THE HUNGARIAN SHARED SERVICE MARKET OR WHAT ARE THE DRIVERS AND THE OBSTACLES OF PROGRESS?

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— Abstract —
Shared service centers are important players at the European service industry. The aim of shared service model is improving processes and making more cost-efficient the operation. We focused on the Hungarian shared service market in this paper.

In our research, we analyzed a lot of Hungarian shared service case studies to disclose the main characteristics of the market. To determine those drivers that contributes the growth and those obstacles that hinder it, we interviewed some key experts from this service markets.

In this paper, we introduced 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.

We compared the positions of these countries in this competition and analyzed what could be the break point for Hungary.

Key Words: Shared Services, Hungarian Service Market, Source Strategy

JEL Classification: M19

1. INTRODUCTION
1.1 Background of the research
The trend that was previously essential only for manufacturing process has now reached the service sector too. On those countries of the world that ensure better cost-benefits, shared service centers (SSC) are developed one after other. In these centers companies delivers back-office functions for other organizational units. (Sebök, 2006)

It is a general phenomenon that the big companies in order to rationalize operational costs by standardization and deliver services as well as over country’s
borders. Depending of the expected assets that at the end of the process a shared service center was created or an outsourcing provider will get the delivery. The key lies in reorganization of processes. And if the function moved to an offshore location than it will mean further cost-reduction.

The fact that a company either organizes a task in-house or makes outsourcing, depends largely on international parent organization. In many organizations there is strict regulation about outsourcing but the management software is also determined to simplify the data collection for the global company system. In such cases the labyrinth of national regulation could be a problem for which much softwares are not prepared. (Gyimóthy, 2011a)

Particularly three factors could influence the decision. The available competence – so the existence of labor required performing the task – the investment incentives and the national tax system. Their equilibrium and the country’s image will influence it. (Sebök, 2006)

1.2 Justification of the research

In the countries of Central and Eastern Europe the shared service model appeared in the early 2000’s. The previous lack of interest caused that the countries lies here counted too small as a market, had less advanced office technologies and information infrastructure that was not attractive for multinational companies. However EU enlargement has changed the situation. It expanded and opened the market and it has accelerated the growth and progress. This change has positively affected the market of service organizations that make Central and Eastern Europe increasingly favor. To which contributed that West European companies laid claim for such shared service centers that operate on the same European cultural and language base, has good local relations and could be accessed easily. From the date of enlargement it became general the using of electronic accounting and invoice. The lack of it hindered to establish shared service centers here.

For companies that are thinking in this region there were four different strategies from the point of view of implementing (Thorniley, 2003:14):

- Delivering the Central and Eastern Europe from a Pan-European center. The U.S. software company chooses this strategy. It is not very cost effective and caused language problems as well but company could obtain a coherent picture about the whole European market.

- Moving the Pan-European center to a Central and Eastern European location. If the company has detected a significant cost advantage, 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-cost and success it was no sense to change. These companies set up satellite centers in this region to test the market or prepare a bigger change. The U.S. IBM did so.

- Creating clusters in the region. More company leaders are thinking in cluster strategy, so creating such regional centers that deliver not only back-office functions but could support more valuable area as marketing or business improvement.

Among these four different strategies in the last ten year setting up of satellite centers and relocation of service centers was the most favor.

Alluring the shares service investments within the region emerged an intense competition among the candidate countries. Countries or even regions developed very attractive offers and incentives, created extra strategy for the industry and set up such a framework that fostering investment attraction and remaining. Hungary also recognized it at earlier 2000’s and support industry progress with incentives. As a result, numbers of shared service investments has chosen Hungary.

1.3 The purpose of the research

The aim of this research was to explore the position of Hungarian service market in Europe and globally. We want to discover the main drivers and obstacles of market progress. Finally, we collected the advantages and disadvantages of Hungarian market and made some forecast.

1.4 Methodology

We collected five shared service case studies (Diageo, IBM, BP, Cemex, BT) and made five interviews with key experts from the Hungarian service markets. We analyzed the case studies and interviews to draw some conclusions from them to disclose the market tendencies and the conditions for growing further.

2. CONCLUSION

Within the regional competition the most important term of establishing shared service centers in Hungary was the early 2000’s.

Compared to the regional competitor countries the advantage of Hungary was not the foreign language skills – though it has rare European language speaking young workforce – but from research of the EU public research agency, the
Eurobarometer released its 2001 study, Hungary is quite weak in foreign language speaking. (EC,2002:35)

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

After the last decade rapid growth the business service industry and within the shared service sector outgrown itself and became one of the key segments of service industries and the major employer of the country.

Today, there are more than 80 shared service centers in Hungary, that primary employ foreign language speaking, educated workforce. The leased office space by shared service centers reaches 200.000 square meters that is approximately one-tenth of the total A-list office space in Hungary. According to the real estate developer’s experiences the technology of these centers becomes forfeited in 3-5 years and after it centers move to Easter where the operational costs are lower. But today there is a tendency not only these centers are remain but some companies move its service center from cheap countries like India to Central and Eastern Europe. (Sütő,2012)

The shared service centers provide a range of business services – most notably in finance, accounting, procurement, logistics, information technology and human resources area – mostly in regional and sometimes in globally. Besides this sector is a major employer, around 1.2% of state budget came from taxes of it in 2010.

