Essay on Development Policy

Supporting the Outsourcing Sector – a Silver Bullet against Kosovo’s Youth Unemployment Crisis?

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Abbreviations

EU European Union
ICT Information and Communication Technology
BPO Business Process Outsourcing
KPO Knowledge Process Outsourcing
ITO Information Technology Outsourcing
ITES Information Technology-Enabled Services
OECD Organization for Economic Co-operation and Development
CEFTA Central European Free Trade Agreement
NEET Young People who are not in Employment, Education or Training
NGO Non-Governmental Organization
CSO Civil Society Organization
1 Executive Summary

Kosovo’s economy is not strong enough to create sufficient employment possibilities for the large number of young people graduating annually from universities, vocational and regular schools. In order to fight the current extreme levels of youth unemployment, a number of development projects from various donors are focusing on job creation and the strengthening of economic subsectors. Business services outsourcing is hereby believed to be one of the most promising sectors to generate large numbers of jobs for young people and has therefore gained a lot of attention and attracted substantial development funds. But can it really act as some kind of silver bullet for the Kosovar unemployment crisis?

This essay tries to investigate this question by explaining the various types of outsourcing activities and then discussing the factors that make a destination attractive to foreign investors and businesses. Through a detailed comparison with two of the classic outsourcing destinations, Poland and the Philippines, it assesses the potential of Kosovo to become a future hub for internationally operating companies. The analysis of the different criteria shows that the country has indeed a few advantages on its side, but is, at the same time, missing some crucial elements.

The Polish outsourcing industry is mainly driven by large numbers of well-educated young academics with good language skills, still comparably low wages and the perfect location of the country in the heart of Europe. The EU membership brings political and economic stability and easy access to one of the largest markets in the world. Solid infrastructure completes the good profile of Poland. In the Philippines, the outsourcing sector profits from historically close ties to the USA and Spain, as well as strong English language capabilities of the population. Even though the average infrastructure of the country is lacking behind and the business climate is not very favorable, the government has successfully supported the creation of economic zones with higher standards, as well as a more attractive investment climate. Another favorable factor is the good internal organization of the Philippine outsourcing sector through a national association, which is lobbying at the highest levels.

In Kosovo however, the general investment climate is not yet attractive enough and the uncertain economic and political situation represents a high risk for businesses. Economic zones with special regulations are planned, but the implementation lacks behind. No business service outsourcing association is in place to organize the sector and represent it on a national level. On the other hand, there is a large number of young talents with solid education, strong language skills and relatively low wage expectations. Plus, the country’s geographical and cultural proximity to the EU turns it into an interesting candidate.
From a development perspective, it makes sense to support the business outsourcing sector, as long as there is a strict focus on sustainability and systemic change. Potentially large numbers of jobs could be created, alleviating the migration pressure for young Kosovars. A growing outsourcing sector not only creates jobs directly, but can also lead to spillover effects in other sectors such as retail, education or facility management. While the most basic types of outsourcing, such as call center and customer services, are generating the highest number of jobs, it is important to keep in mind that young people not only need short-term income, but also long-term career opportunities. This means, they should be exposed to challenges in their daily work to improve their skills and have the possibility to be promoted and advance in their professional path.

The risk of upcoming disruptive changes to the sector due to artificial intelligence and increased automation should not be taken lightly and therefore it is recommended to work on economic development with a broader strategy rather than only supporting individual sectors with limited-impact interventions. The workforce needs to be able to acquire advanced skills that can be used for various professional activities, this would potentially increase the robustness of the whole Kosovar economy.
The Economic Situation in Kosovo

Since the war just before the turn of the millennium, Kosovo has continuously faced major economic problems. They include but are not limited to high unemployment rates especially among young people, low labor participation, a weak and relatively small manufacturing sector, large negative net exports and low levels of investment of both local and foreign capital (MTI, 2014). (European Comission, 2016). Even though the economy recently is showing signs of recovery, they are not sufficient to close the development gap to the other countries of the Balkans region and to tackle the aforementioned underlying issues (European Comission, 2016).

To be able to deal with these problems in a more inclusive way, the government of Kosovo has committed itself to a “National Strategy for European Integration 2020” in 2013. It has the ultimate goal of preparing the country for a European Union (EU) membership and includes, among others, the priority objective of fostering economic development. Good economic governance, competitive market circumstances, a favorable investment climate and free movement of people are necessary to achieve this ambitious objective. Unfortunately, so far none of those four goals have been met. Kosovo needs to be able to ensure a sustainable macro-fiscal environment, become more attractive for domestic and foreign investments and provide much better access to financing for the private sector. The current pace of growth is not enough to meet the needs of the country on its way to become a competitive market economy (National Council for European Integration Kosovo, 2013). Looking only at macro data leads to the belief, that the economy is making good progress, since it has been growing rather strongly over the last decade. This growth however, has mainly been driven by remittances coming from the large Kosovar diaspora and huge sums of foreign aid money that have been pouring into the country. But even with such strong outside factors, the economy couldn’t manage to maintain a more robust job creation, which is very problematic (Cojocaru, 2017).

Despite all these difficulties, the Kosovar economy is still believed to have the potential for growth and sustainable development. The country has several comparative advantages for attracting domestic and foreign investments and increasing export: a young and relatively well educated labor force, unused natural resources, agricultural land of good quality as well as a central location in the Balkans and in Europe with the potential access to regional and EU markets (National Council for European Integration Kosovo, 2013).
2.1 Unemployment

Being one of the youngest countries in Europe, both in respect to the declaration of independence just ten years ago\(^1\) and to the low average age of its population, with an increasing share of people in the working age, Kosovo in theory has a demographic bonus that offers opportunities and potential. The share of young people under 15 consists of almost 26 percent of the population, while the working age group, ranging from 15 to 64 years, accounts for another two thirds (Cojocaru, 2017). But according to the latest results of the Kosovo Labor Force Survey, carried out during the fourth quarter of 2017, the overall unemployment rate lies at an extreme level of 30.6%. The peak of unemployment can be found within the age group of 15 to 24 years, where 55.9% don’t have a job. Another result of the survey shows, that 57.1% of the potential labor force is not even active on the job market due to a lack of employment opportunities, with an alarming peak of 80.1% among females, compared to 34.3% of males (ASK, 2017). The small domestic market and limited integration are important constraints to growth in the job market and a poor business and regulatory environment fosters informality and impedes the growth of firms and the productivity of capital and labor resources. On the other hand, the low quality of education and mismatches between skills supply and demand prevent the inactive part of the labor force from obtaining and retaining good jobs. The chances of transitioning from unemployment to employment are rather slim in Kosovo (Cojocaru, 2017).

