OFFSHORING AND OUTSOURCING IN CENTRAL AND EASTERN EUROPE: OPPORTUNITIES AND PERSPECTIVES

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Abstract: In the rapidly changing global economy, offshoring and outsourcing have become popular business strategies for reducing the costs of companies. A high number of regions and countries have profiled and become popular offshoring and outsourcing destinations over the past 25 years – Central and South America; Central and Eastern Europe; Southeast Asia, China and India etc. Although, countries like China, India and Ireland are traditionally perceived as main countries which receive offshoring and outsourcing business processes, the region of Central and Eastern Europe also rises its popularity as such destination during the last ten years. Several core advantages contribute Central and Eastern European (CEE) region to become a top offshoring and outsourcing destination and be competitive to the traditional offshoring and outsourcing countries like India and China: lower salaries than these in Western Europe and other developed countries (comparable to the salaries in India and China), a relatively low risk profile region for key factors such as highly educated labor force and reliable infrastructure, relatively low inflation pace of the employees' salaries in the region, labor with strong language skills, stable business and political environment, and geographical and cultural proximity to the countries in Western Europe. The paper is developed based on secondary data and investigated the theoretical aspect of the terms offshoring and outsourcing and their versions. The CEE is determined based on different sources which have their contradictions in defining the borders of the region. The author perceived the World Bank understanding that the CEE region covers EU countries - Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia. The current paper aims to make an analysis of the opportunities and perspectives of CEE region as offshoring and outsourcing destination. The first purpose of the author is to investigate the current position of CEE region as offshoring and outsourcing destination. The paper also examines the reasons for the advent of the region to become a receiver area. The second purpose is to analyze the foreign direct investment (FDI) net inflows in CEE for the period 2004-2015 and compare the results of the different economies. The time period is chosen because most of the investigated countries joined EU in 2004. The analysis is based on World Bank data. The current manuscript could be used as a base for a future studies in the investigated area. Future researches could investigate the potential of Central and Eastern European region and also the potential each country to develop as attractive offshoring and outsourcing destination. Furthermore, the scholars could outline the future development trends and forecast the FDI net inflows during the following years.
Keywords: offshoring, outsourcing, Central Europe, Eastern Europe

INTRODUCTION

Offshoring and outsourcing have a great impact on the business processes over the past 25 years. A lot of regions and countries have profiled and become attractive offshoring and outsourcing destinations - Central and South America, Central and Eastern Europe, Southeast Asia, China and India[81]. Although, all these states are popular as offshoring and outsourcing destinations, several existing differences determine the specialization of each region or country. For instance, China is the most preferred manufacturing destination while India has developed favorable business conditions for IT outsourcing, back-office activities and call center services. CEE attracts a huge amount of companies which are situated in Western Europe and North America since 1990s[82]. The first foreign investments are in manufacturing sector especially in the area of high-tech engineering, automobiles and automobile parts manufacturing and electronics made by international corporations like Volkswagen, Toyota, Peugeot-Citroen, Audi and others. The service sector significantly increases the amount of foreign direct investments (FDI) at the beginning of 21 century. Business activities like IT services and software development, back-office and call center services begin to burgeon in that part of Europe. Crucial for the considerable growth is the European Union enlargement in 2004 for the first –wave joined Baltic countries (Estonia, Latvia, Lithuania), Visegrad Group (Czech Republic, Slovakia, Poland, Hungary) and Slovenia and the

[81] Safar, L. (2006) Globalization offshoring in Central and Eastern Europe. *Multilingual*. 17 (6), 33–37.
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second-wave joined Balkan countries Romania and Bulgaria in 2007. CEE region is attractive for foreign investment and provides favorable market conditions for new market expanding and access to more affordable labor and production resources.

