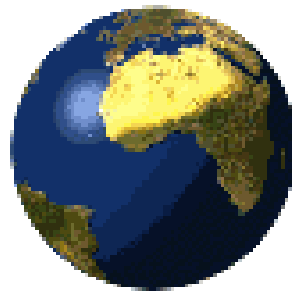


Finding Sri Lanka's Offshoring Niche



**Ismail Radwan, Senior Economist
World Bank, Colombo Office
February 7th 2006**

1 Sri Lanka's current offshoring status

2 Offshoring trends

3 Sri Lanka's Offshoring niche

4 Conclusions

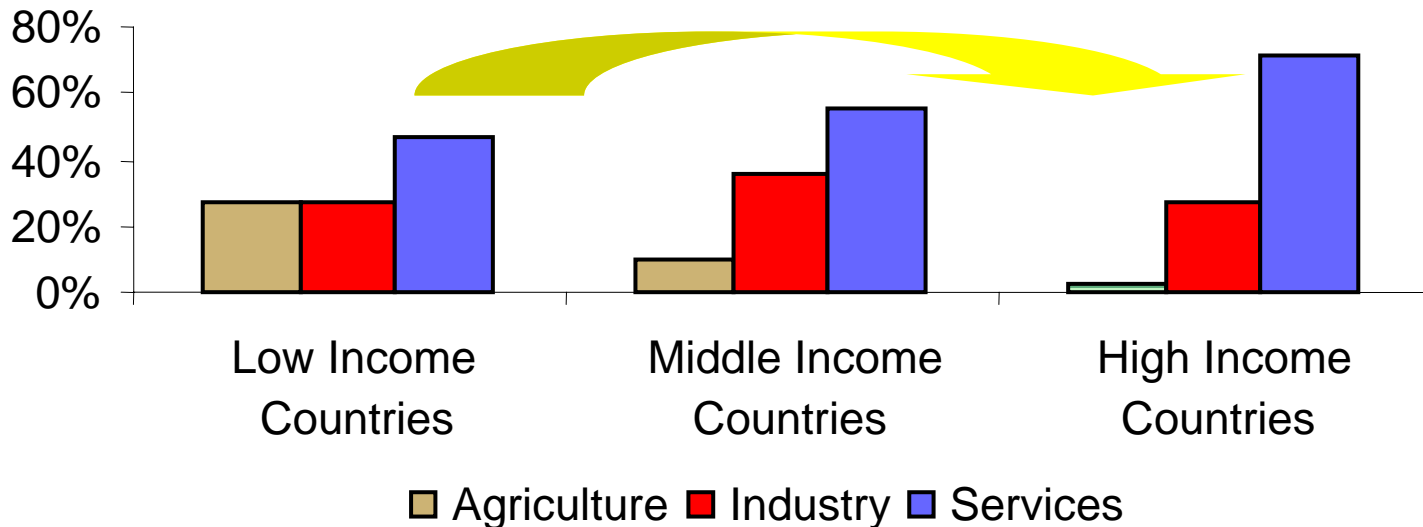


Services as a Stimulant of Growth

- Economic growth is critical to poverty reduction and is spurred by expansion of the services sector

Sectoral Contribution to Country GDP, 2001

Source: World Bank, World Development Indicators Database

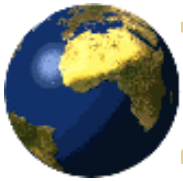


Developing countries can potentially leapfrog the industrial development stage.



Positive Spillover Effects of Services Offshoring

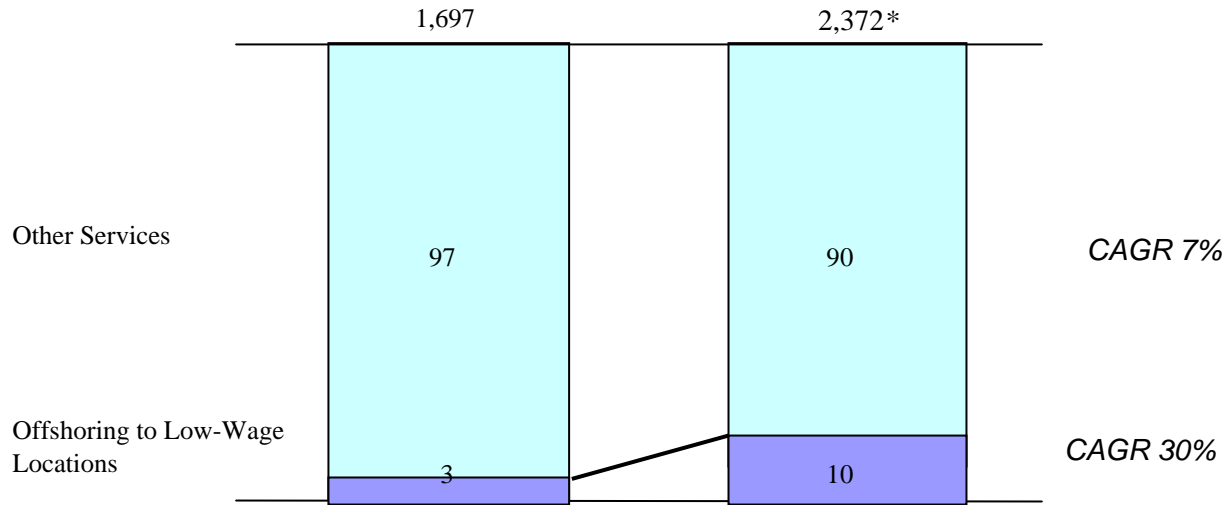
- Incentives are created for education
- The quality of exported services improves which benefits domestic consumers as well
- Technology and knowledge transfer results
- Service processes tend to be more environmentally friendly
- Can reverse the brain drain



Offshoring Segment of the Services Market

Services offshoring is growing at an exponentially faster rate than the market for other services

BPO/IT offshoring to low-wage locations as a percent of total global service exports (\$ billion)