Unemployment and inactivity are also among key risks and they lead to youth disenfranchisement and fragility. The recent “Kosovo Risk and Resilience Assessment” found that the economic exclusion of youth has led to political tensions and violence when mixed with the ethnic and political dimensions of the region (World Bank Group, 2017a). Migration to other countries in Europe and further abroad driven by unemployment has been a prominent feature of Kosovo’s economy since decades. An estimated 400,000 people born in Kosovo are living abroad and an additional 300,000 were born outside Kosovo, but have at least one Kosovar parent. The large majority of emigrants from Kosovo go to the German speaking parts of Europe, their remittances are a crucial part in supporting family members who remain in Kosovo, as well as financing consumption that supports the growth of the economy (World Bank Group, 2017b).

2.2 Economic Sectors with Potential

Several sectors of the Kosovar economy have been identified as having the potential for strong growth and job creation. The selection includes some manufacturing sectors (wood, metal, textile), food

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\(^1\) Kosovo declared its independence from Serbia on February 17, 2008 and as of today has received 114 diplomatic recognitions as an independent state (Ministry of Foreign Affairs Kosovo, 2018).
production, tourism and last but not least the outsourcing of business processes and services, especially in combination with modern information and communication technology (ICT) (USAID, 2015). As other countries such as Bulgaria or Estonia have shown, the ICT industry and with it the outsourcing sector, can have the potential to be a trigger for economic development, job creation and income generation (STIKK, 2015). Creating jobs in the sector and attracting foreign companies to invest in outsourcing relies on a set of preconditions. The sector is usually labor and skill intensive and requires a well-educated labor force, good infrastructure and targeted policies. Section 3 of this Essay looks at the question whether Kosovo is able to live up to these requirements and what can possibly be done to improve the current situation.

3 Service and Process Outsourcing

Rapid developments in ICT and an increased level of internationalization have transformed the way, in which modern businesses operate. Instead of working towards capacity building within the company, it is now very common to outsource more and more processes and services to third-party providers that are specialized in one or more areas. This should allow a more flexible and innovative way of doing business and, in most cases, lead to better cost-effectiveness and to quicker adaptation of modern methods and standards.

3.1 Types of Outsourcing

The providers can be located in the same country (onshore outsourcing), in a country nearby (nearshore outsourcing) or anywhere in the world (offshore outsourcing). Services or processes that are outsourced can either be of more generic nature and not related to the core business of the company, in which case we talk about horizontal activities. As Figure 1 illustrates, three categories of outsourcing services can be distinguished within such horizontal activities, which go far beyond the classic example of a simple call-center (Gereffi & Fernandez-Stark, 2010):

- Business Process Outsourcing (BPO), involves contracting out of operational functions to a third party service provider
- Knowledge Process Outsourcing (KPO), describes the outsourcing of core information-related business activities
- Information Technology Outsourcing (ITO), is a company's outsourcing of computer or Internet related work, such as programming, to other companies

While BPO are typically of lower added value and mainly based on simple skills or tasks and large manpower, KPO and ITO are usually services of higher added value and require more specific skills from the employees of the service provider. BPO is also defined as a subset of outsourcing that
involves the contracting of the operations and responsibilities of a specific business process to a third-party service provider. Because outsourcing often depends on necessary technology and infrastructure that allows external companies to efficiently perform their roles, it’s frequently referred to as Information Technology-Enabled Services (ITES or IT-BPO). Another distinction within BPO can be made between Back Office Outsourcing, referring to a company’s core business operations such as accounting, payment processing, ICT services, human resources, regulatory compliance and quality assurance, as well as Front Office Outsourcing, which includes customer-related services like contact center services, tech support, inbound and outbound sales, trading and marketing (Gereffi & Fernandez-Stark, 2010).

If the outsourcing tasks are more industry-specific and require more distinct expertise to be performed, they are called vertical activities. Figure 2 gives an overview of typical industry sectors that rely more or less heavily on outsourcing activities. Obviously the labor force of the outsourcing destination needs to be ready to deal with the increased requirements of such activities, as they are not as repetitive and general as in the horizontal case.

Figure 1: Horizontal outsourcing services, not industry specific (Gereffi & Fernandez-Stark, 2010)
While the potentially significant advantages of cost reduction, improved flexibility and quality can be drivers for extensive outsourcing in the modern business world, there can also be disadvantages for a company. A business that outsources its processes may be prone to data breaches, communication issues that delay project completion, underestimating running costs and overdependence on BPO providers (Gereffi & Fernandez-Stark, 2010).

3.2 Factors for Strong Outsourcing Sector Growth

What makes an outsourcing destination attractive to foreign businesses? The discussion of the most important factors that influence the decision of an internationally operating company on where to outsource their services and processes to is broad, and these factors are manifold. Not only the expected cost savings are making a location attractive, but also the availability of well-educated employees or the overall economic and legal situation have to be taken into account. Only if a combination of those factors make a destination more attractive to an interested company than what can be provided in-house or onshore, it will be willing to outsource its operations.

The A.T. Kearney’s Global Services Location Index is advertised as one of the leading measurement tools to define the potential of a country to become an outsourcing destination. Because of its broad scope it is used as a main reference and inspiration for this report. First, for the selection of the analyzed countries (see Chapter 4) and second, as basic framework for the direct comparison between them (see Table 1). The A.T. Kearney index is evaluated against 38 measurements across three major categories: financial attractiveness, people skills and availability, and business environment. Because cost advantage is typically still the primary driver behind location decisions, financial factors constitute
40 percent of the total weight in the index, while the two other categories each constitute 30 percent (A.T. Kearney, 2005).

