

OUTSOURCING IN BULGARIA – OPPORTUNITIES AND CHALLENGES¹

Over the last few years, the outsourcing industry in Bulgaria has been generating a steady increase in GDP value and is constantly creating new jobs. The outsourcing industry under the current macroeconomic conditions is described. A comparative study of the financial results and organizational structure of the outsourcing companies is conducted. As a result, the perspectives and challenges for the outsourcing companies in Bulgaria are outlined.

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Overview of the outsourcing industry

Outsourcing in Bulgaria has become a hot topic during the last two decades. The 2018 industry report released by the Bulgarian Outsourcing Association (BOA) reveals that the industry generated 4.8% of GDP equating to EUR 2.1 billion² (BOA, 2018) and paid EUR 13.7 million in taxes, making up 6.2% of the total social security contributions. Currently, outsourcing employs over 60,000 employees. In recent years, Bulgaria has received international recognition and is in the spotlight of many global rankings and reports.

Figure 1



Source. BOA (2018). Bulgarian Outsourcing Industry Report.

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¹ A report presented at the international scientific conference "Economic Development and Policies: Reality and Perspectives". Economic Research Institute at the BAS, 29-30 November 2018.

² 2017 Data, NSI.

Some of the key factors as to why outsourcing remains a growing and profitable industry in Bulgaria, which attracts foreign investments, are:

- A stable economic and political environment: 3.6% GDP growth; a low unemployment rate of 6.2%; low and stable inflation at 2.1%; fixed currency rate (BGN 1 = EUR 1.95583); 10% flat corporate tax – the lowest in the EU (IMF, 2018);

- A low costs of doing business: low labor cost (average wage of EUR 534³); low office space rent (EUR 16 per square meter for prime offices, with 1.8 million square meters of office space in Sofia); low industrial electricity prices (Ministry of Economy and Energy, 2014);

- A talented and qualified workforce of employees; a good educational infrastructure with multilingual capabilities – more than 80% of the workforce has secondary or higher education (BOA, 2017);

- A strategic geographic location and infrastructure – a two-hour flight away from London / Berlin; convenient time zone difference with European markets; fast internet and Long Term Evolution (LTE) coverage (Invest Bulgaria Agency, 2011);

- Bulgaria's membership in the European Union, NATO, WTO; its legal framework is harmonized with the EU legislation (BOA, 2014).

The next section examines the main business models used in outsourcing. A historical overview of outsourcing in Bulgaria is made, and a snapshot of the vendors is presented.

Business models in outsourcing

In order to optimize their cost and operations, many international companies decide to perform certain processes outside of their main operational chain. There is no doubt that a mutual sharing of information and knowledge between partners can build a competitive synergy for the achievement of goals which cannot otherwise be accomplished separately by the organizations themselves (Alexandrova, 2011). This might be achieved through subcontracting those processes to a third party or delegating them to shared service centers within the very same company in order to eliminate waste or increase efficiency (Kimmel, 2015).

Outsourcing can be differentiated into *back office* outsourcing, where internal processes like accounting, recruitment, marketing, etc., are being delegated, or *front office* outsourcing – contact call centers or any customer related activities. *Offshore* outsourcing occurs when a company contracts processes outside of its country of origin.

Information technology outsourcing takes up a significant part of outsourcing in Bulgaria and is referred as ITO. Examples of business process outsourcing (BPO) are: human resources outsourcing (HRO), financial and accounting outsourcing (FAO), knowledge process outsourcing (KPO), voice-based process outsourcing (VBPO), procurement, logistics, operations, and other business processes (Other PBO).

³ NSI, Q2 2018.