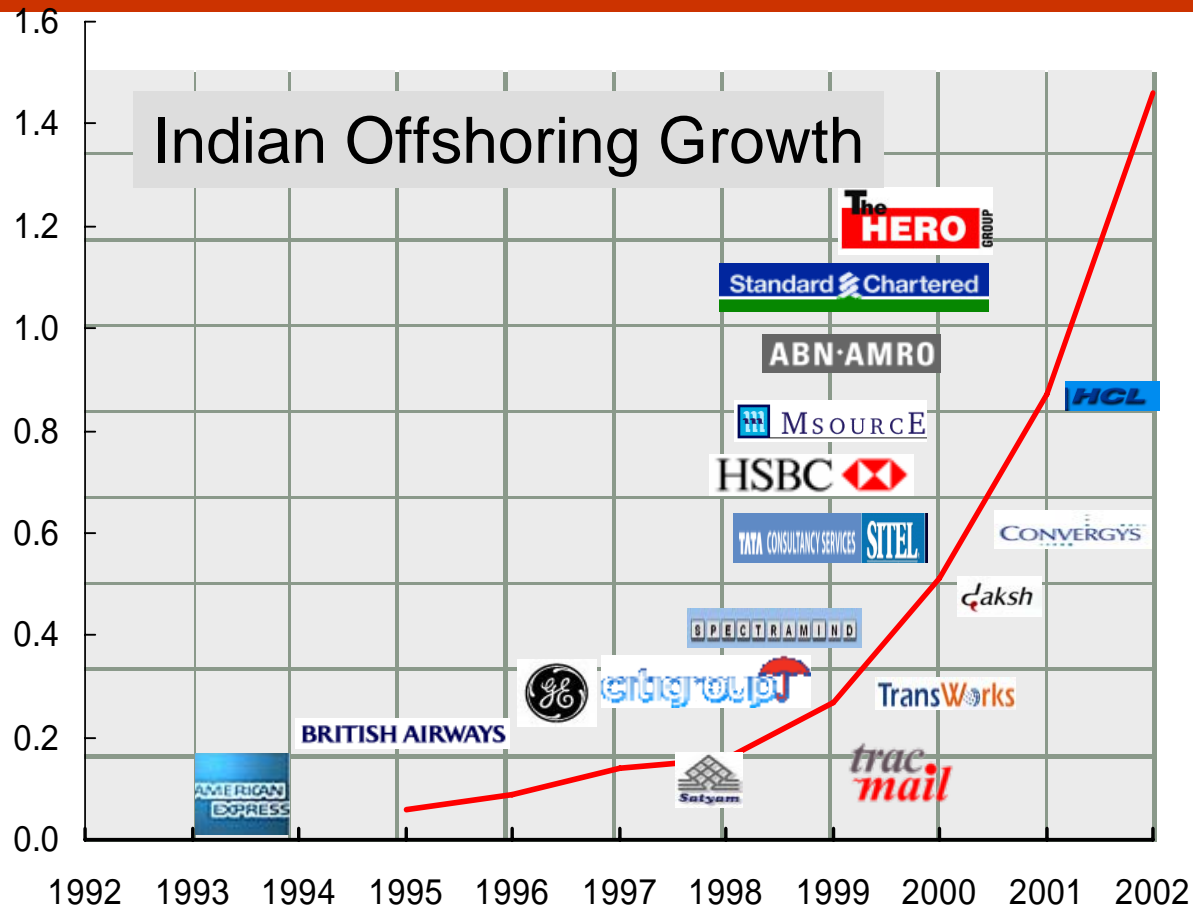
Source: WTO, McKinsey Global Institute Analysis

The contribution of services offshoring to the GDPs of provider countries has increased substantially over the last few years.



India has showed what is possible

Services offshoring has grown at 25-30% for the last decade



Source: NASSCOM; Press reports, Amba Research



Sri Lanka: Offshored companies 2005

amba



HSBC



WNS

Extending Your Enterprise

metatechno
Advance the Technology



INNODATA
ISOGEN

ASTRON

An RR Donnelley Company

OfficeTiger

Virtusa



HelloCorp
where customer service starts with hello



CONVERGYS

BANK ONE



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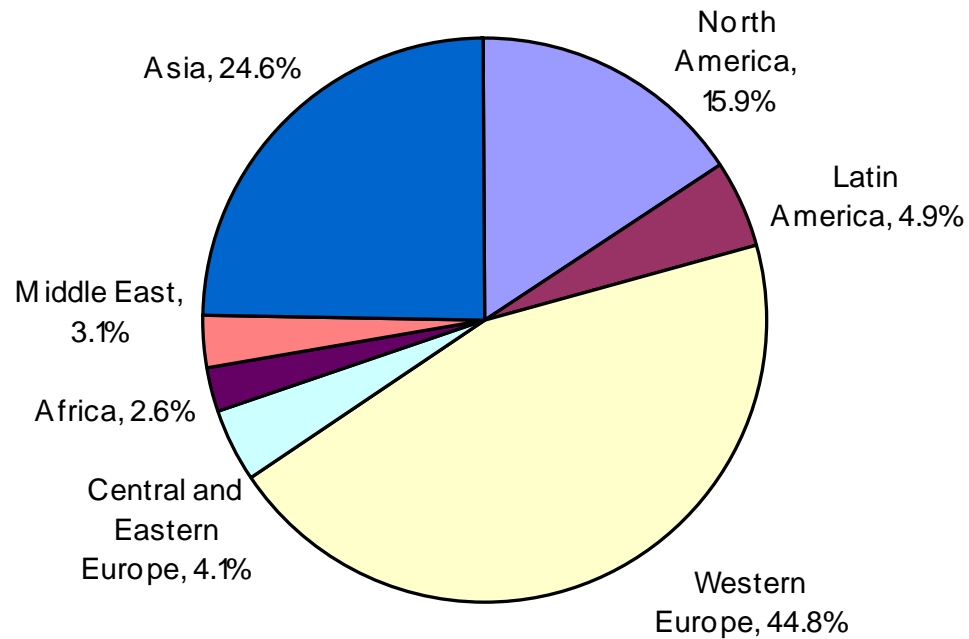


Who Demands Offshored Services?

Western Europe, Japan and North America are the largest customers for offshored services

World Imports of Commercial Services, 2001

Source: World Trade Organization





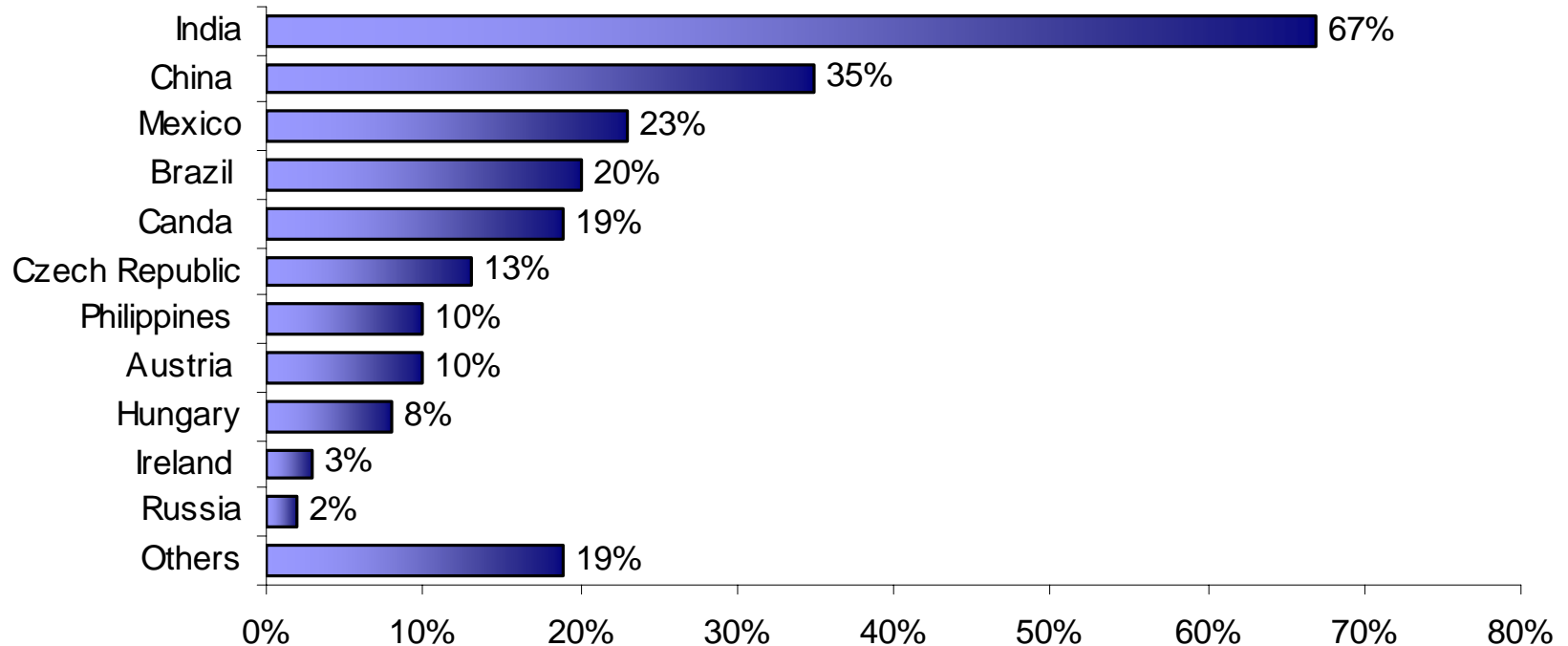
Who Supplies Offshored Services?