In terms of financial attractiveness, the employee’s wages are probably the most important cost factor. Since the operations that are being outsourced are usually quite labor intensive, it is understandable, that companies prefer to outsource their operations to relatively low income countries, as long as the quality of the workforce is still acceptable. Other possible benefits can be gained in the area of infrastructure costs, where for example the prices for offices, electricity and transportation are usually cheaper in emerging economies. On the regulatory side, the tax burden is certainly the central cost driver, but also issues like costs of corruption or exchange rate fluctuations have to be considered (A.T. Kearney, 2017).

Looking at the skills of the labor force, there is the factor of general educational quality at all levels. Apart from that, some skills are more important for the sector than others, like languages, accounting or managerial skills and ICT. That must be reflected well in the education and certification of the labor force. In terms of availability, the number of potentially available employees, mostly enrolled in tertiary education, must be compared with an estimate of the maximal size of the outsourcing sector (A.T. Kearney, 2017).

The third main category of measurements concerns the overall business environment. It includes many factors like the political situation in a country, the economic stability, the administrative burden to open up a new business, the regulatory framework and the reliability of authorities. Additionally, the availability of financing opportunities through loans or banks and the securities for foreign investment are important measurements. Not only the costs but also the quality of the local infrastructure is crucial, telecommunication, electricity, roads, accommodations and much more. Apart from the geographical location, which might be close or far away from the company’s country of origin, there are also a set of cultural characteristics that are crucial for a good and reliable business environment. Finally, the level of organization within the outsourcing sector in the target country is important. Already established associations and other formal clubs make sure that the sector speaks with one voice when it comes to discussing issues like taxes and regulations with policy makers (A.T. Kearney, 2005).

4 Characteristics of Successful Outsourcing Destinations

After having looked in detail at the specifics of the outsourcing business and at different criteria that make a country and its economy a good location for outsourcing, it is time for good practice examples to learn from. Poland and the Philippines have been very successful in promoting their outsourcing capacities in the recent past and have become two of the world’s main hubs for business outsourcing
(A.T. Kearney, 2017). How did they manage to get there? What types of outsourcing businesses could they attract and which criteria were key to their success?

Poland is located in central Europe and a typical example of a nearshoring country, while the Philippines are in a very different geographical context and their main focus lies on offshoring activities. It will be interesting to see if any conclusions can be drawn from these examples to the current Kosovar situation and if it is possible to derive some strategic recommendations.

4.1 Poland

Over the last years, Poland has become one of the top destinations for outsourcing, being in or close to the top ten of A.T. Kearney’s Global Services Location Index for the third time in a row (see Figure 3). The reason for Poland’s success lies in its great value proposition in terms of its qualified and multilingual workforce, low labor and other costs, relatively low risk of doing business and a geographical location at the heart of Europe (Budzyńska, 2016). No other country in the region has so far managed to match the Polish offer for service delivery in the nearshore business (ABSL, 2017). Nearshore locations provide outsourcing work for companies that conduct business in neighboring nations and this proximity allows the nearshore workers to develop a better understanding of client needs. Poland, like many nearshore countries, focuses primarily on finance and accounting work (A.T. Kearney, 2017).

Outsourcing is one of the most dynamic sectors of the Polish economy, growing at a double-digit rate each year. This has led to the situation that Poland is currently the largest outsourcing market in Europe and one of the top players in the world (Ministry of Treasury Republic of Poland, 2013). The number of jobs at business services centers in Poland grew by 15% in 2016 alone and the sector has
become one of the largest employers in the country (Polish Information and Foreign Investment Agency, 2016). 748 business services centers owned by 524 foreign companies employ as many as 198,000 people. This means that foreign investors account for 81% of the jobs in the sector, managing the vast majority (69%) of the business services centers (ABSL, 2017).

4.1.1 Financial attractiveness

The gross average income per capita in Poland is USD 1057 per month, which ranks the country in the lower half of the European Union. Although this means that there are a few cheaper countries in terms of salaries in the EU alone, the number is still significantly lower than in the economic powerhouses of the EU, such as Germany, France or the United Kingdom, where income per capita is USD 3000 or more in gross average (World Bank Group, 2016). The Ministry of Economy estimates that labor costs in Poland are roughly 30-60% lower than in the old EU member states (Ministry of Treasury Republic of Poland, 2013).

Apart from these relatively low labor costs, the government is eager to offer an extensive range of financial incentives to the outsourcing sector. Direct governmental grants for new investments and the creation of new jobs, tax allowances in Special Economic Zones, co-financing of investments in research and development infrastructure of enterprises, tax allowance for research and development activities and real estate tax exemption are offered to interested parties (ABSL, 2017).

4.1.2 People skills and availability

An important factor for the Polish success is the significant depth of talent the country can offer, it is unmatched in central eastern Europe (A.T. Kearney, 2017). Each year, more than 400’000 graduates leave the higher education system, which is the target entry-level demographic for the outsourcing sector. This makes Poland one of the largest talent pools in the region (Ministry of Treasury Republic of Poland, 2013). The most sought after knowledge of employees on the Polish job market are language skills, a requirement which matches well the multilingual abilities of the local workforce (Budzyńska, 2016). As we have seen in section 3, skills other than languages that are important for the outsourcing sector include management skills, accounting and ICT. Looking at the over 200’000 students who are enrolled in topics related to business and administration as well as the almost 55’000 ICT students per year, it’s not difficult to understand the huge potential in Poland (ABSL, 2017).

The working conditions in the outsourcing sector are usually quite good, but what the sector offers to potential employees goes beyond the often permanent employment contracts or salaries above the national average. Almost more important for young employees is a clear career path and great opportunities for further development (Polish Information and Foreign Investment Agency, 2016).
4.1.3 Business environment

Probably the most important factor that shapes Poland’s business environment is the membership in the European Union (Budzyńska, 2016). As a member of the EU, Poland can offer more political and economic stability and protect intellectual property rights better than other big outsourcing nations like China or India, making it a very reliable partner for outsourcing (Ministry of Treasury Republic of Poland, 2013).

