

**Elżbieta MARCINKOWSKA, ScD**

Faculty of Management, AGH University of Science and Technology

e-mail: emarcink@zarz.agh.edu.pl

DOI: 10.15290/ose.2017.05.89.15

## **INSTITUTIONAL APPROACH IN THE ASSESSMENT OF COMPETITIVENESS OF THE OFFSHORING SERVICE LOCATIONS IN POLAND**

### **Summary**

Changes in the global economy observed in the last decade are, to a significant extent, the result of the globalization of markets and the liberalization of international service-oriented turnover. The progressive globalization changes the conditions for the operation for the business entities of an international character. These companies, adapting to new market conditions, are seeking solutions which would allow them to maintain their competitiveness. One of the tools that companies use to improve their competitiveness is offshoring (BPO). This is a process related to the transfer of the implementation of production and service processes to the territory of another country. Location choice in the BPO decisions has become an important strand of the international business literature with a number of scholars examining the influence of host country variables such as property rights, intellectual property protection, public trust in politicians, government factors and others. Poland is the Central and Eastern European leader in the sector of modern business services. This country has many business service centers with foreign capital, which employ thousands of employees. Additionally, employment in this sector is systematically growing by 20% each year. Poland's attractiveness on the map of offshoring investment projects results mainly from a very well qualified and cheap workforce. Offshoring Centers located here offer both BPO and KPO services.

**Key words:** offshoring, business service centers, New Institutional Economics, Poland

**JEL Classification:** K22, K23, O30, O43.

### **1. Introduction**

For a decade, the number of foreign business service centers in Poland has been increasing. They operate in the form of centers of the following types: Business Process Outsourcing (offshoring), Share Service Centers, Knowledge Process Outsourcing, and Research and Development Centers. The decision to locate this type of activity in Poland results from many factors. The institutional factor is a significant one among them. Institutions affect the organization's behavior. The new institutional economy, which examines the impact of institutions on organizations, tries to explain processes in modern economy, while reaching beyond the economic sphere and focusing also on social,

political, legal factors, etc., as well as subjects them to economic analysis. Such an approach – institutional approach - is applied for evaluation of competitiveness on the international level, since the institutional order significantly affects competitiveness of a given country.

The purpose of the article is to apply the institutional factor in the assessment of competitiveness of Poland, in comparison to other countries of Central and Eastern Europe, as a place for locating modern services for business. The article describes formal institutions, focusing on legal regulations, especially compliance with ownership rights, protection of intellectual property, judicial independence, effectiveness of legal regulations in resolving disputes, etc., on the basis of the available economy competitiveness studies conducted by the World Economic Forum.

## 2. Contemporary offshoring of business services

The concept of outsourcing, which had been developing from many years, has evolved in the last two decades, crossing the borders of countries and continents. Assignment and implementation of certain activities outside the company's structure by specialized suppliers has become quite a typical solution in modern economy. Outsourcing evolved quite efficiently from a simple business solution into a strategic solution. It has become a concept, which - in the right conditions - may provide sustainable competitive advantage. At present, companies seek such outsourcing solutions that would bring them the assumed benefits. According to the results of the research on outsourcing, implementation of this concept gives the companies, above all, reduction in costs, allows to focus on basic operations, improves quality and effectiveness of the transferred processes, changes the cost structure, raises the level of customer satisfaction [Doing, Ritter, Speckhals, Woolson, 2001; Yang, Kim, Nam, Min, 2007; McIvor, Humphreys, Wall, McKittrick, 2009]. For many companies, offshoring - a concept rooted in outsourcing – is the means allowing them to grow, develop and achieve the planned benefits. Adopting this solution, namely Offshoring, means that the transferred internal processes are implemented outside the borders of the country of the parent company [*Information Economy Report...*, 2009, p. 73]. Companies assume two basic solutions with regard to offshoring. One of these solutions consists in internalization, namely separation of business tasks from the company's own organizational structures and their transfer to a daughter company, a branch operating abroad, in the form of direct investments. The second solution means assigning business services to an external, foreign supplier. The intensive increase in offshoring service investments, which has been recorded for a decade, allows to assume that this trend will remain at a constant level [Bardhan, Kroll, 2003; Roth, Menor, 2003; Ellram, Tate, Billington, 2007]. Companies apply offshoring in the areas of production and services. Offshoring investments in the area of services for business gain particular importance for the Polish economy.