The key question is that a parent company why choose Hungary when looking for an investment location to establish a new service center. To win this competition Hungary has to prove that the society is cosmopolitan, capable of operating international level, young people speak several languages and well-educated. But there is a serious responsibility on government and the leaders of local government. If cities have close, well-equipped offices and public transport infrastructures then it could mean a high attraction. At such a decision about 40-50 countries compete on a list.

Several consulting firms make rankings that can help in choosing investment location. Perhaps one of the most famous lists is the A.T. Kearney annually compiled Global Services Location Index (GSLI), that ranking the most favor 50 countries on the base of service sourcing. Three aspects took 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 are India, China and Malaysia. Position of Hungary is continuously changing but it was constantly in the first 40 countries. Unfortunately within Central and Eastern Europe Hungary is not too competitive.

The next table represents the changing of rankings in Central 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 few years ago Hungary could prove relatively easily the benefits for the potential SSC investors, until now the situation has changed.

Table 1: Changing in ranking of Central and Eastern European countries

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<td>Estonia (18.)</td>
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Unfortunately, in recent ten years Hungary has completely sidelined in the first 10-20 positions, as the same has happened with the Czech Republic, Poland and Slovakia. Although the business service sector has been growing during this term.

However the position of Baltic countries (Latvia, Lithuania and Estonia) has significantly strengthened but judgement of Romania and Bulgaria also improved a lot. So these countries are the major competitors of Hungary now. It is true that more Asian countries overtook Hungary on the global service market but for example the world-leader India is not competitor because companies chooses India for one purpose and Central and Eastern Europe for another. In India there are such services that are like to mass production and do not need special skills. On the global service market it contributes to the position-loosing of Central and Eastern European countries the fact that Middle-East and North-Africa has also appeared among the most popular locations. The reason of their uprising is based on the large and educated population and proximity of Europe.

Hungary’s biggest competitive advantage is that labor cost is still lower than West-European. This is reinforced the fact that low labor costs are coupled with higher expertise and the investor company could get workforce similar to West-European but at more lower price. And not only the labor costs are lower but the other incremental costs (training, office, etc.) are also cheaper. (Nagy,2010)

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

On the Hungarian service market the vast majority of shared service centers are in Budapest. But according to experts it should be changed in the future because without it the growth will be unsustainably. If the change was successful the current number of employee could grow with 5-10% annually because the 80% of shared service centers are still in expansion phase. This growth potential is clearly visible at expansion of functions in certain centers. While in Hungary there is neither shortage of workforce nor oversupply, in Czech Republic or in Slovakia the shortage could be sensible. In Hungary the labor supply of provincial cities, especially the university cities are still unused. However, it is necessary major
infrastructure investments, since service centers need large and advance office. These could be the source of growth because there are a lot of EU subsidies for these purposes. (Mártonffy, 2010) For now, Budapest has unbeatable advantage in young, foreign language speaking workforce in comparing with the other cities but hopefully this asset will be decrease in the future. (Szilágyi, 2011)

The most important expectation for the young, educated workforce of shared service centers the quick learning ability and decision-making skill. In service centers there are higher attrition rates than in other sectors. The reason of manpower exchange is those high expectations in these centers that could meets only with diploma or degree. But this job could be interesting initially but could be very monotonously for these high educated employees after a little while. Because of it in the service centers the attrition rate could reach the 20-30% annually. It is also usually if an employee change job between two service centers, naturally for higher position. (SSC Recruitment, 2010)

The “job-hopping” phenomenon that the young workforce migrates from one center to another, exist in India long ago. It became a well-known problem in Hungary as well. There is such a company that do not let in any visitor into the center because of fear from the competitors. Other companies apply incentives to remain workforce. (Sebök, 2006)

The 80% of Hungarian shared service staff is high educated, speaking foreign languages excellently, about 20% has 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. On one hand this is the source why shared service centers recruit mainly among highly educated people but it is also true there are some centers where needs really qualified expert for example from the field of engineering or IT. The competitiveness of Hungary depends also on maintaining labor cost on low level. (Mártonffy, 2010b) Today the numbers of shared service workforce are estimated about 40,000 without the employees of different business service companies and call-centers. (Gyimóthy, 2011b)

The year of 2011 was not good for the Hungarian service market. However many investor was thinking in Central and Eastern Europe and Hungary was also on the list but last year Hungary was not winner too many times. In 2011 Poland was the favorite country. There are two argues by Poland. One is the even more scarce workforce than in Hungary. The other is better international political image that is not very lucky for Hungary now. But these are short time influence factors that will be diminish in medium time. It is sure that more SSC will come to Hungary and the only question is how many. The government regulation and the incentives
has also key role in it. Now Hungary is supporting the high value-added, research-based service centers.

It could be an important point of view that Hungary posses those conditions – infrastructure, regulation, etc. – that need to stimulate investments. The quite high standards of living is also an asset by Hungary.

Nowadays there is a tendency in Hungary on outsourcing and shared service market. There is a demand of process optimization and automation, so those services that reduce operational costs and increase productivity. (Berta, 2011)

BIBLIOGRAPHY