The World Bank ranks Poland as 27th in their most current “Doing Business” report (2018), which is a solid rank at about the OECD high income countries average, significantly better than potential competitors for nearshoring in the region within the EU, like Hungary (rank 48) or Bulgaria (50), or outside the EU, like Ukraine (76). In the World Economic Forum’s “Global Competitiveness Index 2017-2018” (2018), Poland ranks as 39th, the report mentions the tax regulations and rates, restrictive labor regulations and political instability as the most problematic factors for doing business.

4.2 The Philippines

The Philippines are another example of a country that succeeded in developing a large business service export industry in the 2000s. In the past few years it has outperformed most countries in outsourcing industry growth. The Philippines has established itself as a top destination for outsourcing services, in particular for contact or call centers, which dominate the Philippine outsourcing industry, followed by knowledge process outsourcing, information technology outsourcing and animation (Errighi, et al., 2016), (Mitra, 2011). The Philippines even managed to overtake India in terms of call center industry employees and revenue as of 2010 and 2011 and have become the number one voice services center in the world. The local outsourcing industry has a current total annual revenue of about 23 billion USD (Remulla & Medina, 2012), (Gonzales, 2018).

The country has already been a top runner in the A.T. Kearney Global Services Location Index when it was first published in 2005 (see Figure 3) and has since managed to hold that position (A.T. Kearney, 2017). Main factors driving and constraining the Philippine outsourcing industry are, very similar to the Polish case, access to educated human resources, financial attractiveness and costing advantages, the level of infrastructure and modern technology as well as favorable legal and regulatory developments. These factors have made the country a prime offshoring destination (Mitra, 2011).

4.2.1 Financial attractiveness

The gross average income per capita in the Philippines is USD 298 per month, ranking it in the lowest third of the countries in the East Asia & Pacific region, but on a similar level with countries like Indonesia, Vietnam or Thailand (World Bank Group, 2016). On a global scale and especially compared
to high income countries, such income levels offer potential savings in labor cost that are extremely attractive to a company looking for outsourcing possibilities. A rise in foreign direct investment has enabled rapid development of the outsourcing industry. For companies wishing to expand their operations in the Philippines financing has typically not been a principal impediment (Mitra, 2011).

4.2.2 People skills and availability

The Philippines have a large pool of young people with higher education - more than a quarter of holds a tertiary degree - and strong English language capabilities, a native advantage in terms of human resources (Errighi, et al., 2016). Due to the history of the Philippines the people are familiar with multiple cultures such as the Spanish and the US-American, for the same reason they have usually very good language skills (Tschang, 2016), (Mitra, 2011). The Philippines are even considered to be the third largest English-speaking country in the world (IBPAP, 2018).

In the academic year 2015-16, almost 650’000 students graduated from higher education, with close to a third of them having studied business administration or related topics and around 77'000 information technology (Commission on Higher Education of the Philippines, 2017).

The Philippine work force has gained a reputation for being flexible, productive, loyal, dedicated and with key strengths in terms of work ethics, attention to detail and ability to communicate and take initiatives, combined with an overall service culture mindset (Mitra, 2011).

4.2.3 Business environment

The World Bank ranks the Philippines as 113th out of 190 countries in their most current “Doing Business” report (2018), which is not very impressive. Potential competitors in the region, like Indonesia (rank 72) or even Thailand (26) and Malaysia (24) are far better ranked. In the World Economic Forum’s “Global Competitiveness Index 2017-2018” (2018), the Philippines rank as 56th, the report mentions the country’s inefficient government bureaucracy, inadequate supply of infrastructure and corruption as the most problematic factors for doing business.

The Philippine government has undertaken a series of regulatory and legal reforms directly facilitating outsourcing industry development (Mitra, 2011). In terms of capital-related policies, there are simplified regimes for customs, import and export procedures in place, and duty-free importation of capital equipment is possible. On the operation-related side, exemptions on local taxes and permits, as well as VAT can be made and in special cases, a four-year exemption from corporate income tax is possible, extendable up to eight years, with the option to pay a special 5% tax on gross income after (IBPAP, 2018).
In the most current Philippine Development Plan PDP 2017-2022, the government plans to further work towards a better investment climate for foreign businesses by lowering capital requirements and aligning guidelines, to pass an act to improve the ease of doing business and to invest on infrastructure improvement (National Economic and Development Authority, 2017). Other important steps to improve the business environment for outsourcing have already been taken. Since the deregulation of the telecommunications industry in 1993, the Philippines has developed globally competitive ICT infrastructure, with two fiber-optic networks covering most regions of the country (Errighi, et al., 2016). Export-oriented industrial parks or their equivalents provide land, physical infrastructure and special incubator facilities. Industrial parks in major cities serve as magnet not only for foreign and local corporate investments but also in terms of attracting manpower from different parts of the country (Mitra, 2011). The Information Technology and Business Processing Association of the Philippines (IBPAP) and other industry association are lobbying for legislative measures aimed at strengthening the sector further such as (IBPAP, 2018):

- upgrading standards and accreditation to ensure a better match between the skills of graduates with the requirements of the industry;
- marketing the industry more aggressively to the local talent pool;
- strengthening awareness of the country’s competitive edge in ICT, voice and non-voice BPO services in existing and new markets;
- advocating high-impact public policies;
- strengthening BPAP’s Public-Private Partnership with government to fund key programs such as study-to-work training programs.