For a decade, the number of offshoring investment projects in Poland has been growing. Foreign business service centers, functioning in all larger cities in Poland, provide services to business entities from all over the world, the main clients of all the companies operating in Poland being entities from Western Europe and the United

States. Poland is the leader in this type of services in Central and Eastern Europe. Offshoring companies operating in Poland provide business services, above all: IT services, financial and accounting services, services related to contact with the customer. Apart from the aforementioned, the provided services include services in the field of banking, HR, Supply Chain Management, Research and Development, Procurement, and others.

The attractiveness of a locating them in Poland depends, above all, on access to qualified and competent staff, good infrastructure conditions, positive atmosphere for business. However, it is worth providing a more thorough description of the institutional factors and their impact on development of this type of investments in Poland.

### 3. Institutional approach in offshoring decisions concerning location of services for business

The aim of the research of Institutional Economics is to explain the impact of institutions on behaviors and functioning of individuals and organizations. How to define an institution? An institution is associated with certain legal frameworks, legal rules, but also with social standards, with behaviors of individuals, who imitate the behavior of a given community. It is difficult to present one binding definition, which would cover the entire complexity of this concept. In the past, the definition of an institution appeared in the works of the main creators of the so-called Old Institutional Economics. T. Veblen, in his famous book entitled *The Theory of the Leisure Class* provided a definition, according to which social institutions *are at the same time special methods of life and of human relations. [...] The institutions are, in substance, prevalent habits of thought with respect to particular relations and particular functions of the individual and of the community* [Veblen, 1971, p. 169-171]. In his definition, Veblen emphasizes the issue of habits of mind. The author also points out the problem of social institutions being ill-adjusted to the contemporary conditions, in which the individual functions. The second co-author of Institutional Economics beside Veblen is J. Commons, who defined an institution as *many organized going concerns, such as the family, the corporation, the trade association, the trade union, the reserve system, the state* [Commons, 1934, p. 146, after: Stankiewicz, 2007, p. 46]. In this definition, the emphasis is put on the notion of *going concerns*, present in the transaction processes, which in turn are characterized by specific principles and rules of behavior of individuals. In new institutional economics, the most often quoted definition of an institution is the definition of the Noble Prize winner D. North, who stated that *Institutions are the humanly devised constraints that structure political, economic and social interaction. They consist of both informal constraints (sanctions, taboos, customs, traditions, and codes of conduct), and formal rules (constitutions, laws, property rights). Throughout history, institutions have been devised by human beings create order and reduce uncertainty in exchange* [North, 1991, p. 97].

Similar definitions of an institution are presented by other representatives of the New Institutional Economics, such as O. Williamson and K.J. Arrow [see: Williamson, 2000; Arrow, 1970]. It is worth emphasizing one difference in attitude towards an institution between North and Williamson: the former treats institutions and organizations as

two different categories, while the latter believes organizations to be a good example of an institution.

The aforementioned definition created by North distinguishes between formal and informal institutions. The institutional approach to the market research of business services provided under offshoring of services consists, above all, in taking into account both formal and informal institutions. Therefore, research takes account of legal norms, such as ownership, constitution, legislation, acts, but also cultural standards, tradition and customs. Formal institutions are systems of rules, which control the organization's behavior. They can be relatively easily identified and examined. This paper thus analyzes formal institutions, which are characterized by significantly greater variability than informal institutions. It is difficult to compare the level of institutional effectiveness. The institutional system functioning in a given economy is the result of many factors, for example previous experience, tradition, but its level is also determined by the development of a given country. Limited access to information, unclear and badly enforced ownership, and market entry barriers for foreign entities are examples of inefficient institutions, which, in turn, impede the inflow of foreign investments. The institutional factors that clearly impede free capital flow are corruption, political instability, lack of law enforcement, frequent changes of political parties. Poor institutional system causes the increase of transaction costs, which are the main object of studies in New Institutional Economics.

### **3. Presentation of institutional factors in Poland and in Central and Eastern Europe, and offshoring investments**

Services for business are provided worldwide. The main locations include Asia (India, China, Malaysia, Vietnam), Central and Eastern Europe, Central and South America (Mexico, Chile, Brazil).

As it has already been mentioned, Poland has become the most popular location for offshoring investments in Central and Eastern Europe, where both basic and advanced business services are provided. Some locations – such as, for example, Cracow – are some of the largest locations in general in the world for this type of investments.

