CHANCES FOR THE DEPRESSED CENTRAL EUROPEAN REGIONS OF THE EUROPEAN UNION TO DEVELOP: CAN SHARED SERVICE CENTRES BE THE DRIVING FORCE?

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ABSTRACT

Shared Service Centres (SSCs) may lead to job creation in the professional field in the less developed EU region. By 2015, in the CEE region, the number of employees in this sector exceeded 335,000 and the trend tends to be increasing heavily. Looking at the actual numbers of the sector, the author tries to define the main decision making factors for a SSC to settle down in the region. The paper focuses on the evaluation of possibilities, arguing if the development of the SSC sector can continue creating jobs in this region. KEYWORDS: regional development, education, technological change, economic development, growth, shared service centres.

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Introduction

The purpose of this paper is to analyse the opportunities of the Shared Service Centres (SSCs) in Central European countries, including Hungary. It is obvious that a significant amount of new educated workplaces has been created in the CEE countries’ labour market in the last decade. Language skills and the presence of educated workforce provided very good starting conditions to establish SSCs in the region. The author of this paper tries to define whether this trend can continue and new centres will be opened. Also, there is a seek to define the main factors that are necessary in the region to continue this labour force creation process for educated workforce.

The object of research is to analyse whether new SSCs can be established in the CEE region; it is followed by a short introduction of the current SSC situation in general at the regional and the global level.

The objectives of research are to show the current number of the SSCs market in Central European countries and also in Hungary, in its SSC sector. The author presents trends in this sector too.

The task of research is to define the key factors determining a decision on the SSC site location. The second part of the paper summarises how Hungary is corresponding to these key factors.

The paper is based on a literature survey as a research method. From a methodological perspective, companies opening up SSCs in the region have already set up forums with universities where these topics are frequently discussed. Economic institutions and the major advisory firms also provide economic reports on the labour market changes and FDI investments in the region, where significant amount of data and publications are available. Furthermore, theoretical studies on the labour market and published analyses also provide significant research topics that are helpful to collect, compare and analyse data.
From von Thünen to Krugman (Bacsi, 2007: 26–35), economists have tried to understand what types of economic activities have been located at a given point in the world, and why (Dubé et al., 2015). From the outset, the location theory emphasised the role of distance, economies of agglomeration, and rent seeking in the location of firms and industries (Lengyel, 2005: 3). In the last decade, we can see a new development of organisational and financial structures in the global world called Shared Service Centres (Acuman, 2001: 1).

The author of this paper tries to define the new ways these centres have been developing (Deloitte, 2015) in the CEE region.

1. Shared Service Centres – a new way for company restructuring and job creation

The shared service is a new way of organising business operations within multi-national companies. In Europe, this phenomenon appeared in the middle of the last decade. As a predecessor of this phenomenon, we can define the so-called relocation of factories to cheap labour countries. However, these new centres are mainly focused not on cheap labour, but they are based on qualified labour.

One of the main reasons of this phenomenon, of course, was the continuous seek to decrease costs within international companies. The fields of operations where the costs may be decreased vary in three different groups:

- Financial and HRM back-office costs,
- IT back-office costs, and
- R&D services.

Companies usually focus on the first two groups, however, in the last few years the first “outsourced” R&D centres also appeared in the market. The way of operation in these centres rely on the annual financial scheme where the rendered services are paid by the headquarters to the centres at a third-party price.

1.1. Reasons for a SSC from a company’s point of view

Analysing the main factors that underline the decision of a multinational company to establish a Shared Service centre, it is obvious that companies intend: to acquire new qualified labour and at the same time to increase quality simultaneously decreasing the running costs. A multinational company has to determine the scope of services that are worth to be outsourced, and it is part of the preliminary phase. The main factor in this process is to determine whether these processes can be standardised and centralised in a new SSC (Oshri, 2012: 91–96). In the next phase, there have to be determined the exact processes that can be outsourced (Thomas, 2013: 25–30). Usually, when a new SSC is formed, then it is opened as a new legal entity within the company group, and its own management and operational rules have to be determined (Wang, 2007: 284–288).

1.2. Requirements to establish a SSC from a business perspective

The first step towards the planning of a SSC is to determine which services will be provided. Generally, all transactional processes which can be standardised are suitable for a migration into a SSC. The second step is to conduct an analysis determining which process steps should be performed by the SSC and which should remain decentralised. SSCs are often separate business units with their own organisational and operational structure. Therefore, a SSC may even decide to transfer the selected processes to an external service provider (Chen, Moor, 2009).