4.3 How about Kosovo?

As described under section 2.2 of this essay, outsourcing of business processes and services has potential for growth and employment generation in Kosovo. The country’s demography and an already growing ICT sector are good preconditions. Kosovo would be ideally suited as a nearshoring destination for European Businesses due to its geographic and cultural proximity as well as solid foreign language capabilities among the labor force. Especially the good German language capabilities are an important competitive advantage with regards to the markets of Germany, Switzerland and Austria (STIKK, 2017). In combination with the strong ties with the large diaspora mainly in the German speaking countries of Europe could be used as a driver for the outsourcing sector (Hunya, 2017). If business people with a local background living abroad see the potential for promising investments in Kosovo, they are more likely to take the risk. This is already happening, as individual examples of
successful diaspora entrepreneurs show. However, this could be done on a much bigger scale if the economic and regulatory preconditions in the country were better. The formation of an official body, like an association would be of great help to give the sector more visibility and to speak in one unified voice.

There is no official data published on the number of companies already operating in the outsourcing sector, but estimates go from 50 up to 220 in 2014, numbers which probably have seen an increase since then (MTI, 2014), (USAID, 2015).

Some of the main issues in Kosovo are:

- Inadequately educated workforce (Cojocaru, 2017)
- Lack of proactive product development as well as research and development (USAID, 2015)
- Only few foreign investors and company owners (MTI, 2014)
- Companies lack dedicated marketing resources (USAID, 2015)
- Lack of connections to foreign partners/buyers (USAID, 2015)
- Tax system not well balanced to attract investors (Shaipi & Xërxa, 2014)
- Weak rule of law and contract enforcement (Hapçiu, 2017)

4.3.1 Financial attractiveness

Labor costs in Kosovo are significantly lower compared to the vast majority of European countries. The gross average income per capita in Kosovo is USD 321 per month, in Europe only in the Ukraine has a lower value (World Bank Group, 2016). This could be a very attractive setting for outsourcing business activities from a financing point of view.

From 2011 to 2015, 270 million Euros in total or around 142 Euros per capita have been invested from outside the country in average per year, with about a third of it flowing into real estate (KIESA, 2016). However, the Kosovar government has so far not managed to incentivize increased foreign investments into the outsourcing sector, there are no special investment programs or taxation regimes in place. A common strategy with a clear systematic approach to promote FDI and the outsourcing sector is missing, as well as initiatives like special industrial zones with financial incentives for IT related businesses or similar (Shaipi & Xërxa, 2014), (STIKK, 2015).

4.3.2 People skills and availability

Kosovo has 20 higher education institutions per 1 million inhabitants which greatly exceeds the EU average and 6,669 students per 100,000 inhabitants, which is nearly double the EU average. However, all research in Kosovo indicates that there is a major disparity between the supply of higher education system and labor market demands. Regardless of the high unemployment rate, in general employers
struggle to find qualified personnel for open positions in almost every sector and industry in Kosovo. The lack of skills is a problem for the private sector even for occupations which are theoretically oversupplied by the education system, like it is the case with economists or lawyers. Missing skills or skills mismatch lower the productivity of a worker and forces the companies to further train their employees on the job. There are two different types of skills mismatch, first, the one that is caused by a wrong study topic selection and second, the one that is caused by outdated or incomplete curricula. Both of course reduce the cost benefits and through that the motivation for foreign investors to come to Kosovo, especially when looking at the outsourcing sector (MEST, 2017), (Hapçiu, 2017).

Even though there have been reforms, the education system in Kosovo is still not able to match the demand of the private labor market. A main driver for higher education institutions to allocate their resources seems to be the number of people interested in a specific topic rather than the capacity needs of the market (Hapçiu, 2017).

4.3.3 Business environment

Kosovo is a member of the Central European Free Trade Agreement (CEFTA), a free trade agreement between currently seven states in the Western Balkans. But these states are all in a similar situation to Kosovo and certainly not the ones where interesting investments are coming from or where services could be exported to in a large scale. Kosovo it has certain privileged access to the markets of the EU, US and Turkey, however the ultimate goal for true European market integration would be a full membership in the EU (USAID, 2015). In terms of exporting and providing nearshoring services, the lack of visa liberalization with the European Union through the Schengen scheme has been reported as a major obstacle for companies (STIKK, 2017), (Hapçiu, 2017).

The World Bank ranks Kosovo as 40th out of 190 countries in their most current “Doing Business” report (2018), which is quite a good result considering the difficult political and regulatory situation the country is still in only ten years after declaring its independence. The competition in the region however is strong, with some nations like Bulgaria (rank 50), Albania (65) or Bosnia & Herzegovina (86) clearly running behind Kosovo, but also a clear top performer with Macedonia (11). The report mentions Kosovo as one of the top ten economies showing the most improvement on the “Doing Business” indicators and a special section praises the country’s reform of the insolvency framework (World Bank Group, 2018). The World Economic Forum unfortunately doesn’t have any specific data on Kosovo in the “Global Competitiveness Index 2017-2018” (2018).

Although the government is planning a number of additional reforms to improve the situation for the outsourcing sector, much of it remains patchwork and a clear vision and the willingness to go through this reforms is missing. In terms of infrastructure, Kosovo is in a comparatively good state and
competitive on a regional level. Internet connectivity and penetration are even above the regional average, while lots of high quality office space is available (STIKK, 2017).

4.4 Comparison Table

Table 1 provides a detailed and direct comparison of the most important location factors for choosing an outsourcing location between Poland, the Philippines and Kosovo. The selection of factors was done by the author, inspired by the A.T. Kearney Global Services Location Index and the BPO and Shared Service Location Index developed by Cushman & Wakefield, which is an American commercial real estate services firm (A.T. Kearney, 2005), (Cushman & Wakefield, 2015). The country-specific content has been systematically collected from multiple sources, as referenced in the boxes.

