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China's emergence as a global trading power began more than a decade ago when it surpassed South Korea and Taiwan as the largest exporter of athletic shoes to the US. In 2002, China surpassed long-time manufacturing powerhouses Japan and Mexico as America's biggest single source of consumer electronics. In Europe, Waterford Wedgwood recently closed two factories in the UK and outsourced more than 1,000 jobs to China. At the time of the closures, CEO Redmond O'Donoghue was quoted as saying, "we have a loyalty to Europe, but we can only sustain jobs [here] if we're competitive."

O'Donoghue's sentiment rings true throughout the western world, as jobs in both Europe and the US continue a seemingly unending exodus to the cheaper, more fertile lands of China. With factories in Shanghai and Shenzhen employing female workers who earn an average salary of \$120 per month, it is no wonder many of the world's manufacturers have an eye focused on China as a way to maintain or increase competitiveness and profitability.

Traditional consumer goods such as textiles and electronics are not the only areas where China is making competitive inroads. China is also mounting a serious challenge to Asian and Western suitors in the technology arena, as software development and software testing are both growing sectors in China's burgeoning economy. These industries have a huge effect on the localization industry. They directly influence how our industry will maintain profitability in the future. While 2004 may be the Chinese Year of the Monkey, there is nothing monkey-like in the way China is managing growth and tempting global companies to invest in their economy.

China as a Source of Localization Testing

As of late, many discussions have arisen in the localization industry regarding the outsourcing of engineering and testing functions to China. Many companies under intense pressure to increase gross margin have begun to bypass traditional US or European-based vendor solutions, or indeed their own operations, in favor of China.



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According to the Gartner group, by the year 2004, more than 40 percent of companies will have already shipped some tech-related work overseas or will be testing the idea. A similar report from Gartner continues by forecasting that in 2005, the North American IT industry will be outsourcing software development and testing work worth \$160 billion, of which nearly a third is destined for China's shores.

What is the driving force behind these decisions? In most cases, it is cost, or rather the desire to reduce operating costs and increase profits. On average, hourly rates in China for testing can be as little as 25% what they are in Europe and North America. Additionally, outsourced Chinese testing solutions provide a client company or vendor with an extended flexible workforce that can increase or decrease as needed. The increased cost savings also has the potential to allow companies the opportunity to complete more projects or perform additional testing.

China Versus India

Why is China becoming such an attractive market for outsourced testing over traditional stalwarts such as India, Ireland, or Israel? When discussing this question, many contributing factors come into play: education, infrastructure, government sponsorship, and free-market economics.

A February release by SinoCast China IT Watch discusses this point in depth. The premise of the article focuses on the fact that there is no comparison between China and India's software and testing industries, because of the different development patterns and stages. Specifically, the article refers to the fact that India's software industry focuses on the software outsourcing business and has established a leading position in this market. In this aspect, China's software industry is not on par with its Indian counterpart. However, Indian software companies do not possess research and development strengths, which means they do not possess intellectual property rights of

their own. Thus, India's software industry is heavily dependent on the international market and is subject to economic fluctuations in their patron nations.

Even though China, up until now, has lagged behind India in the software and testing industry, Chinese software companies have developed internal research and development strengths, and thus, intellectual property rights.

Despite the fast growth that India is experiencing, its shortage in independent intellectual property rights make it impossible for India's software industry, including testing, to sustain long-term growth. China's software industry has the upper hand on its Indian rival in this way; China's growth ceiling is significantly higher. This goes a long way in explaining why China is eclipsing India in Foreign Direct Investment (FDI).

Moreover, in India, the domestic market for software products is soft, due to the slow development of India's internal IT industry. China, on the other hand, has one of the world's largest domestic software markets, one that can sustain a downturn in global IT markets. This insulation, though on a much smaller scale, is similar to what China was able to achieve during the Asian crash of the late 90s. During the downturn in the Asian economy, which saw many of China's neighbors teeter on financial ruin, China was able to artificially support growth through domestic protectionism.

Lastly, indecision and a clear lack of guidance on the part of the Indian government have prevented the formulation of a policy aimed at developing India's software industry. To this point, India's software boom has been largely financed through entrepreneurship.

Conversely, the Chinese Government has initiated positive and clear-cut programs designed to promote the development of its software industry. This includes large-scale investments by the central government in IT infrastructure, advanced education and tax incentives aimed at attracting growth in the hi-tech sector, including software development and testing. On the issue of education, China is now graduating advanced engineering degrees at a rate of 325,000 per year, which is nearly triple the rate of India. This means that the government is actively supplying the testing market with a much larger work force than India.

Why Not China?

Even though China offers a low-cost solution for testing services, it also possesses some potential drawbacks. Topping the list of drawbacks are cultural differences, English language proficiency (lack of it, rather), and lack of legal recourse to the piracy of intellectual property. Companies that don't look past China's shiny veneer—to closely examine the risks and develop plans to deal with them—are likely to lose much (if not all) of the benefit. If not addressed correctly, entering into an offshore outsourced solution with China can end up becoming more costly than keeping the testing in local or traditional testing centers.

Cultural differences are often underestimated when entering a new market. In the case of China, a lack of understanding can be critical. Many Western companies fail to appreciate the intricacies of the professional relationships that have deep roots in China's tradition of bureaucracy. This lack of appreciation can manifest into differences in expectations, weakened lines of communication, and outright mistrust. Cultural differences also can lead to a basic misinterpretation of the individual tasks and the overall project plan. A way to address this situation is to make sure that all requirements and needs are articulated in a way that the level of performance is predetermined. Action plans and granularity of scope need to be established in advance—along with ramifications for when the pre-established level of service has not been met.

Since a Western company cannot legally own a Chinese business outright, companies that opt to set up an operation in China need to go into a joint venture with local interests. Because of the legal structure in China, a Western company has little recourse, should the business relationship sour. Many companies have lost capital equipment, clients, and intellectual property.

Faced with the prospect of losing more than just their initial investment, some companies opt for solutions that are not so risky. Giving back some of the cost advantages afforded to doing business in China, companies choose legal security in favor of profit margin.

Adding to the legal difficulties, intellectual property (IP) piracy is a serious concern when doing business in China. Even though China has joined the WTO, software and IP piracy is on the rise. It is not uncommon for a Western company's source code to find its way onto the Chinese market. To combat piracy, companies need to work with vendors that adhere to stringent security procedures and that have established a clean reputation with other customers. References and processes need to be checked prior to outsourcing any testing services to a Chinese vendor.

There's no question that outsourcing to China has afforded some companies dramatic benefits in IT and testing operations, freeing money for projects that otherwise might never have been undertaken. Yet, it is important to assess the actual upfront and ongoing cost savings of an offshore engagement, which can vary by company and project. Factors such as vendor management, travel, communication with in-house staff, and knowledge transfer all come at a price. All of this means that the advertised cost savings for outsourcing to China is not always the end savings. The biggest mistake that companies make is assuming the savings will match the salary differential.