To deliver the services defined in service level agreements (SLAs) (Colman, 2006: 37–39), it is essential to implement an adequate IT infrastructure, a workflow management system and an information management system (Alvarez et al., 1999: 1). Focusing on these major implementation issues ensures that all services and communications provided are performed via clearly defined interfaces (Towle, 2015: 83–85).
2. The SSC phenomenon in the world

Based on the above requirements, many companies have already decided to create a SSC. These companies belong to different industries. As an example, the author of this paper collected a list of companies that have already decided on a SSC: 3M, AIG Insurance, Allied Signal, American Express, Amoco, BASF, Bertelsmann, Bristol Myers, British Airways, Chase Morgen Grenfell, Ciba Specialty Chemicals, Citibank Bankers, Coca Cola Company, Trust, Delta, Diageo, Eaton, EDC Scicon, Ericsson, ExxonMobil, Fidelity, Ford, GE Medical Systems, Girobank, Gothenburg, Guinness, Hewlett-Packard, Hewlett-Packard, Hughes Training, Interox, Kellogg’s, Microsoft, Merrill Lynch, Polaroid, Rubbermaid, Scottish Amicable, Seagram, Sterling Commerce, Unisys, United Distillers, Volkswagen-Audi, Volvo, Wang, Whirlpool, Woodchester (Novinite.com, 2013; Deloitte, 2015: 3; Ernst and Young, 2014). As it can be seen, many industries are represented in the list. This phenomenon has become a normal economic pattern for companies operating in many countries. Looking at Europe, one can identify which countries are the main SSC countries and one can identify them based on the number of SSCs in the CEE region as well. The map below shows the main cities that have attracted a significant number of SSCs (Figure 1).

![Fig. 1. European Shared Services Job Market 2017](image)

*Source: EMEA Analytics: SSON Analytics.*

3. The SSC phenomenon in Central Europe

Central and Eastern Europe has experienced a massive growth in shared services and outsourcing activity over the past 15 years. Emerging countries such as Bulgaria, Lithuania and Croatia are seeing huge growth, although well-established Poland still has most of the centres. Hungary has gained several centres as well (Ernst and Young, 2014: 4–21).

In this region, over 15 years there has been developed a mature and experienced business services sector. There are around 1000 centres employing 335,000 professionals in Q1 2015. The Compound Annual Growth Rate (CAGR)\(^2\) (Belvedere, 2017: 198) in employment has been 17% over the past seven years, and it is two times faster than its growth in India (Deloitte, 2015: 1). There is also a secured supply of strong fresh graduate talents and a line of experienced outsourcing senior management talents. Furthermore, there is a broad diversity of city locations with dedicated talent profiles, labour and real estate cost arbitrage.

\(^2\) *Compound Annual Growth Rate (CAGR)* is the mean annual growth rate of an investment over a specified period of time longer than one year.
quickly changing structure of services from back to front office functions is available, proving high quality and stability over time.

For multi-national corporations there have been worked-out destinations of global services command centres with a size of an average complex often exceeding 3.000 FTEs\(^3\) (Deloitte, 2015: 1). The economic and political stability across the region is coupled with the EU legal code and the regulatory environment. In addition, there are also attractive investment incentives in the region due to the available EU structural funds.

4. Site location for multinational companies within Europe – main factors that influence the decision process

There are sought ways how new SSCs can be attracted to this region. Based on interviews with Big Four experts and the literature survey, scholars managed to identify seven factors that are essential when deciding where to site SSC operations. The author has looked at the future trends of these factors in the Central and Eastern European region. Below are presented the main seven factors (Borman, 2012).

4.1. Financial incentives

In this respect, the focus mainly is not on the EU subsidies that a company could gain in a location process, but rather on the financial and tax environment of a country. The governments of Central European countries compete to make their countries more and more attractive to foreign investors (Deveraux, Griffith, 2003). They have taken measures such as tax reforms that would encourage business development. For example, Estonia started a 19% flat-tax regime in the mid-90s, Romania, Poland and Hungary cut taxes under 20% for corporations while Latvia and Lithuania have instituted a low 15% flat tax on all income, corporate and personal (Ernst and Young, 2014). These incentives are not applicable to internal shared services functions, which are non-revenue generating. However, for more complex internal arrangements, where shared service centres operate as profit centres, these changes make for a very positive tax position. These taxes are now well embedded and there are no indications that they are going to be modified drastically. Looking at the regional aspects, the less developed regions may also provide infrastructural developments supported by the central government that may be attractive to shared service companies, e.g., such as road or infrastructure developments.