OFFSHORING AND OUTSOURCING IN CENTRAL AND EASTERN EUROPE: CONCEPTS AND DEFINITIONS

The Central and Eastern Europe (CEE) region

The CEE region primarily includes all the countries which were part of former Eastern bloc. According to Global Water Partnership[83] the Central and Eastern region includes countries mainly located on the Black Sea, Baltic Sea and Danube basins. The region is geographically situated between the German speaking countries in Europe and Russia. The coverage of Central and Eastern region varies depending on the source that examined the research topic and the aim of the study. Different business and non-profit organizations have their own interpretations considering CEE region and which countries should be included in it depending on the investigations and search they conduct and the purposes of the analysis. Table 1 summarizes the different understandings of various specialists and organizations which present their point of view which countries should be included the CEE region.

Table 1 Determination of Central and Eastern Europe region

The Central and Eastern Europe (CEE)	Source
EU countries - Bulgaria, Czech Republic, Hungary, Poland, Romania, Slovakia	Weastra.com, 2010
EU countries - Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia	World Bank, 2016 For Europe organization, 2008 Bouzanis, 2016 Rozmahel et al., 2013
EU countries - Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia **Other countries** - Serbia, Bosnia-Herzegovina, Macedonia, Kosovo, Montenegro and Albania	Organization for Economic Cooperation and Development, 2016
EU countries - Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia **Other countries** - Serbia, Bosnia-Herzegovina, Macedonia, Kosovo, Montenegro, Albania, Russia, Ukraine, Moldova, Belarus and Turkey	UNESCO, 2008

CEE region consists of European Union (EU) countries which were part of the former Eastern bloc - Visegrad group - Czech Republic, Hungary, Poland, and Slovakia and the two Balkan countries – Bulgaria and Romania[84]. In addition to that, World bank[85] and For Europe organization[86] append to that group the three Baltic countries Estonia, Latvia and Lithuania which did not join the Commonwealth of Independent States (CIS) after the breakup of USSR and became part of the EU in 2004 and the Balkan countries - Slovenia and Croatia which are also part of EU. In other studies and reports CEE group of countries is even larger. The

[83] Gwp.org (2012) *Central and Eastern Europe* [online]. Available from: http://www.gwp.org/gwp-in-action/Central-and-Eastern-Europe/.

[84] Weastra.com (2010) *Why to invest in Central Eastern Europe?* [online]. Available from: http://www.weastra.com/cee-countries/.

[85] Rozmahel, P. et al. (2013) *Integration of Central and Eastern European Countri es: Increasing EU Heterogeneity?* WorldBank (2016) *Foreign direct investment, net inflows* [online]. Available from: http://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD?end=2015&locations=B8&name_desc=false&start=1990&view=chart.

[86] Alam, A. et al. (2008) *Productivity Growth in Eastern Europe and the Former Soviet Union*.
Bouzanis, A. (2016) *Economic Snapshot for Central & Eastern Europe* [online]. Available from: http://www.focus-economics.com/regions/central-and-eastern-europe.

Organization for Economic Cooperation and Development[87] broadens the list of countries including former Yugoslavia union countries (Serbia, Bosnia-Herzegovina, Macedonia, Kosovo and Montenegro) and Albania. Furthermore, for the purposes of some analysis the group non-EU countries sometimes is increased with the former USSR countries – Russia, Ukraine, Moldova and Belarus which are part of CIS nowadays and Turkey which are also considered as part of CEE[88].

Offshoring and outsourcing core

Offshoring and outsourcing are similar terms but they are not synonyms[89]. Offshoring represents a process which aim is to relocate some of the business activities beyond the borders of the country. The offshoring process can be accomplished in two ways. Firstly, the business processes can remain inside the company with the establishment of subsidiary or branch company. The process is more well-known with the term – "captive offshoring"[90]. Secondly, some of the business processes could be outsourced to another foreign company. The third-party company begins conducting the business activities after signing a contract. The process is more familiar as "offshore outsourcing". Outsourcing has two variations, the already mentioned "offshore outsourcing" which is implemented in a foreign country and "domestic outsourcing" which is realized in the same country where the company is located. Table 2 summarizes the findings and presents the different offshoring and outsourcing terms.