The attractiveness of offshore outsourcing services locations is confirmed by the report entitled *Offshoring Opportunities Amid Economic Turbulence*. This report presents the list of the most attractive offshore outsourcing locations in the world. Table 1 presents the leaders among offshoring services providers. The order in which the countries have been presented results from the investment attractiveness index level, which is influenced by such parameters as: low costs including taxes, infrastructure, quality and availability of employees, and business environment.

**TABLE 1.**

**Global Services Location Index Top20 in 2016 and 2011**

Rank 2016	Country	Rank 2011/ (change in ranking)
1	India	1 (0)
2	China	2 (0)
3	Malaysia	3 (0)
4	Brazil	12 (8)
5	Indonesia	5 (0)
6	Thailand	7 (1)
7	Philippines	9 (2)
8	Mexico	6 (-2)
9	Chile	10 (+1)
<b>10</b>	<b>Poland</b>	<b>24 (+14)</b>
11	Vietnam	8 (-2)
12	Bulgaria	17 (+5)
13	Romania	25 (+12)
14	Sri Lanka	21 (+7)
15	United States	18 (+3)
16	Egypt	4 (-12)
17	Russia	20 (+3)
18	Latvia	13 (-5)
19	Costa Rica	19 (0)
20	Colombia	43 (+23)

Source: Prepared by the author based on [*Global Services Locations Index*].

Poland holds a high position as the most attractive location in Central and Eastern Europe. Poland advanced from the 24th to the 10th spot within five years, which is the highest recorded advancement among countries of Central and Eastern Europe. It is worth noting that, apart from Poland, further spots in the ranking of the 20 best locations in the world are occupied by Bulgaria (12), Romania (13), Russia (17), and Latvia (18). Spots outside the top 20 are occupied by Hungary, Ukraine, Slovakia, and the Czech Republic. Decisions concerning transfer of operations or establishment of new undertakings in Poland are based on specific premises. There are many factors determining selection of a location in this or other parts of the world. Significant factors include access to qualified and cheap personnel, good infrastructure and friendly environment for business. However, one might wonder: do - and to what extent - institutions defining the most fundamental rules affect the decision about an offshoring service location? How are institutional factors perceived and assessed? To make such a description and evaluation, I used the research conducted by the World Economic Forum. The Global Competitiveness Report presents the assessment of competitiveness of economies in the world based on three basic pillars of assessment, namely: Basic requirements subindex, Efficiency enhancers subindex, and Innovation and sophistication factors subindex.

The further division under the three aforementioned areas distinguishes twelve main areas subject to evaluation. Table 2 presents competitiveness results achieved by the world leader and the countries of Central and Eastern Europe. The analysis covers competitiveness of 138 world economies.

**TABLE 2.**

**Global Competitiveness Index 2016-2017**

Country	Rank 2016-2017	Score (1-7)
<b>Switzerland (Leader)</b>	<b>1</b>	<b>5,81</b>
Estonia	30	4,78
Czech Republic	31	4,72
Lithuania	35	4,60
<b>Poland</b>	<b>36</b>	<b>4,56</b>
Russian Federation	43	4,51
Latvia	49	4,45
Bulgaria	50	4,44
Slovenia	56	4,39
Romania	62	4,30
Slovak Republic	65	4,28
Hungary	69	4,20
Croatia	74	4,15
Ukraine	85	4,00

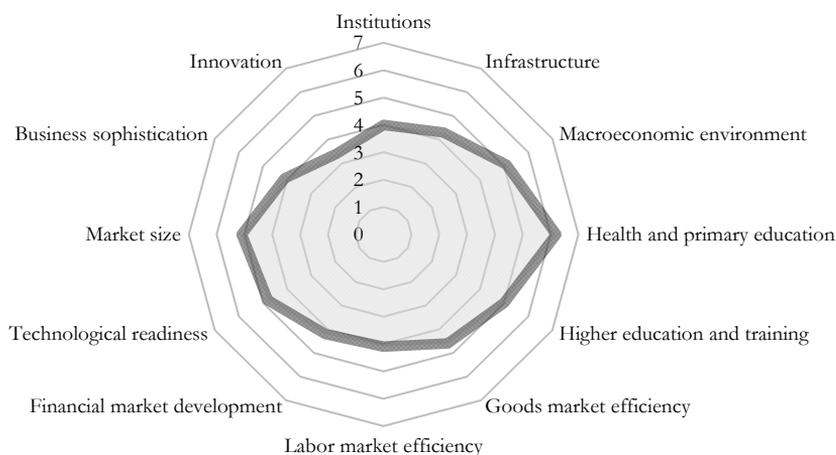
Source: Prepared by the author based on [*World Economic Forum. Executive Opinion Survey*].