4.2. Language skills

The total number of English speakers in Central and Eastern European countries is estimated to be over 30 million, while the number of German speakers is over 16 million (Eurostat, 2015: 63).

In terms of foreign language skills (other than English) the countries of the CEE region can be divided into three main groups of counties according to the prevalent foreign language:
- German language: Poland, Czech Republic, Slovenia, Hungary, Romania.
- Russian language: Latvia, Lithuania, Poland, Bulgaria, Czech Republic, Slovakia.
- Latin languages (French, Spanish, Italian): Romania.

If one looks at the number of English speakers in the region by countries, he/she may find the following numbers:
This data shows that the number of professionals employed in 2015 (338 000) can still be increased heavily in the coming years.

\(^3\) An FTE of 1.0 is equivalent to a full-time worker or student, while an FTE of 0.5 signals half of a full work or school load.
4.3. Labour turnover

A low labour turnover is a very desirable thing for any shared services centre as it shows not only the loyalty of employees, but also leverages the investments in employee development to the maximum. Many of the CEE countries are positioned in the most favourable areas benefiting from both a low labour turnover and low labour cost. The business process outsourcing (BPO) industry, however, generally has higher labour turnover rates than the overall average per the economy, for example: 30–35% in India, 20–30% in Eastern European Centres, 20% in the UK and 15% in South Africa. Shared service centres themselves are reporting varied effects (Deloitte, 2015: 1). Whilst in major cities these turnover rates are often exceeded, with careful management these levels can be reduced. For instance, in the case of a major centre opened by a European electronics group, they have managed to keep the levels around 10% per annum. However, turnover ratios depend a lot on the chosen location within the CEE countries. In the most populated areas, leaders of shared services now admit that the costs of reducing this turnover is the inevitable cost of operating in the region.

4.4. Office availability and costs

Even though real estate costs have been growing constantly during the past years in all CEE countries, these locations are still attractive compared to others in Asia or Western Europe.

A decade ago finding quality business spaces in most Eastern European countries was a challenge, especially outside the capitals. Today, the situation is changed as large scale real estate developments, such as business and technology parks, as well as numerous office buildings, have been completed. Office spaces are now available at reasonable costs in capitals, and smaller towns in all CEE countries. In the last decade, in the site search process there can be seen a new phenomenon, the multinational companies tend to leave the capitals and settle down usually in agglomeration or even in the so-called middle size cities on the European scale. The author collected some cases where these centres appeared in these territories (Ernst and Young, 2014) (Table 2).

<table>
<thead>
<tr>
<th>Company</th>
<th>City / Town</th>
<th>Country</th>
</tr>
</thead>
<tbody>
<tr>
<td>ProRate Service Centre</td>
<td>Nitra</td>
<td>Slovakia</td>
</tr>
<tr>
<td>KBC Shared Service</td>
<td>Brno</td>
<td>Czech Republic</td>
</tr>
<tr>
<td>Sappi Global SSC</td>
<td>Krakow</td>
<td>Poland</td>
</tr>
<tr>
<td>Accenture</td>
<td>Lodz</td>
<td>Poland</td>
</tr>
<tr>
<td>Hewlett Packard</td>
<td>Wroclaw</td>
<td>Poland</td>
</tr>
<tr>
<td>Office Depot SSC</td>
<td>Cluj-Napoca</td>
<td>Romania</td>
</tr>
<tr>
<td>ITSH (DT)</td>
<td>Pecs</td>
<td>Hungary</td>
</tr>
</tbody>
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Source: the author’s own research.
Based on the above, one can see a significant increase over the last five years in building new offices that reflect the needs generated by the SSC phenomena. In smaller cities, the general office used to be available in the inner cities and the parking facilities were not sufficient. In this new process, the SSCs require the so-called A class offices that are green and smart buildings and provide enough parking places. As a result, these new office buildings in new locations can even reach the space of 30,000 to 100,000 sqm. Besides, the availability of labour, the number and size of available office buildings has also become a key factor in the site search decisions (Dantons, 2015).