India has emerged as a leader on the service provider side of the offshoring market

A.T. Kearney Six-Industry Survey

In Which Countries Do You Currently Have Offshore Operations?

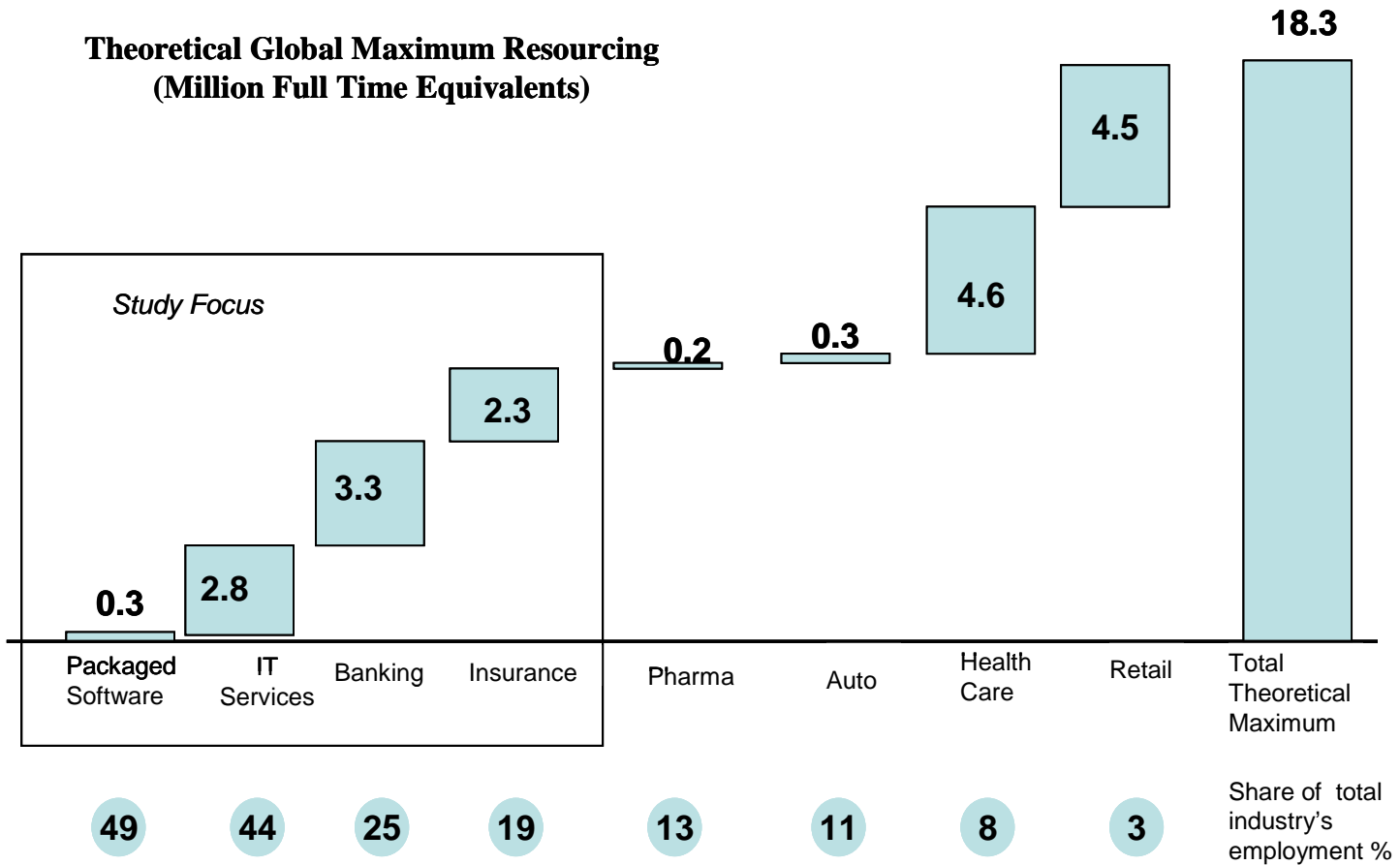
Source: A.T. Kearney, Making Offshore Decisions





Vertical Segmentation of the Offshoring Market

Offshore employment is expected to double in each sector by 2008





Horizontal Segmentation of the Offshoring Market

Performing more complex transactions requires greater access to a highly skilled labor pool

Back Office	Customer Contact	Common Corporate Functions	Knowledge Services and Decision Analysis	Research and Development
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Sample Functions

<ul style="list-style-type: none"> • Basic data entry <ul style="list-style-type: none"> - Applications - Data conversion • Transaction processing • Document management 	<ul style="list-style-type: none"> • Customer Relations <ul style="list-style-type: none"> - Call centers (in/out-bound) - On-line service • Tele-marketing • Collections 	<ul style="list-style-type: none"> • Shared corp. services <ul style="list-style-type: none"> - Finance/Acct. - HR - Procurement - IT services * Help desk * Maintenance * Applications 	<ul style="list-style-type: none"> • Research services • Customer and portfolio anal. • Process claims • Risk mgmt. • Credit underwriting 	<ul style="list-style-type: none"> • Content development, engineering, & design • New product design <ul style="list-style-type: none"> - Specs - Prototypes - Testing
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Source: McKinsey Global Institute



Low-cost labor



Access to highly skilled labor pool

1

Sri Lanka's current offshoring status

2

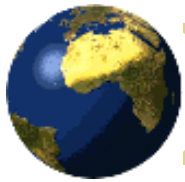
Offshoring trends

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Assessing Sri Lanka's Offshoring Potential