Table 2 Offshoring and outsourcing versions

Location of production/service	Inside the company	Third-party company
Domestic country	Internal process	Domestic outsourcing
Foreign Country	Captive offshoring	Offshore outsourcing

Source: Based on Sass, M. & Fifekova, M. (2011)

Captive offshoring and offshore outsourcing are typical processes for a company which "exports" some of its business activities beyond the national borders to another country. These activities could remain inside the company if they are implemented in another affiliate owned by the parent company or be provided by a third-party company located in a foreign country. Why companies decide to offshore or outsource? The main reason to proceed to these business activities is the willingness of the companies to focus their efforts on their core competences which can increase their competitiveness at domestic and international markets[91]. Another reason for keeping some of the business activities inside the company is that they could not generate much savings. Most of the auxiliary business activities like accounting, software development, and customer service centers are usually outsource to other companies that are specialized in current area. Usually, a higher share of the services are outsourced in the same domestic country but last 10-15 years CEE region became an attractive area for such business activities especially for companies that are situated in Western Europe and North America (offshore outsourcing). For the term offshore outsourcing, the authors sometimes define as "arm's length trade"[92], but that term is not so commonly used. Comparing to offshore outsourcing, captive offshoring is typical for R&D departments because of the sensitive information that should be kept inside the company structure. The choice between captive offshoring and offshore outsourcing is also influenced by the presence or luck of specialized companies which could accept the business process and maintain a high level of implementation. Furthermore, captive offshoring and offshore outsourcing are not mutually exclusive business decisions. Some international companies apply both strategies in one and the same foreign country or in different ones.

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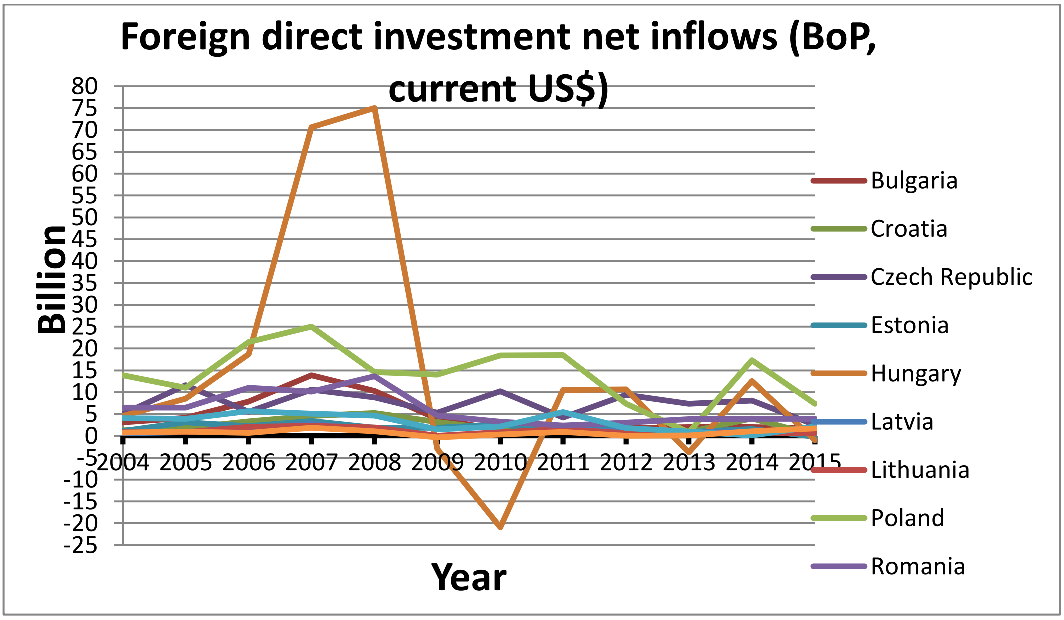
METHODOLOGY OF THE RESEARCH