<table>
<thead>
<tr>
<th>Financial Attractiveness</th>
<th>Location Factors</th>
<th>Poland</th>
<th>Philippines</th>
<th>Kosovo</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average wages (USD per month)</td>
<td>1057 (2016, WB)</td>
<td>298 (2016, WB)</td>
<td>321 (2016, WB)</td>
<td></td>
</tr>
<tr>
<td>Infrastructure costs</td>
<td>- Office market is the most dynamically developing in Central and Eastern Europe (ABSL, 2017)</td>
<td>- Rental costs are competitive (Lee, et al., 2014)</td>
<td>- Expensive electricity for companies due to subsidies for households (DHinfrastructure, 2011)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- unreliable and expensive electricity supply, highest prices for electric power in Southeast Asia (Lee, et al., 2014)</td>
<td>- Internet usage costs competitive internationally (STIKK, 2015)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Travel costs</td>
<td>Low (Europe) High (Asia, Americas)</td>
<td>Low (Asia) High (Europe, Americas)</td>
<td>Low (Europe) High (Asia, Americas)</td>
<td></td>
</tr>
<tr>
<td>Tax incentives for FDI</td>
<td>Yes, extensive range of incentives are available (ABSL, 2017)</td>
<td>- Yes, several different schemes available (Lee, et al., 2014)</td>
<td>Not available at the moment, but tax incentives and tax breaks for foreign investors should be in preparation (KIESA, 2016)</td>
<td></td>
</tr>
<tr>
<td>FDI in current USD (average from 2012-2016)</td>
<td>11’950 million (WB)</td>
<td>5’262 million (WB)</td>
<td>289 million (WB)</td>
<td></td>
</tr>
<tr>
<td>FDI in current USD per capita (average from 2012-2016)</td>
<td>315 (WB)</td>
<td>52 (WB)</td>
<td>160 (WB)</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>People Skills and Availability</th>
<th>Poland</th>
<th>Philippines</th>
<th>Kosovo</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unemployment (% of total labor force)</td>
<td>6.2 (2016, WB)</td>
<td>2.7 (2016, WB)</td>
<td>27.5 (2016, WB)</td>
</tr>
<tr>
<td>Youth unemployment (ages 15-24, in %)</td>
<td>17.7 (2016, WB)</td>
<td>7.7 (2016, WB)</td>
<td>52.4 (2016, WB)</td>
</tr>
</tbody>
</table>
### Tertiary enrollment (% of total population)

- **Poland**: 68 (2014, WB)
- **Philippines**: 36 (2014, WB)
- **Kosovo**: 37 (Denver University, 2018)

### Skills mismatch

- Overeducation is highly persistent (Kiersztyn, 2013)
- Downward trends in over- and undereducation in Poland (ILO, 2014)
- Increasingly difficult to fill vacancies due to lack of qualifications (Errighi, et al., 2016)
- Mostly college graduates entering the sector (Errighi, et al., 2016)
- Education remains too theoretic, not matching the labor market needs (Hapçi, 2017)
- Linkages between education, vocational training and labor market needs are weak (Hapçi, 2017)
- Oversupply in a number of industries or professions, significant shortages in other professions (Hapçi, 2017)

### Language capabilities

- **Poland**: Acceptable, lower half in the EU (Eurostat, 2015)
- **Philippines**: Very good for English (Errighi, et al., 2016)
- **Kosovo**: Good for German, English (STIKK, 2017)

### Business Environment

<table>
<thead>
<tr>
<th>Poland</th>
<th>Philippines</th>
<th>Kosovo</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Business Regulation</strong></td>
<td>Good</td>
<td>Bad</td>
</tr>
<tr>
<td><strong>Economic Growth</strong></td>
<td>Fair, GDP growth around 2.5% over the last 5 years (WB)</td>
<td>Strong, GDP growth around 6.5% over the last 5 years (WB)</td>
</tr>
<tr>
<td><strong>Political Stability</strong> (Estimate of governance from -2.5 to +2.5)</td>
<td>Good: 0.85 in average over the last 5 years (WB)</td>
<td>Very weak: -1.03 in average over the last 5 years (WB)</td>
</tr>
<tr>
<td><strong>Foreign Investment Regulation</strong></td>
<td>Among the most attractive countries for FDI in Europe (EY, 2017)</td>
<td>Restrictive economic provisions of the Constitution, as well as pertinent laws, rules, and regulations (National Economic and Development Authority, 2017)</td>
</tr>
<tr>
<td><strong>Cultural Factors</strong></td>
<td>European values and culture, good for nearshoring</td>
<td>Strong cultural ties to US and Spain for historic reasons, good for offshoring from these regions (Mitra, 2011)</td>
</tr>
<tr>
<td><strong>Special Economic Zones</strong></td>
<td>Yes, 14 SEZ are currently operating in Poland (ABSL, 2017)</td>
<td>Yes, SEZ are well developed (Tschang, 2016)</td>
</tr>
<tr>
<td><strong>Organization level of sector</strong></td>
<td>Organized through association, Association of Business Service Leaders (ABSL)</td>
<td>Organized through association, Information Technology and Business Process Association of the Philippines (IBPAP)</td>
</tr>
</tbody>
</table>

---

### Notes

1. **Business Environment**
   - **Poland**: Good
   - **Philippines**: Fair
   - **Kosovo**: Fair

2. **Economic Growth**
   - **Poland**: Fair
   - **Philippines**: Strong
   - **Kosovo**: Fair

3. **Political Stability**
   - **Poland**: Good
   - **Philippines**: Very weak
   - **Kosovo**: Weak

4. **Foreign Investment Regulation**
   - **Poland**: Among the most attractive countries for FDI in Europe
   - **Philippines**: Restrictive economic provisions
   - **Kosovo**: Not yet attractive enough

5. **Cultural Factors**
   - **Poland**: European values and culture
   - **Philippines**: Strong cultural ties
   - **Kosovo**: European values

6. **Special Economic Zones**
   - **Poland**: Yes (14 SEZ)
   - **Philippines**: Yes (SEZ well developed)
   - **Kosovo**: 3 SEZ planned

7. **Organization level of sector**
   - **Poland**: Organized through association
   - **Philippines**: Organized through association
   - **Kosovo**: Not well organized
IT Infrastructure  | Good, Poland is among the largest investors in ICT infrastructure in the EU (Sörvik & Kleibrink, 2016)  | IT Infrastructure is competitive, at least in major cities (Errighi, et al., 2016)  | Internet infrastructure on par with developing countries (STIKK, 2015)