Costs, labor and the business climate – are the key issues

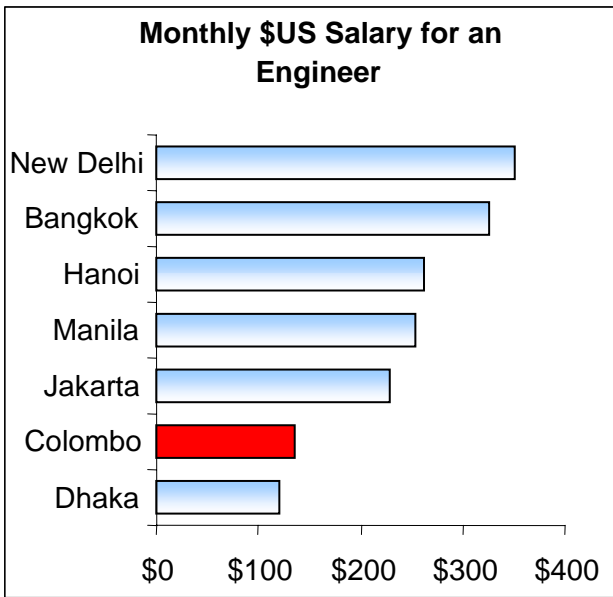
Category	Sub-Category	Key Factors
Financial Structure (40%)	Compensation Costs	Average wages and median compensation costs for relevant positions
	Infrastructure Costs	Electricity and telecommunications costs
	Real Estate Costs	Office rents per square meter
	Regulatory Costs	Corporate tax rate and quantification of other regulatory costs
People Skills and Availability (30%)	Labor Force Availability	Population and total workforce
	Labor Force Quality	Literacy rates and English-speaking ability Proportion of population pursuing tertiary education Education expenditure as a % of GDP Availability of information skills
	Reputation	Existing IT and BPO market size Quality rankings
Business Climate (30%)	Infrastructure	Connectivity, availability of telecommunications, electricity, transportation
	Regulatory Policies	Security of intellectual property and piracy rates Barriers to doing business
	Economic Stability	Fluctuation of exchange rates
	Political Stability	Corruption and governance

Source: Adapted from A.T. Kearney

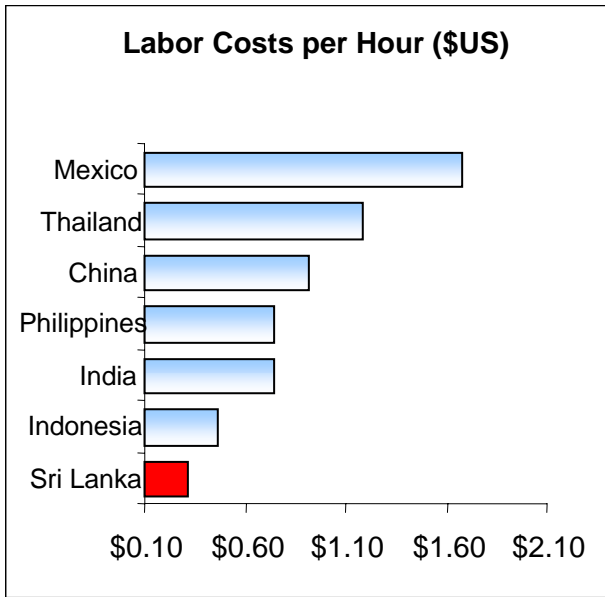


Sri Lanka's Offshoring Potential

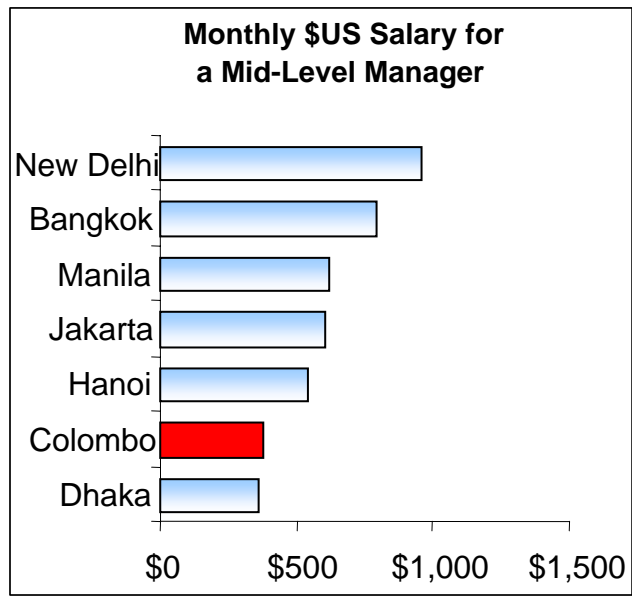
Sri Lanka has some of the lowest compensation costs in the region



Source: Bangladesh Board of Investment, 2004



Source: Economist Online Country Briefings Economic Data 2004



Source: Bangladesh Board of Investment, 2004



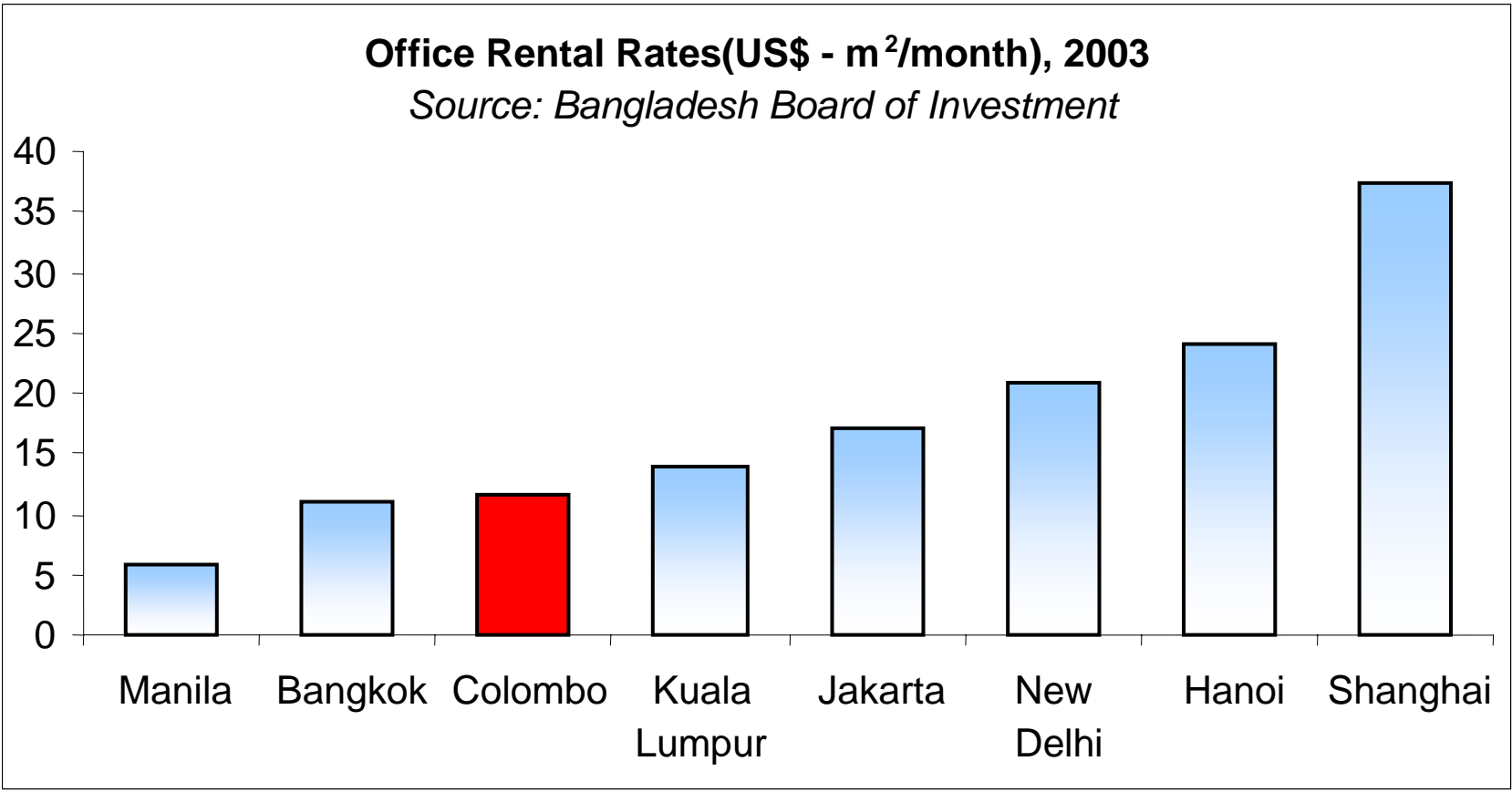
Sri Lanka: Financial Structure Analysis

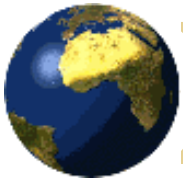
- Compensation Costs
 - Lower labor costs per hour than many of its competitors
 - Low wage rates for higher level functional roles such as engineers and mid-level managers
- Infrastructure Costs
 - Fixed line and mobile calls cost substantially more than those in India
 - Electricity tariffs are among the highest in Asia
- Real Estate Costs
 - Office rents in Colombo are much lower than average monthly rates in other major Asian cities
- Regulatory Costs
 - Rigid labor regulations result in high firing costs and often lead to substantive legal expenses and inefficient use of resources