4.5. Labour available in SSCs for university graduates in Central Europe

The experience of the past two decades shows that the post-communist universities and colleges provided a significant number of educated people that could not find a workplace in the post-communist economical structures, since the new structures were not financially viable enough to employ them. Therefore, international SSCs could find a significant amount of educated workforce in the post-communist countries such as Hungary, Romania, Slovakia, Poland, and Bulgaria. In addition, language skills were also important in the post-communist university education system, therefore, the language skills were also available. In the last decade, these skills supported the continuous growth of the SSCs presence in the Central Eastern European region. Comparing the EU member states that joined the EU in 2004 and the so-called “old” member states, it is obvious that the education system of the CEE countries deliver a higher rate in the number of tertiary educated workforce (8.59 per 1000 inhabitants) than that of the “old” EU member states (7.47 per 1000 inhabitants). The public spending figures show that the CEE countries may be more efficient in this field than the old EU states and the US, although the new states also spend the same proportion (approx. 5.3%) of their annual budget for these purposes.

However, the migration of labour force to western European countries from eastern countries created a significant number of new jobs in different industry sectors in the CEE countries, meanwhile it limited the number of available workforce for the SSCs (Eurostat, 2015). The size of migration of labour force from eastern countries to western European countries is immense. This is the main phenomenon in the decreasing unemployment rate of the eastern countries. In Hungary, the estimates show that 5–600,000 people could leave Hungary to work abroad within the EU. Looking at the Polish estimations, one can even count up to 2.4 million of people leaving Poland to work abroad. Moreover, statistical experts calculate that due to the economic crisis that started in 2008 in Romania, at least 2.7 million of people left Romania to work abroad since the beginning of the last decade.

However, there are several signs that some people return to their home country for work. One of the main reasons of return is the Brexit fear and the appearance of western level payments in Central European countries. The SSCs can already provide a level of payment that encourage people to go back to work to their home country. Since many young and single people went abroad for work, they are also more flexible and ready for changes, even if these changes may be seen as a “step backwards”.

Analysing labour market changes in the CEE countries, it can be identified that these markets lack not only the skilled labour, e.g., for assembly plants, but also, the available number of educated labour force became very small compared to that of a decade ago. Therefore, if companies intend to set up more SSCs in the region in the coming years, they will probably face the challenges of available educated workforce. Besides hiring activities, the companies need to co-operate in educating labour. Furthermore, companies operating with the SSCs should also build new kind of relationships with the CEE region universities in order to obtain necessary amount of educated labour (Orion Partners, 2008).

In case these companies are involved in education co-operation with the CCE institutions, the educated workforce could deepen its specific knowledge relating the topics that could be outsourced to SSCs such as human relations, book-keeping with finance, IT and procurement. This could lead to the higher quality of service that the SSC workforce could deliver.
4.6. Existing location or new location for a SSC in the CEE Region

In the decision process on a site location for a SSC, companies usually at first look, whether they have already any strong and viable business history in that region or even already have the own site for several functions (e.g., a branch or a production facility). The experience that companies have already gained in the region may have a significant impact on the site location decision process. Furthermore, companies also look at the way how business is carried out in the region, and try to identify the main business patterns. In addition, companies evaluate the main types of costs they have to bear, such as overheads and real estate expenses. In the site search process, having determined the above-mentioned factors, companies will look at general infrastructural conditions. These infrastructural factors are mainly the number of available office buildings, areas, IT infrastructure and auxiliary services in the region (Schulz, 2009). Companies usually try to find a region where traffic conditions are acceptable, office spaces are available, since they assume that in such a region they may find the necessary labour easier than in a region where these conditions are rare. As has been mentioned above, if companies have an operating history with a plant in a certain region, they may already have knowledge of the main patterns how to make business in that region. This background knowledge usually has the main impact on the decision-making process (Thomas, 2013).

Conclusions and future expectations

Having evaluated the key factors above, one can presume that as long as political and economic stability is present in the CEE region and the EU structural funds flow into the CEE economies, the economic prosperity may continue to last for the next decade as well. Looking at predictions of economic think tanks for national economies, it can be assumed that the economic growth will sustain in the CEE region in the coming years and this will help avoid major economic shocks in the region (Nguyen et al., 2013). The availability of workforce is influenced by skills levels, unemployment and migration. These will remain volatile factors, particularly as migration levels respond to slowdowns in growth across the developed economies of Europe in the next five years. However, the depth of the labour force and the skill base in the region indicates that though pay inflation may again start to rise in pace, the underlying workforce will remain available in sufficient numbers to support long-term operations in the region (Marciniak, 2013).