General infrastructure  | - Good, approaching EU average (European Comission, 2018)  - “Dealing with Construction Permits” rank 41 (World Bank Group, 2018a)  - “Getting Electricity” rank 54 (World Bank Group, 2018a)  - “Registering Property” rank 38 (World Bank Group, 2018a)  | - Fair, but lags behind regional (Mitra, 2011)  - “Dealing with Construction Permits” rank 101 (World Bank Group, 2018b)  - “Getting Electricity” rank 31 (World Bank Group, 2018b)  - “Registering Property” rank 114 (World Bank Group, 2018b)  | - Partially underdeveloped, especially electricity supply (European Comission, 2016)  - Roads improved significantly (MEST, 2017)  - “Dealing with Construction Permits” rank 122 (World Bank Group, 2018c)  - “Getting Electricity” rank 106 (World Bank Group, 2018c)  - “Registering Property” rank 34 (World Bank Group, 2018c)


IP protection  | Good, being a member of the EU (European Union, 2018)  | Fair, Intellectual Property Rights Code in place since 1998 (Mitra, 2011)  | Fair, some progress, but significant further efforts are needed to reach EU standard (European Comission, 2016)

Table 1: Comparison of location factors for outsourcing in Poland, the Philippines and Kosovo (WB = based on World Bank data gathered from data.worldbank.org)

Some of the main enabling factors for Kosovo are assumed to be the low wages in the country, a general affinity to foreign languages among the work force and the geographical and cultural proximity to the European market. Main hindering factors are the low level of organization within the outsourcing sector, skills mismatch and the generally low political and economic stability in the country. Further details will be discussed in Chapter Fehler! Verweisquelle konnte nicht gefunden werden.

5 How can Development Cooperation support the Outsourcing Sector?

After the in-depth look at the potential of and requirements for successful outsourcing business and the comparison between countries in different situations, it is time to ask the question, how
development cooperation can effectively support the sector. Generally, but also specifically for the case of Kosovo, as a means to tackle the youth unemployment problem.

Capacity building and empowerment of beneficiaries are core tasks of international development and the strengthening of local competencies is crucial to any modern program approach trying to achieve true sustainability and systemic change. This is especially the case when trying to support a whole economic sector, like outsourcing, since that involves a large number of stakeholders with very different objectives and responsibilities and it needs all of them to be up to their tasks for the sector to function as a whole. For a systematic analysis of different dimensions of empowerment, this essay uses the metaphoric approach of the Capacity Development Butterfly, as illustrated in Figure 4 (Zimmermann, 2011).

5.1 The Capacity Development Butterfly

The four wings are representing the individual, the network, the organization and the system levels. The butterfly of empowerment orients itself on existing potentials and opportunities and of course, it can only fly, when all four wings are functional and moving in a harmonic and coordinated way. The four dimensions are not independent but ultimately depend on each other, both in terms of enhancement or constraint. The organizational development leads to empowerment at the moment when human resource competencies are strengthened, internal processes and structures are adapted, and relationships to other organizations are improved (SDC, 2006).

![Figure 4: Capacity Development Butterfly (Zimmermann, 2011).](image-url)
5.1.1 Human Resources Development

The purpose of the first capacity development dimension is to strengthen knowledge and competencies of the individuals and to encourage self-reflection. It should lead to clarity regarding claims, rights, obligations and responsibilities. The focus of interventions lies on coaching and training. This includes for example the working on values, motivation and strategies, but also the strengthening of key capabilities and skills. Teamwork, leadership and communications are other crucial topics for human resource development (SDC, 2006), (Zimmermann, 2011).

Looking at the factors that describe the Kosovar outsourcing potential in Table 1, it becomes clear that the skills mismatch is probably the main issue in terms of human resources development, as it is also described in more detail in chapter 4.3.2. Another factor that could be a target for an intervention are the 30.1% of young people who are not in employment, education or training (NEET). The question could be asked whether this is due to cultural factors, due to their motivation and work ethics, due to large amounts of remittances keeping them away from the labor market or if there are other reasons.

5.1.2 Organizational Development

The second dimension deals with the development of organizations, either from the private sector, civil society or the government. The purpose is to increase the capacity by learning and performing through commonly acquired experience and knowhow. Other goals include better adaptation to new responsibilities and forms of cooperation, development of the organization’s culture and enlargement of the potential for self-help. Interventions should focus on change management, which includes strategy development and PCM, knowledge management, as well as working on visions, goals, internal rules and structures (SDC, 2006), (Zimmermann, 2011).

NGO’s working in Kosovo, CSO’s, the Kosovar government and the private sector all seem to have the potential to increase their capacity through fostering a better learning and knowledge management culture. Interventions could focus on the facilitation of these processes. Clearer visions and goals should be formulated for the different actors and responsibilities would have to be accepted. Development projects should include organizational development as a cross-cutting topic for all partners in all their activities and especially the international organizations and NGO’s in the country would be well advised to lead the change by acting as positive examples.

5.1.3 Development of Cooperation Systems

In the third dimension, it’s all about cooperation and the development of networks. The purpose is the exchange of experiences and knowhow, improved performance through collaboration and the building of strong relationships, as well as formal and informal partnerships. Interventions are
targeting network management and can include the organization, development and management of cooperation and networks on communal level, through public-private-partnerships or sector-, respectively product-related (SDC, 2006), (Zimmermann, 2011).

The level of cooperation should be increased in the Kosovar outsourcing sector. It would be a big step, if a business association could be established with a clear task, giving the sector a voice on the political level and helping its members to deal with common issues. This step could be facilitated and supported through a development intervention. Other interventions could target the national branding of the Kosovar outsourcing sector towards international clients. A strong common brand would make it easier for companies to get in touch with businesses abroad as it would create a level of trust that is very hard to achieve for individual firms. It could even go as far as the creation or support of investment promotion offices in the most interesting markets.

5.1.4 Systems Development

The fourth and last dimension is the development of the system. Its purpose is to improve the legal, political and socio-economic framework, the implementation of policies that enable people, organizations and networks to develop and to increase their capability, and last but not least dealing with social justice issues. Interventions in this area are mainly related to policy advice, through the creation of round tables, confidence building, process design and many more (SDC, 2006), (Zimmermann, 2011).