Sri Lanka's Offshoring Potential

Office rents remain reasonable

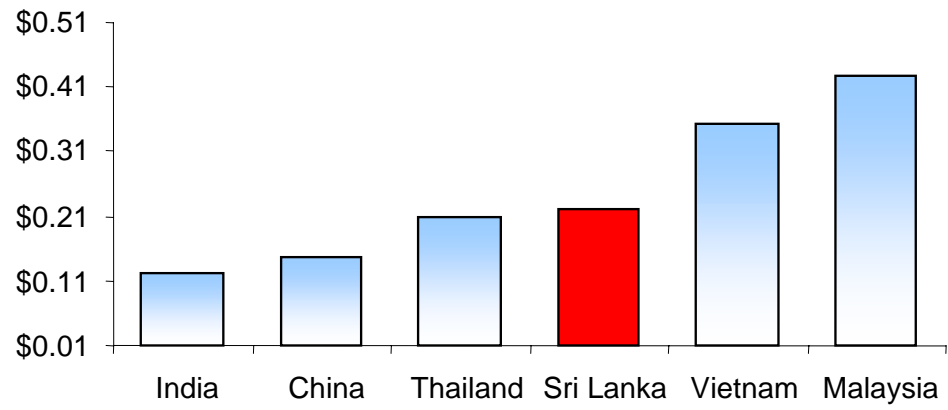




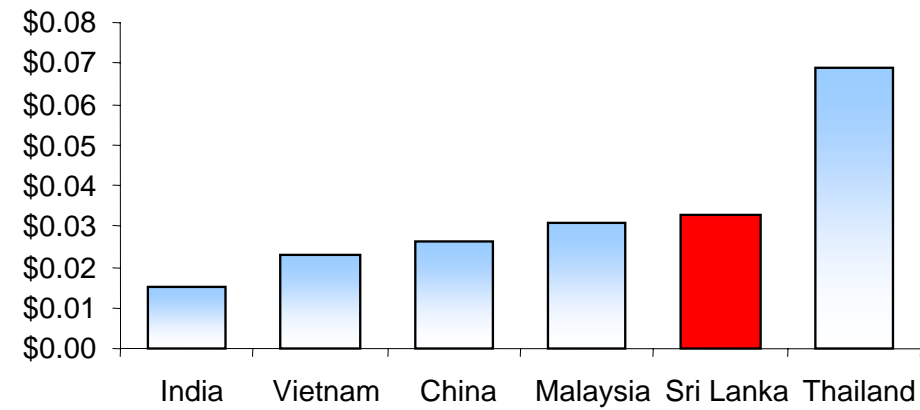
Sri Lanka's Offshoring Potential

Phone call charges remain high

Cost of a 3-Minute Mobile Phone Call (\$US)
Source: UNCTAD Handbook of Statistics, 2004



Cost of a 3-Minute Fixed-Line Phone Call (\$US)
Source: UNCTAD Handbook of Statistics, 2004

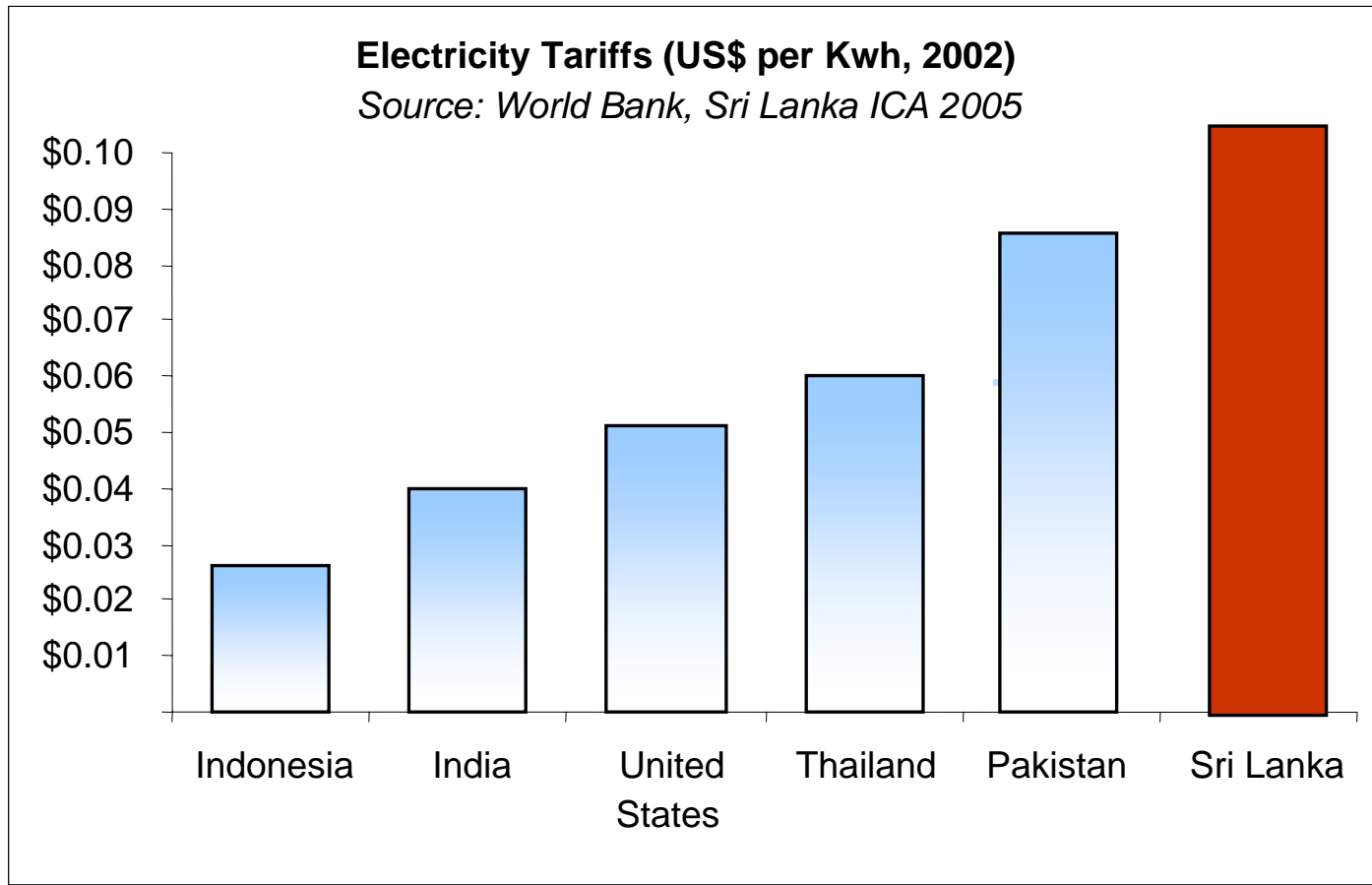


Sri Lanka's call costs are twice those of India
Unlike other countries, call costs are rising not falling