The most competitive economy in the world is the economy of Switzerland, and the most competitive countries of Central and Eastern Europe are ranked among the top thirty. Poland holds the 36th place and is the fourth most attractive economy in this part of the world. The countries placed ahead of Poland in this ranking are Estonia (30), the Czech Republic (31) and Lithuania (35). Figure 1 presents competitiveness results for Poland in all competitiveness pillars.

Poland's competitiveness was assessed at the level of 4.56, which placed our country in the 36th place in the ranking of the most competitive world economies. Among the twelve pillars of the competitiveness index, our country achieved the worst results in the field of Innovations (3.4) and Institutions (4.0), Business Sophistication (4.1), and Labor market efficiency (4.1). The areas given the highest score include: Health and Primary Education (6.2), Macroeconomic environment (5.1) and Market size (5.1).

FIGURE 1.

## Global competitiveness index – details for Poland



Source: Prepared by the author based on [World Economic Forum. Executive Opinion Survey, 2016].

TABLE 3.

## Global Competitiveness Index 2016-2017. Basic Requirements

Country	Rank 2016-2017 Basic requirements	Pillar 1 Institutions score	Pillar 2 Infrastructure score	Pillar 3 Macroeconomic environment score	Pillar 4 Health and primary education score
<b>Singapore (Leader)</b>	<b>1</b>	<b>6,10</b>	<b>6,50</b>	<b>6,15</b>	<b>6,75</b>
Estonia	20	5,11	4,98	6,13	6,51
Czech Republic	31	4,10	4,68	5,89	6,35
Lithuania	35	4,21	4,65	5,44	6,25
Latvia	41	4,00	4,38	5,56	6,16
<b>Poland</b>	<b>45</b>	<b>3,99</b>	<b>4,34</b>	<b>5,14</b>	<b>6,19</b>
Slovak Republic	54	3,48	4,24	5,28	5,95
Russian Federation	59	3,63	4,87	4,30	5,02
Bulgaria	60	3,53	4,01	5,21	5,94
Croatia	68	3,63	4,58	4,41	5,78
Hungary	69	3,31	4,24	5,12	5,62
Romania	72	3,59	3,61	5,53	5,48
Ukraine	102	3,05	3,93	3,17	5,95

Source: Prepared by the author based on [World Economic Forum. Executive Opinion Survey, 2016].

As it has already been mentioned, one of the three main pillars forming the competitiveness index is the Basic requirements subindex, which consists of: Institutions, Infrastructure, Macroeconomic environment, Health and primary education. Table 3 presents the results for the Basic requirements index, with division into four main pillars distinguished in this index, for Poland, other countries of Central and Eastern Europe and the world leader.

The presented partial Basic requirements competitiveness index for Poland and other Central and Eastern European countries shows that, in this part of the world, the Institutions pillar is the one that is the most poorly assessed. This ratio received the lowest score in all countries in this part of Europe. The assessment of the Institutions pillar for Poland reaches the level of 3.99 with the maximum score being 7. Therefore, this is an area that requires improvement. Estonia, the Czech Republic, Lithuania, and Latvia recorded results better than Poland in this segment. Table 4 presents the exact areas under assessment within Institutions in Poland.

**TABLE 4.**
**Institution index in detail – Poland**

Institutions	Rank – Poland	Value <sup>1</sup> Poland – 4,0
Property rights	74	4,2
Intellectual property protection	72	4,1
Diversion of public funds	54	3,9
Public trust in politicians	104	2,4
Irregular payments and bribes	39	4,8
Judicial independence	81	3,8
Favoritism in decisions of government officials	75	3,0
Wastefulness of government spending	84	2,9
Burden of government regulation	119	2,7
Efficiency of legal framework in settling disputes	73	3,5
Efficiency of legal framework in challenging regs	102	3,0
Transparency of government policy making	109	3,6
Business costs of terrorism	54	5,5
Business costs of crime and violence	51	5,0
Organized crime	51	5,2
Reliability of police services	84	4,1
Ethical behavior of firms	60	4,0
Strength of auditing and reporting standards	47	5,0
Efficacy of corporate boards	47	5,1
Protection of minority shareholders' interests	67	4,1
Strength of investor protection	49	6,0