The future growth depends on the ability to attract centres that provide more advanced and sophisticated services. Two global trends will work in the CEE’s favour in this transition. First, the global market for outsourced business process services is expected to continue growing, about 10% annually, to a projected value in 2020 approaching USD 100 billion (Orion Partners, 2015).

In addition, basic, lower value-added services are naturally migrating toward the lowest-cost locations, such as India and the Philippines. At the same time, investors are increasingly valuing near-shoring solutions for more sophisticated processes, bringing them closer to home (National Association of Software and Services Companies, 2015).

The following areas are potential sources of growth in advanced business services in the CEE region:

- Middle-office for banks and insurance companies: broad spectrum of end-to-end processes, including loan and mortgage process servicing, fraud detection, policy and claims handling;
- Advanced IT programming: software development, IT systems administration and integration services, IT infrastructure hosting;
- Supply-chain and logistics coordination centres: supply-chain optimization centres for FMCG (fast-moving consumer goods), logistics;
- Business research and analytics: high value-added business research for professional firms and financial institutions, and business analytics including big data advanced customer-base analytics;
- Research and development: contract research across many industries and technology fields.
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**MAŽIAU IŠSIVYSČIUSIŲ CENTRINĖS EUROPOS REGIONŲ VYSTYMOSI EUROPOS SĄJUNGOJE GALIMYBĖS: AR PASLAUGŲ CENTRAI GALI TAPTI PAGRINDINE JĖGA?**

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Santrauka

Paslaugų centrai gali sukurti naujas darbo vietas mažiau išsivysčiusiuse Europos Sąjungos regionuose. 2015 metais darbuotojų skaičius šiuose sektoriuose išaugo iki 335 000 ir panašu, kad dar augs. Straipsnyje siekta pagrįsti tokių paslaugų teikimo naudą mažiau išsivysčiusiems regionams pritraukiant didelės tarptautinės organizacijos, vertinamos ir bendrų paslaugų centruose galimybės.

Atlikus analizę nustatyta, kad centriniuose regionuose šias paslaugas dar galima plėsti. Taip atsiranda galimybė mažiems bankams ir draudimo bendrovėms prisijungti prie didesnių ir teikti papildomas paslaugas; administruoti informacinio technologijų centrus, kurie vykdytų informacininių technologijų priežiūrą; logistikos srityje kurti koordinavimo centrus, kur būtų optimizuojamos vertės kūrimo grandinės; atliekami verslo tyrimai ir analizė, siekiant kurti ne tik esamų mažų organizacijų pridėtinę vertę, bet ir didesnėms organizacijoms pasinaudoti esamų mokslinio potencialu už mažesnę kainą bei žinant vietines subtilybes.

Reikia paminėti, kad šiuose regionuose gerokai išaugo kvalifikuotų darbuotojų skaičius, nes universitetai parėmė nemažai atitinkamų specialistų. Tokie bendrų paslaugų centrai ir pradėti kurti, iškeliant tokias paslaugas, kurioms teikti reikia daug žinių, į mažiau ekonomiškai išsivysčiusius regionus. Jie pradėti kurti sūnūs, kur yra pakankami išimtoksliniių žmonių, galičių dirbti tokius darbus, be to, yra būtina infrastruktūra, galima nuomoti patalpas. Šių atvejų darbuotojų samdymo išlaidos siek tiek mažesnės negu „motininėse“ šalyse: pigesnė patalpų nuoma ir mažesni darbuotojų atlyginimai skatina tokias organizacijas kurtis svetur.

Antrajame etape jau galima kurti tokius centrus mažesniuose miestuose, kur yra skirtingų institucijos, kuriose rengiami informacinio technologijų ar kiti paslaugų centru gebantys atlikti specialistai. Tiesa, kartais tokiems centrams steigtis pritriksta biuro patalpų į tai turėtų atkreipti dėmesį tų miestų savivaldybės.

**PAGRINDINIAI ŽODŽIAI:** regionų vystymas, švietimas, technologiniai pokyčiai, ekonominis vystymasis, augimas, paslaugų centrai.

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