Sri Lanka's Offshoring Potential

Electricity charges also remain high





Sri Lanka: People Skills and Availability Analysis

● Labor Force Availability

- Size of the total working population is limited due to small population
- Although labor is cheap, the country does not produce large numbers of graduates each year like India and China

● Labor Force Quality

- Literacy rates are among the highest in Asia
- Government is under-investing in the tertiary education system
- Several private institutions provide opportunities for technical education in the tertiary sector and supplement 13 public universities

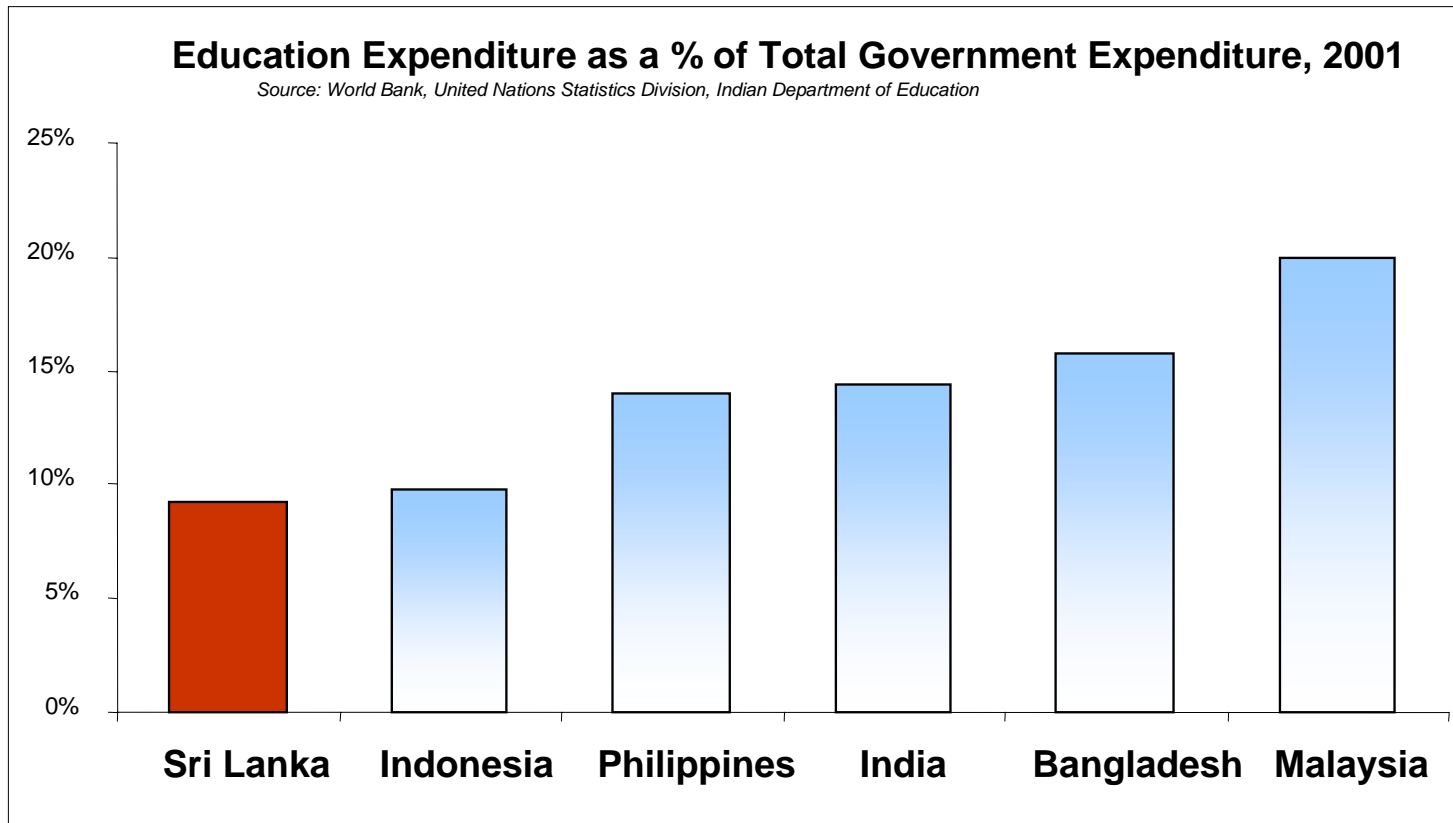
● Reputation

- Existing offshored services market is still very small but the country has a first mover advantage
- Offshore manufacturing reputation is already very strong
- Potential to leverage overseas population and diaspora connections



Sri Lanka's Offshoring Potential

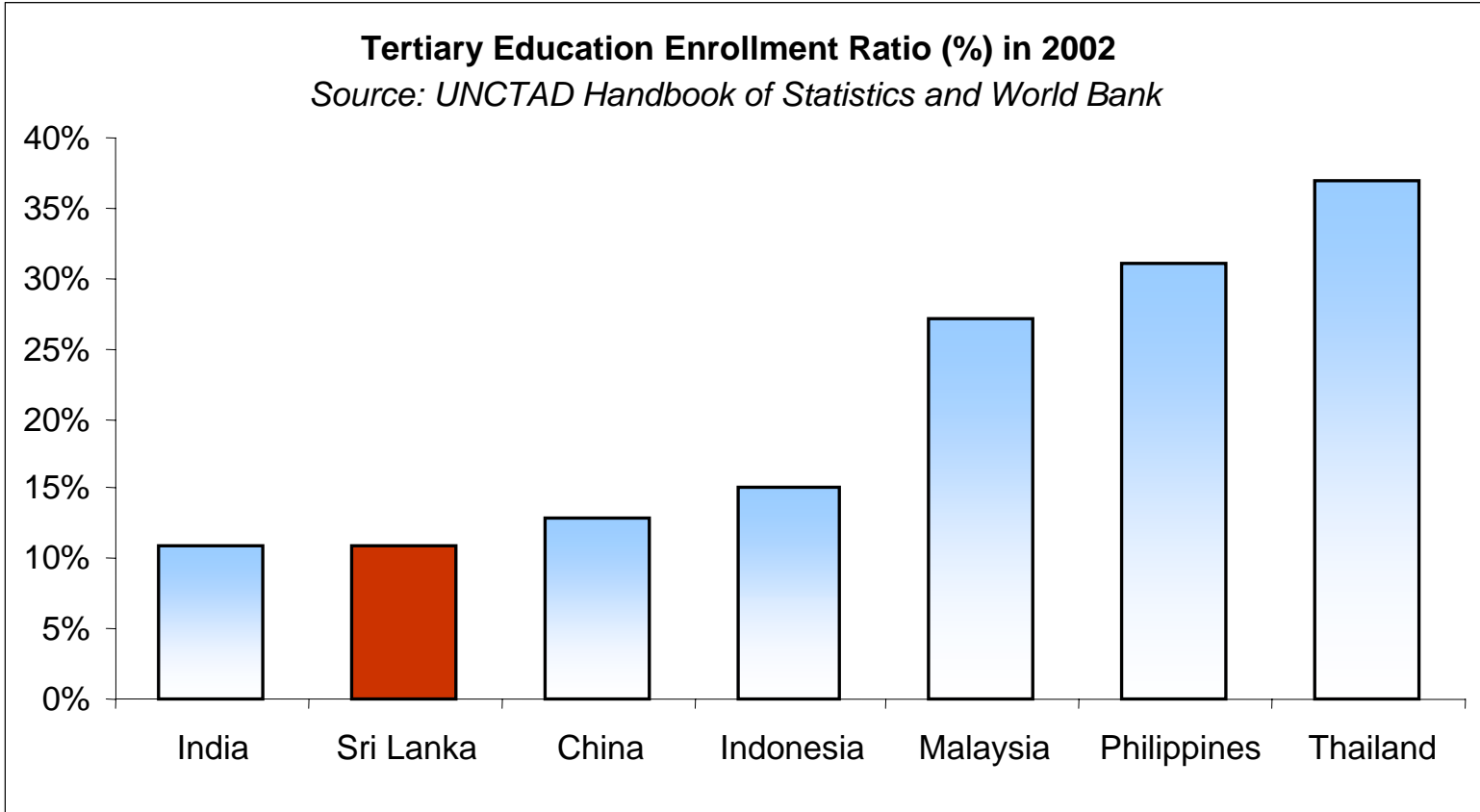
Sri Lanka is not investing enough in education