Next to the dimension of individual development, the system level is probably the one requesting the most attention by development organizations in the business outsourcing sector in Kosovo. Here, the possible intervention areas are manifold. From facilitating round tables related to tax or IP policies and the general investment climate in the country, to helping to establish good communication channels between private companies and the relevant governmental bodies for the sake of forming trustful relationships to mention just two examples. However, the systems level might be the most difficult to tackle, to find its weak spots and failures requires an even more thorough analysis of the current situation than for the other dimensions and such analysis includes a large number of stakeholders with very different roles and responsibilities. To deal with governments and politicians is always a balancing act, as they might not really be interested in the long-term development of their country, but rather only focus on quick results that help them in the next elections.

5.2 Should Development Cooperation support the Outsourcing Sector?

Outsourcing has become a crucial element in the development of low performing economies. Apart from direct employment generation, there are also indirect effects on the service-exporting economy.
Every new job in the service export industry can lead to the creation of additional jobs in indirectly related sectors such as infrastructure and facility maintenance, accommodation and transportation or education and social work (Mitra, 2011).

From this point of view it makes perfect sense for a development organization to support the outsourcing sector, as long as the interventions are based on a systemic approach and sustainability is the guiding principle. For projects targeting the private sector and job creation in general, the impact should never improve the situation only for a chosen few beneficiaries, but the whole economic sector should profit from the support. This would lead to growth and through that to a stronger demand for an accurately skilled labor force, creating more employment opportunities, as well as putting pressure on the education sector.

Important is also to critically look at the quality of the jobs generated and their position along the outsourcing value chain, guided by the question, whether they are of value to the employees beyond short-term creation of income. Because in the end, a healthy economy requires a skilled labor force with good career opportunities and flexibility. If the newly created jobs are only of very low added value or none at all, the employees don’t develop the necessary skill set to adapt to a changing environment. As soon as the demand situation changes, through a disruptive technological development or a new competitor country entering the market with a better business case, low-skilled people will find it very hard to find another opportunity because their abilities are too one-dimensional. For the sake of sustainability, it is important that such disruptions are taken into consideration already when projects and interventions are designed.

And indeed, after Budzyńska (2016) the whole outsourcing sector is recently facing a potentially disruptive change due to a decline in the importance of the labor cost factor in comparison with skilled labor force and technical infrastructure. Countries in the low-value-add niche may see their opportunities erode as those with a strategy to advance aggressively along the value chain and to capitalize on the potential of jobs that manage automation do better (A.T. Kearney, 2017). Furthermore, industry analysts are speculating that the industry may become fully automated within a few years. The majority of business services centers increase the usage of automation in their operations, from basic to more sophisticated automation involving robotics tools, autonomy process automation and cognitive solutions (ABSL, 2017).

6 Discussion

This essay examined the question, whether supporting the business service outsourcing sector in Kosovo could be a silver bullet for development cooperation against the extreme level of youth unemployment. While the title is intentionally formulated in a provocative way, the analysis followed
a more pragmatic course. Economic development and job creation are complex and usually slow processes involving many different stakeholders, each one with its own idea and agenda. Therefore, supporting a single sector is usually not enough to resolve the unemployment problem, neither in Kosovo nor anywhere else in the world. Nevertheless, the outsourcing industry can have an impact that goes beyond direct employment, benefiting other sectors indirectly. It makes sense to support the sector and try to use it as a catalyst for general economic improvement. Crucial for the success is, however, that interventions are simultaneously targeting other underlying issues such as skills development and the regulatory framework. Labor market projects should, if possible, work on both the demand and supply side, supporting the private sector to create jobs and the education sector to better align skills that are trained with the needs of employers.

Looking specifically at the situation in Kosovo, there are a number of strengths and weaknesses with regards to its attractiveness as a business outsourcing destination. On the positive side, there is the cultural and geographical proximity to its most important target market, the EU, but also its strong ties to the US, which plays a crucial role in the country since the war in 1999. This situation makes Kosovo an strong candidate for outsourcing and especially nearshoring activities. The labor force is young, usually well-educated and has good language skills. Salaries in the country are comparably low and the IT infrastructure is at the level of other European nations.

Stronger growth of the sector is, however, negatively impacted by a weak regulatory framework and little incentives for foreign companies to invest in Kosovo. No attractive tax schemes are in place, special economic clusters or zones are inexistent and the general political stability in Kosovo is considered as weak. The outsourcing sector so far consists mainly of individual companies and lacks a decent level of organization and coordination. Kosovo’s economy is suffering from an unfavorable international reputation. An outsourcing association with a unified voice would not only help to lobby towards the local authorities, but also create a better national branding that can lead to increased visibility and trust building with regards to international clients. Another significant issue is the skills mismatch. Although over a third of Kosovars are enrolled on a tertiary educational level, they are not well prepared for the labor market. Either the curricula of their studying topics are outdated or not in line with the needs of the private sector, or the most popular study topics like law or economy are not sought after by employers. Vocational education on the other hand, has a bad reputation, a fact that is leading to a significant lack of practical experience among graduates.

Kosovo would be well-advised to orient itself more on the examples of successful outsourcing nations, like the ones described in this essay, Poland and the Philippines. Policies on every level should be aligned and coherent to create a more attractive environment in the education sector and in terms of financial and business regulations. Development organizations working in the country should act as
advising partners, supporting such efforts through targeted support and interventions, without losing the focus on the systemic approach and capacity building. More dependency on donor expertise or international money is not what the country needs at this point.

Finally, the huge difference in unemployment or even inactivity in the job market between the female and male labor force poses an additional challenge to the weak Kosovar economy. Whether the gap is caused by cultural or social circumstances, it can potentially have severe implications and needs special attention. It seems to be clear that every economy profits from a more gender-balanced participation in the labor market. Therefore, gender and social inclusion needs to be included as transversal topic and mainstreamed across all development activities. The same is true regarding the inclusion of minorities such as the Serbian and Roma population.
7 Bibliography