For the purposes of the paper, the author chooses that the CEE region covers the territory of Eastern bloc countries that have joined the EU in 2004 – the Baltic countries (Estonia, Latvia, Lithuania), Visegrad Group (Czech Republic, Slovakia, Poland, Hungary) and Slovenia and the second and third-wave accession Balkan countries Romania and Bulgaria and Croatia which joined EU in 2007 and 2013 accordingly. The author introduces the abbreviation EU-CEE which includes the above mentioned states. That abbreviation would be used for the purposes of the analysis. One of the most commonly used indicators when offshoring and outsourcing are investigated is foreign direct investment[93]. Foreign direct investment (FDI) refers to international investments of a current company which has control or significant influence on other company situated in a foreign country[94]. FDI contains equity capital, reinvestments and other capital. In addition, it should be specified that FDI concerns to investment equity flows in the investigated country. Although, FDI is one of the most used indicators, it has also its limitations. The FDI indicator cannot fully describe the international investments in the current country. The FDI do not include nonequity cross-border transactions. Furthermore, the data provided by FDI balance of payments omit capital flows which are attracted locally. Due to the limitations of the current paper, FDI will be the only examined indicator.

RESULTS AND DISSCUSION

Analysis of the Foreign Direct Investment net inflows

Based on the FDI indicator described in the methodology, the current study provides data about foreign direct investment net inflows in the EU-CEE countries - Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia. The investigated figures are gained from the World Bank website data base. The investigated period is from 2004 to 2015. The period is chosen because it includes the first, second and third-wave accession CEE countries in the EU in 2004, 2007 and 2013 accordingly. The examined data is exposed in US dollars.



93 Hardy, J. et al. (2011) Upgrading Local Economies in Central and Eastern Europe? The Role of Business Service Foreign Direct Investment in the Knowledge Economy. *European Planning Studies*. [Online] 19 (9), 1581–1591. Marin, D. (2006) A New International Division of Labor in Europe: Outsourcing and Offshoring To Eastern Europe. *Journal of the European Economic Association*. [Online] 4 (2–3), 612–622.

94 WorldBank (2016) *Foreign direct investment, net inflows* [online]. Available from: http://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD?end=2015&locations=B8&name_desc=false&start=1990&view=chart.

Figure 1 Foreign direct investment net inflows

Source: Based on World Bank (2016) [online] Available from: http://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD?end=2015&locations=B8&name_desc=false&start=1990&view=chart last accessed on 22.11.2016

The data shows that the highest FDI for the whole period has Hungary, Poland and Czech Republic which are part of the first-wave countries that joined EU in 2004. Hungary is the country that raises the highest amount of capital during the period – over 182 billion $. The country reaches its peak in 2008 after a considerable growth compared to the beginning of the period. The significant fluctuation of the amount of foreign direct investment flows during the years is typical for the country. Compared to all other countries, Hungary reaches the top position in 2008 with over 75 billion $ and the bottom position in 2010 with nearly -21 billion $. Poland holds the second top position with around 170 billion $ raised capital during the whole investigated period. Poland also reaches its peak of 25 billion $ a couple of years since it become part of the EU, in 2007. Typical for the country is the stable amount of investments that attracts every year and they fluctuate between 11 and 25 billion $. Poland is in top three countries which raise the highest FDI net flows each year except in 2013. Czech Republic figures remained stable during the whole investigated period. The country attracts between 5 and 11 billion $ investments every year except the last one. The fourth country which is part of the Visegrad group raises capital of over 37 billion $ during the period. The other economies that become part of the EU in 2004 – Slovenia and the Baltic countries – Estonia, Latvia and Lithuania are not very attractive for foreign investors during the investigated period and they are the four countries which attract the lowest amount of capital.The second-wave accession countries Romania and Bulgaria hold the fourth and fifth position accordingly with around 73 and 54 billion $ raised capital during the whole investigated period. Bulgaria reaches its peak in 2007, the year of its accession whereas Romania attracts the highest amount of investments during next year. The level of raised capital is nearly 14 billion $ for both countries during their peaks. At the beginning of 2009 the FDI net inflows decrease considerably. Croatia which is the last CEE country that joined EU raises nearly 29 billion during the examined period. It is interesting that the country attracts the highest amount of investments during the period 2006-2009 which is before the date of their accession.