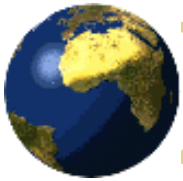




Sri Lanka's Offshoring Potential

Tertiary education is being restricted unnecessarily



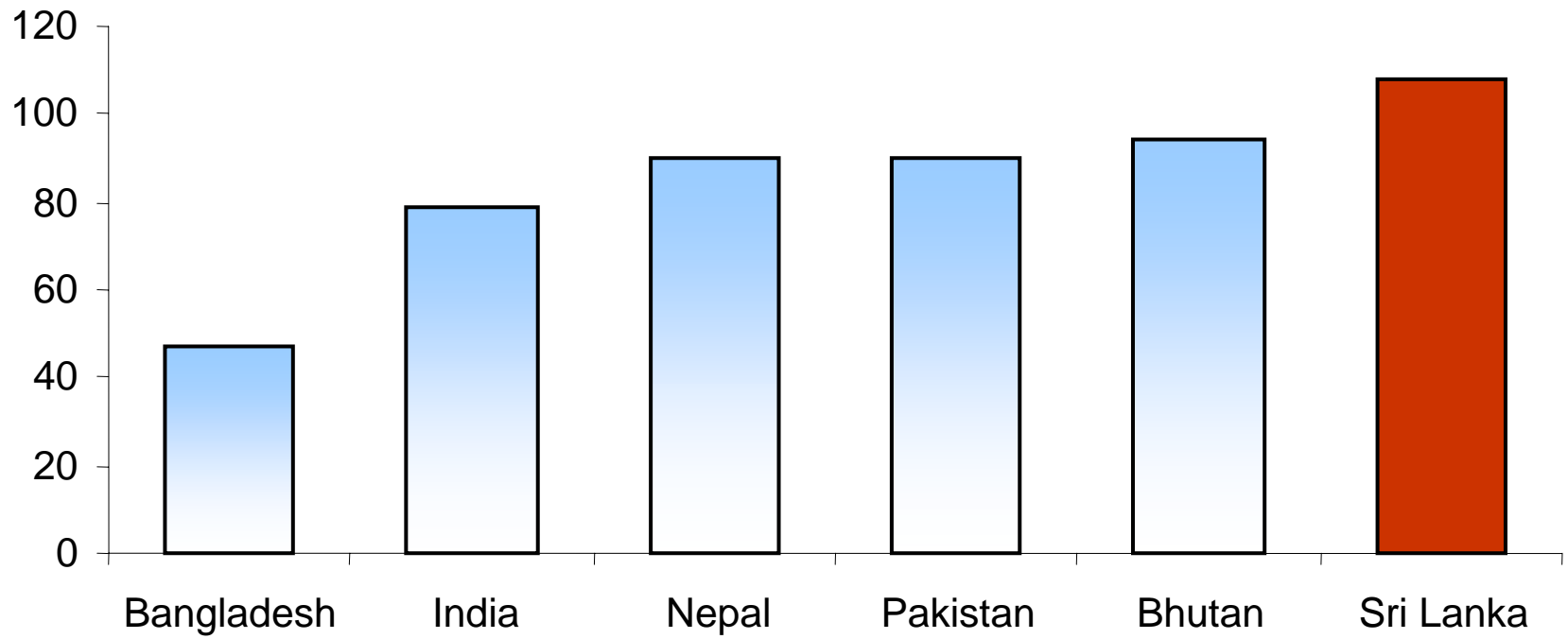


Sri Lanka's Offshoring Potential

Labor flexibility is a key issue

Weeks of Salary in Notice, Severance, and Penalties

Source: World Bank, Doing Business in South Asia





Reducing regulatory barriers

Sri Lanka needs to make it easier to do business

Labor rigidity (weeks of severance)

Lowest		Highest	
United States	0	Egypt	162
New Zealand	0	Brazil	165
Australia	4	Sri Lanka	176
Singapore	4	Zambia	176
Georgia	4	Sierra Leone	188

- Sri Lanka ranks at 75 out of 155 countries.
- Starting a new business requires 8 different procedures and still takes 50 days.
- Enforcing a contract takes 440 days on average.



Sri Lanka: Business Environment Analysis

● Infrastructure Availability

- Telecommunications is a rapidly growing sector
- Internet availability lags that of regional competitors
- Low capacity and unreliability of electricity generation
- Transportation system is an area of pronounced weakness

● Regulatory Policies

- Longest time required for contract enforcement in all of South Asia
- Difficult and time-consuming registration processes
- Lack of intellectual property security but annual losses due to piracy are much less than those in other Asian offshoring destinations

