thought out up front. Risks need to be managed throughout the whole process. Knowledge of the target market and its trends is the key to a successful strategy.

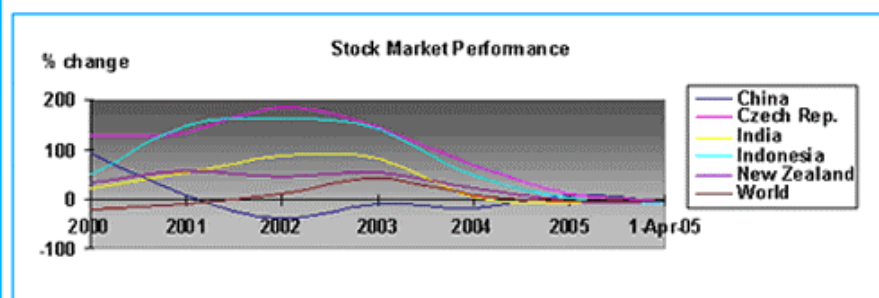
Supply chain change specialists State of Flux compile and analyse essential data for countries around the world on a regular basis. Please feel free to print out the image below for an overview of five of the top candidates for low cost country outsourcing and sourcing.

Facts and Figures 2006

	China	Czech Republic	India	Indonesia	New Zealand	
						
The Potential for Outsourcing						
Political Risks	<ul style="list-style-type: none"> The climate for outsourcing in China is good. Authorities have opened the economy to increased foreign trade and investment to spur economic growth. A new member of the WTO, China has to arrange its export prices, tariffs and state currency controls with both the US and the EU. Costs for outsourcing will increase. Copyrighting and piracy are the main problems for foreign companies. 	<ul style="list-style-type: none"> The Czech Republic is one of the most stable and prosperous economies of the post-Communist states to outsource to. Following the entry into the EU, regulations will be adjusted to EU tariffs and standards. Prices will slowly increase. An adoption of the Euro currency is planned for 2010. 	<ul style="list-style-type: none"> Government controls on foreign trade and investment have been reduced in some areas, but high tariffs and taxes are still unfavorable for outsourcing. India plans to liberalize investment in civil aviation, telecom, and insurance sectors in the near term. Bordering to unstable regions around Pakistan poses the risk of political clashes. 	<ul style="list-style-type: none"> Outsourcing to Indonesia involves high risks due to the current economic and political instabilities. Terrorism is a major concern, as is the very high inflation rate. A high rate of corruption is a further challenge. 	<ul style="list-style-type: none"> While New Zealand offers a highly stable and skilled environment for outsourcing, the tightness of resources and the persistence of inflation pressures are concerns. Free trade discussions with China began in 2004, creating new trade options. After the government was narrowly reelected in 2005, no major changes in terms of trading policy are to be expected. 	
Economical Risks	<ul style="list-style-type: none"> China is the second largest economy in the world when measured by purchasing power parity, and it continues to be the fastest-growing major economy in the world, markedly outpacing India. China has trumped the US to become the world's leading exporter of high-tech goods. The government is raising personal income and consumption, and introduces new management systems to increase productivity. China has a vast current account surplus due to the older generation saving up to 70% of their salaries. 	<ul style="list-style-type: none"> The per-capita output is approximately two-thirds that of the large Western European economies and on par with that of Portugal, Greece and Slovenia. Moves to complete banking, telecommunications, and energy privatisation, will add to foreign investment. High fiscal and current account deficits could be future problems, leading to inflation. 	<ul style="list-style-type: none"> India is the fourth largest economy in terms of purchasing power parity and the second fastest growing major economy in the world. Services are the major source of growth. India has emerged as one of the largest players in software and business process outsourcing services. The huge and growing population, expected to surpass China by 2030, is a fundamental problem. Despite strong growth, there is a high combined state and federal budget deficit, running at approximately 9% of GDP. 	<ul style="list-style-type: none"> Indonesia has a market-based economy in which the government plays a significant role owning over 164 enterprises and administering prices on several basic goods such as fuel, rice, and electricity. Indonesia's economy is undergoing a process of rebuilding after being hit by the tsunami in late 2004. Indonesia has a very high inflation rate and increasing costs. 	<ul style="list-style-type: none"> Exporters are exposed to a high exchange rate and declining profit margins. New Zealand's heavy dependence on trade leaves it vulnerable to economic performance overseas. Export volumes have fallen for three of the last four quarters. Import prices, especially oil, outstripped export prices. There is a large and increasing current account deficit, which will possibly continue to fuel inflation. Domestic savings are not sufficient and foreign investment is needed. 	
	GDP (PPP) total GDP per capita Inflation, GDP deflator /yr GNI GNI per capita	<ul style="list-style-type: none"> US\$ 8,091 trillion US\$ 6,193 6% US\$ 1,7 trillion US\$ 1,290 	<ul style="list-style-type: none"> US\$ 198,976 million US\$ 19,488 4% US\$ 93 billion US\$ 9,150 	<ul style="list-style-type: none"> US\$ 3,602 billion US\$ 3,262 5% US\$ 675 billion US\$ 620 	<ul style="list-style-type: none"> US\$ 758.1 billion US\$ 3,200 15% US\$ 248 billion US\$ 1,140 	<ul style="list-style-type: none"> US\$ 96.18 billion US\$ 23,897 5% US\$ 82 billion US\$ 20,310