What are the trends? The first trend is that almost all the countries present their highest figures in the period 2006-2008 and for some of them that period continues to 2009. That is the period before the financial crisis hits the Europe and more precisely the countries situated in Western Europe which are the main investors in EU-CEE countries. The second trend is that most of the countries the Visegrad group - Czech Republic, Slovakia, Poland, Hungary and the Balkan countries- Romania and Bulgaria show a significant increase of the FDI inflows during the first couple of years after their become part of EU.

Reasons for investing in EU-CEE

Several facts sustain the theory that EU-CEE region is very attractive for investors located in Western Europe and North America. The author outlines the most essential motives for business relocation.

Labor force. The EU-CEE region is famous for the quality of its labor force[95]. People are highly educated[96], the percentage of people with university degree is very high and it is slightly lower than the percentage in the developed countries in Western Europe and North America. Also, most of the people in these countries possess strong language skills and speak at least one foreign language. The highly educated labor force is one of the most important preconditions for the attraction of foreign companies who choose CEE region for investments in offshoring and outsourcing activities.[97]

Cost reduction. The labor cost in EU-CEE countries is lower compared to Western Europe and other developed countries. The salaries in the region are also comparable to these in biggest outsourcing and offshoring

[95] Safar, L. (2006) Globalization offshoring in Central and Eastern Europe. *Multilingual*. 17 (6), 33–37.

[96] Hardy, J. et al. (2011) Upgrading Local Economies in Central and Eastern Europe? The Role of Business Service Foreign Direct Investment in the Knowledge Economy. *European Planning Studies*. [Online] 19 (9), 1581–1591.

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destinations like India and China. The inflation pace of the employees' salaries in the region is a little higher compared to the countries in Western Europe but remains relatively low[98].

Location and culture. The region is situated between Western Europe, Middle East Asia and former USSR countries – Russia, Ukraine, Moldova and Belarus. The geographical and cultural proximity of CEE region to the countries in Western Europe is a precondition for the raise of capitals from Western European investors[99]. As advantages of the region could be outline the easy communication because most of the countries are situated in the same time zone like Western European countries and the travelling between countries and cities which are linked with the abundance of well-developed auto, railway and low-cost airline connections

Political and business environment. The stable political environment is decisive for international investors. As a part of EU and NATO, the investigated EU-CEE region provides favorable conditions for development of offshoring and outsourcing activities. High quality business environment is also crucial for the investors[20]. The favorable conditions such the absence of restrictions for attraction of foreign investments, especially companies situated in another EU country, fast speed internet connection, high quality of telecommunication and power networks attract a lot of international investors since the beginning of 21st century. The access to domestic markets allows the investors not only to gain from the labor force and cost reduction but also to serve the local society, offer their products and services and make profits.

CONCLUSIONS AND RECOMENDATIONS

The EU-CEE region is emerging as favorable offshoring and outsourcing destination since the beginning of 21st century. Not only the favorable business conditions and stable political environment but also highly educated labor force, the opportunities for cost reduction and geographical and cultural proximity to Western Europe are crucial preconditions for the attraction of many investors primarily located in the developed countries in Western Europe and North America. CEE raises their highest FDI inflows during the period 2006-2009 when most of the countries present significant increase of the investments since the first years of their accession to EU. Due to the limitations of the current study, future researches could investigate the potential of CEE region to develop as attractive offshoring and outsourcing destination, outline the future development trends and forecast the FDI net inflows during the following years.

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