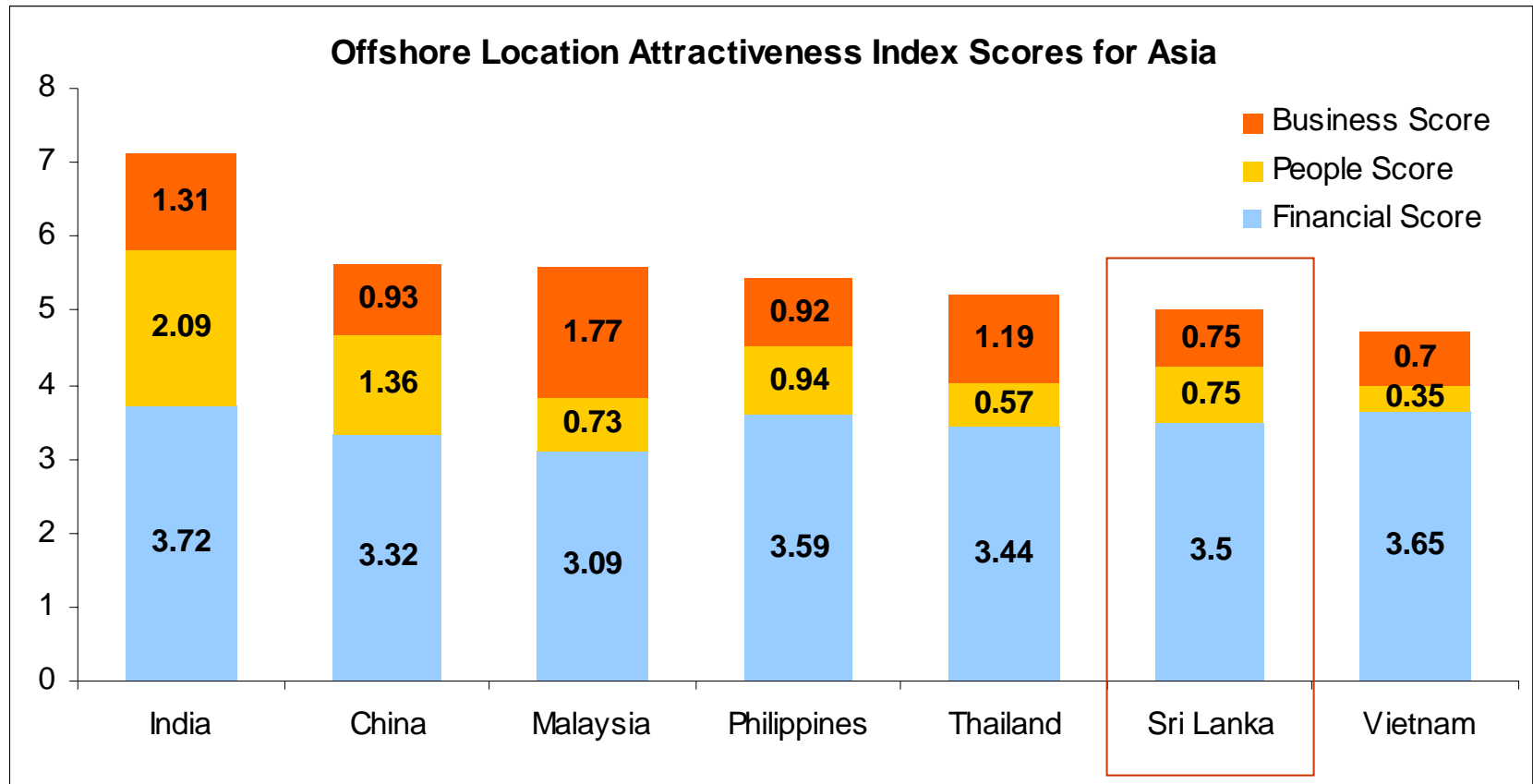
● Political and Economic Stability

- Exchange rate fluctuation quite similar to that in other Asian countries
- Recent measurement of governance shows Sri Lanka outperforming other lower middle income countries



Drivers for Offshoring Growth: Country Perspective

Sri Lanka has potential but there is still some way to go to catch up with India and China as an offshore location



Source: A.T. Kearney 2004.



Summary of Sri Lanka's Comparative Position

- Sri Lanka's main strength lies in the relatively low wage structure for even high-skilled and well-qualified workers
- Size of the labor pool remains a key constraint
- Several features of the business environment detract from the country's attractiveness as an offshoring destination

<i>Financial Structure</i>		<i>People Skills/Availability</i>		<i>Business Environment</i>	
Compensation Costs	●	Labor Availability	●	Infrastructure	●
Infrastructure Costs	●	Labor Quality	●	Regulatory Policies	●
Real Estate Costs	●	Reputation	●	Stability	●
Regulatory Costs	●				
Factor Rating (1-4)	3.5	Factor Rating (1-3)	0.75	Factor Rating (1-3)	0.75

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Sri Lanka's Offshoring niche

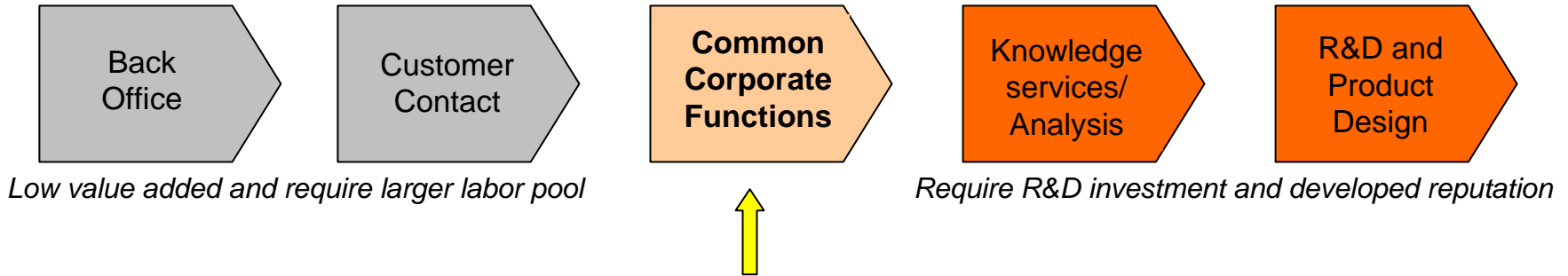
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Conclusions



Success depends on finding a niche

Functional Area Value Chain



Leverage relatively large number of accountants and IT professionals in this high growth area while developing potential for future expansion to higher value added activities as education and technology investment grow

Industry Focus

Light Manufacturing Connection

All firms require shared corporate functions

Substantial opportunity to create partnerships and expand existing relationships

Geographic Focus

Indian Connection

Possibility to enter joint ventures

Disaster recovery and business continuity?



Enterprise Level Strategies

At the enterprise level, firm strategy should focus on quality and innovation while maintaining high levels of customer satisfaction.

● Financial Structure

- Regular benchmarking against competitors' cost structures
- Innovation as a means for achieving greater cost efficiencies while improving quality

● People Skills and Availability

- In-house training programs to continuously improve performance and quality of services

● Business Environment

- Detailed assessments of ICT requirements and potential gaps
- Unified industry association structure for improved dialogue with government and other stakeholders.



Government Policy Framework

Sri Lankan government support will be crucial to the development of offshoring as a potential engine for economic growth.

● Financial Structure

- ❏ Financial incentives to encourage FDI
- ❏ Development of services export processing zones and benefits

● People Skills and Availability

- ❏ Renewed focus on technical education in the tertiary sector
- ❏ Assistance with and incentives for firm training initiatives
- ❏ Development of local and foreign awareness about the offshored service sector in Sri Lanka

● Business Environment

- ❏ ICT and physical infrastructure improvements
- ❏ Policy reforms to address labor rigidity and regulatory constraints



Sri Lanka – What is working



1. Great place, great people

2. Attractive incentive package

3. Conducive regulatory and legal framework

4. Modern infrastructure, port / airport / telecoms

5. Excellent government support from BOI and ICTA



Sri Lanka – Where more work is needed



1. Telling and re-telling our story

2. Streamlining government and regulation UDA / TRC

3. Expanding and improving education and English language

4. Attracting the major players in the market

5. Creating peace and political stability



Making it happen.....

Realising Sri Lanka's potential means tackling five key issues

- Achieving peace and political stability
- Expanding and improving education
- Removing regulatory barriers
- Reducing infrastructure costs, especially in telecoms
- Consolidating industry associations



THANK YOU



**Ismail Radwan, Senior Economist
World Bank, Colombo Office
February 7th 2006**