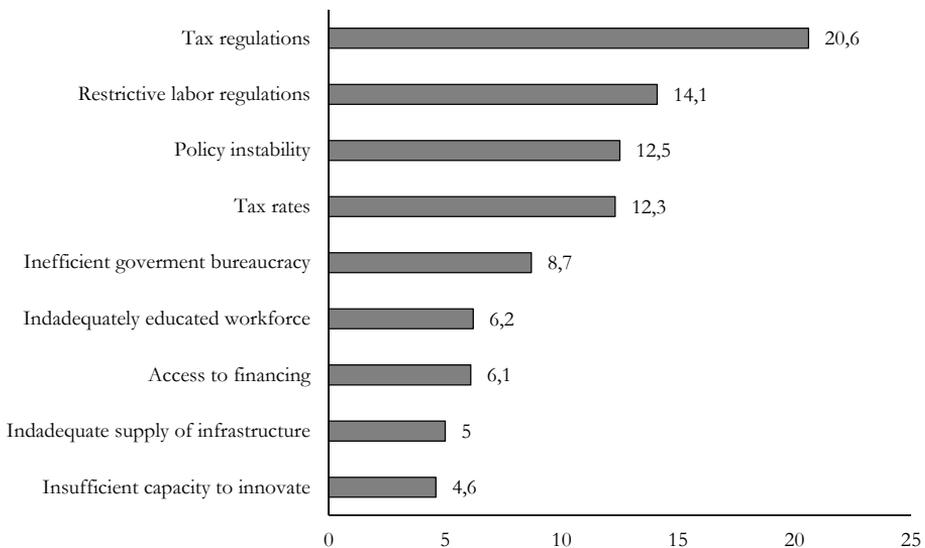
Source: Prepared by the author based on [World Economic Forum. *Executive Opinion Survey*, 2016].

<sup>1</sup> Values are on a 1 to 7 scale, only *strength of investor protection*: value are on 1 to 10.

At this level, the assessment of institutions is very general and it is worth delving deeper into the structure of this competitiveness index and taking a closer look at institutional factors, which constitute an element subject to evaluation. The report assesses formal institutional factors, and does not examine informal factors, such as culture, faith, customs, etc. (see: Table 4).

High scores were given to strength of investor protection, business costs of terrorism, organized crime, efficacy of corporate boards, strength of auditing and reporting standards. The lowest scores were given to the areas such as: public trust in politicians, burden of government regulation, wastefulness of government spending, and favoritism in decisions of government officials.

**FIGURE 2.**  
**Most problematic factors for doing business in Poland**



Source: Prepared by the author based on [*World Economic Forum. Executive Opinion Survey, 2016*].

These weaker results in the area of Institutions are confirmed by the following comparison where the respondents indicated the most difficult areas in the conduct of economic activities in Poland. The greatest problems for business are tax regulations, restrictive labor regulations, policy instability, tax rates and others (see: Figure 2). These indications concern institutional factors. The tax law lacks stability and simple solutions.

## 5. Conclusions

The choice of location for running business by foreign entities is determined by social, economic, political, and cultural factors. The attractiveness of Poland as compared to other destinations in Central and Eastern Europe for business service centers is confirmed by the most recent market research of offshoring services. Poland is the most appealing location in this part of the world. In the research conducted among foreign companies providing services for business in Poland [ABSL, 2016, p.], the choice of Poland as the location is determined mainly by the - very important for this type of companies – labour market of employees with university degrees, who are competent and speak foreign languages. The second important factor is the good infrastructure in the broad understanding, i.e. transport infrastructure, office areas, etc. Another strength is the great number of cities prepared for this type of investments, and their positive approach to investors. The conducted analysis of institutional factors is only a fraction of the entire analysis of offshoring decisions. When examining institutional factors, namely the formal ones, we can see that our country does not reach the standards of other countries in this region. Nowadays, Estonia, Latvia, Lithuania, and the Czech Republic create better institutional conditions. Competitiveness of economies of the aforementioned countries (apart from Latvia) is also given higher rates than the competitiveness of Poland. It can be thus assumed that institutionality is important for offshoring decisions, and the obtained institutional effectiveness in Poland is at a satisfactory level for foreign investors for now. This may, however, change very soon. The institutional system in Poland requires further modifications leading to its greater effectiveness.

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