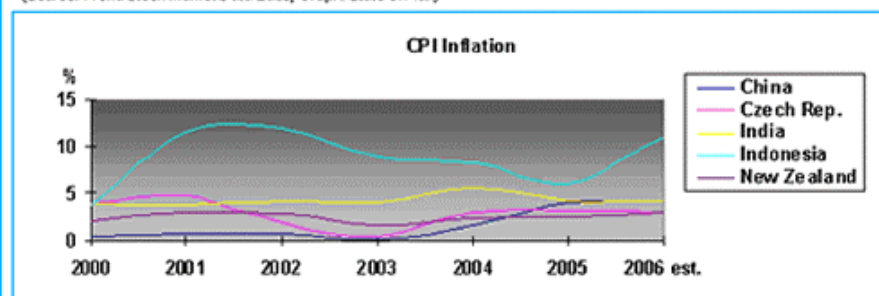
	China	Czech Republic	India	Indonesia	New Zealand
The Costs of Outsourcing					
Labour	<ul style="list-style-type: none"> The growing middle class aims for a western standard of living. Wages will continue to increase according to WTO. 	<ul style="list-style-type: none"> The low average wage rates in the Czech Republic will rise towards European standards. 	<ul style="list-style-type: none"> While a quarter of Indians still live below the poverty line, a large middle class has formed. 	<ul style="list-style-type: none"> The standard of living is relatively low. Wages probably will be adjusted to meet the inflation rate (15%). 	<ul style="list-style-type: none"> High standard of living. The current high rates of increase in labour and other business costs present a further risk, particularly if inflation remains high.
Skills	<ul style="list-style-type: none"> Human Development Index: 0.755 (85th) – medium Educational levels vary by region. English-speaking college graduates are common, but specialised skills are scarce. 	<ul style="list-style-type: none"> Human Development Index: 0.874 (31st) – high Highly skilled workforce. High education and literacy levels. 	<ul style="list-style-type: none"> Human Development Index: 0.602 (127th) – medium Labour, well-educated and unskilled, is abundant. 	<ul style="list-style-type: none"> Human Development Index: 0.697 (110th) – medium Government has increased the duration of compulsory schooling. Specialised skills are scarce. 	<ul style="list-style-type: none"> Human Development Index: 0.933 (19th) – high Labour force is highly skilled and mobile. High education and literacy levels.
Minimum wages per hour	<ul style="list-style-type: none"> Minimum wages vary by region from around US\$ 0.30 in Beijing to around US\$ 0.52 in Shenzhen. 	<ul style="list-style-type: none"> Around US\$ 1.41. 	<ul style="list-style-type: none"> Around US\$ 0.14. 	<ul style="list-style-type: none"> Effective 2006, Jakarta has raised the minimum wage for workers by 15% to around US\$ 0.51. 	<ul style="list-style-type: none"> US\$ 6.76 per hour.
Population	<ul style="list-style-type: none"> 1,306,313,812 	<ul style="list-style-type: none"> 10,241,138 	<ul style="list-style-type: none"> 1,102,600,388 	<ul style="list-style-type: none"> 241,973,879 	<ul style="list-style-type: none"> 4,107,400
Labour force	<ul style="list-style-type: none"> 778.1m 	<ul style="list-style-type: none"> 5.25 million 	<ul style="list-style-type: none"> 482.2 million 	<ul style="list-style-type: none"> 105.7m 	<ul style="list-style-type: none"> 2.05 million
Unemployment rate	<ul style="list-style-type: none"> 4.2% 	<ul style="list-style-type: none"> 9.3% 	<ul style="list-style-type: none"> 10.1% 	<ul style="list-style-type: none"> 9.6% 	<ul style="list-style-type: none"> 3.4%
Corporate Tax	<ul style="list-style-type: none"> 33% for domestic companies. About 20% for foreign companies. The government plans a unified tax rate of 24.26%. A new list of export taxes covers 148 clothing items. In a major tax policy shift, value-added taxes on manufacturers will be reduced in 2006. 	<ul style="list-style-type: none"> 28%. A reduced rate of 25% applies to investment companies, investment funds and pension funds. 	<ul style="list-style-type: none"> 36.6% for domestic companies. 41.8% for foreign companies. Taxes are significantly higher in India than in other Asian countries where they are around 25%. In most developed countries rates are 25-30%. 	<ul style="list-style-type: none"> Rates are stepped and top out at 30% of taxable income. Many firms use licensing to avoid the difficulties of gaining investment approval and the expense of providing expatriate packages in Indonesia. 	<ul style="list-style-type: none"> 33%. The New Zealand government offers virtually no incentives for foreign investment. There is no capital gains tax. All Customs clearances are now required to be lodged electronically.

General Trends in Costs for Outsourcing



(Source: World Stock Market Data Base; Graph: State of Flux)

- The performance of the countries on the world stock market gives an indication of the overall business climate.
- The Czech Republic and Indonesia are losing value; the climate for foreign investment is rather unfavourable.
- India has lost stock market value in the past, but has been stable over the last two years.
- New Zealand has only had minor losses and is one of the best markets to invest into.
- China has recovered from losses in 2005 and is on an upward trend in the long run.



(Sources: IMF, C.ZSO, Statistics New Zealand; Graph: State of Flux)

- The inflation rate is highest and rising in Indonesia creating a rather unstable environment for outsourcing costs, especially wages.
- India and China are at a comparable level and will have increasing costs.
- New Zealand and the Czech Republic have the lowest rates. The Czech Republic's is rather stable, while New Zealand's is prone to increase and has been increasing.