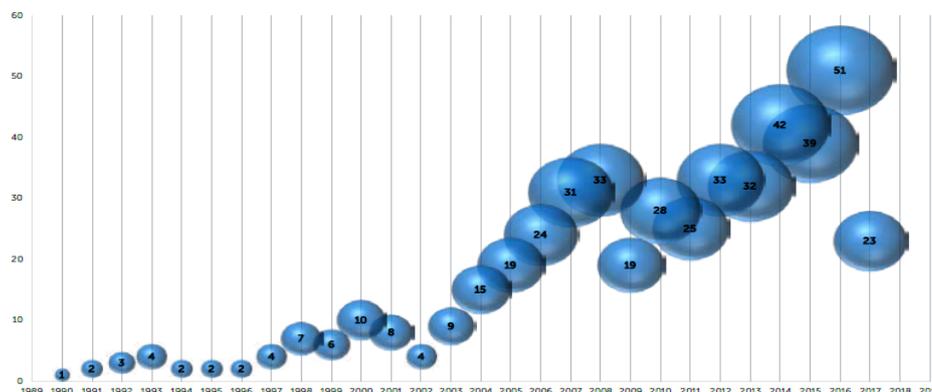
Historical overview of outsourcing in Bulgaria and a current snapshot of the industry

Companies began outsourcing to Bulgaria after the fall of the communist regime, but most of them started doing so after Bulgaria was accepted into the EU. At the beginning of the democratic government very few foreign companies set foot in CEE and Bulgaria in specific. In 1992, Coca-Cola HBC started operating in Bulgaria and established a plant in Kostinbrod. Since then, Coca-Cola HBC has also created a shared service center, where HR, financial and IT services are provided for all the European branches of the entity. According to the latest available data, the company currently has over 2,300 employees in the country (Coca-Cola HBC, 2018).

It was after Hewlett Packard set foot in Bulgaria in 1998 and later built its Global Business Center in 2006 that Bulgaria became an attractive outsourcing destination for the big international companies. Over the years, HP (Hewlett Packard GDBC and Enterprise Services Bulgaria) became a leader in employing BPO and ITO specialists in Bulgaria and it currently outsources IT projects, customer support, HR, business analysis, supply chain, finances, etc., employing more than 4000 people in the outsourcing industry (HPE, 2018).

Figure 2

Number of outsourcing companies by year of establishing operations in Bulgaria



Source. BOA (2018). Bulgarian Outsourcing Industry Report.

The current snapshot regarding the outsourcing industry can be presented, as follows (BOA, 2018):

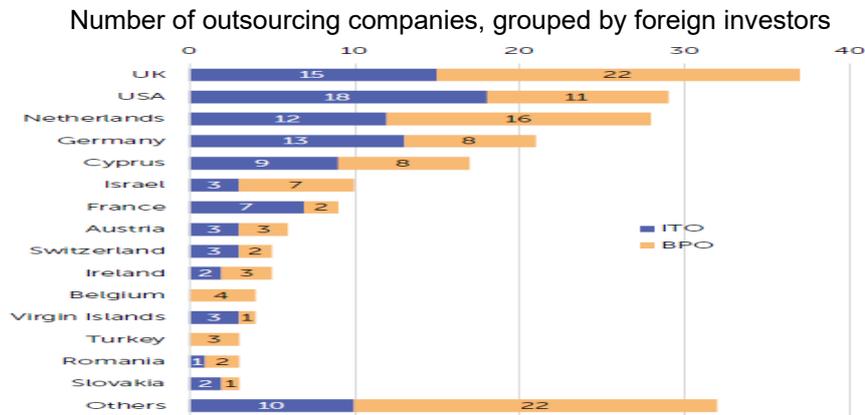
- 477 outsourcing vendors in Bulgaria (49% ITO, 51% BPO);
- 60,664 people are employed in the industry (28.4% ITO, 71.6% BPO). 83% of them are based in Sofia, the rest are located in Plovdiv, Varna, Burgas, Veliko Tarnovo and other big cities across the country;
- The outsourcing industry generates an 18.2% annual growth in operating revenues with a turnover of EUR 2.1 billion and a profit of EUR 116.9 million, with average revenue of EUR 35,103 per employee.

A comparative study of outsourcing vendors in Bulgaria

Outsourcing companies, grouped by ownership

When speaking about the ownership of outsourcing vendors in Bulgaria, over half of the companies have Bulgarian ownership (250 companies or 52.4%). The remaining 227 companies have a foreign origin (BOA, 2018). The graphic below represents their distribution by country and type.

Figure 3



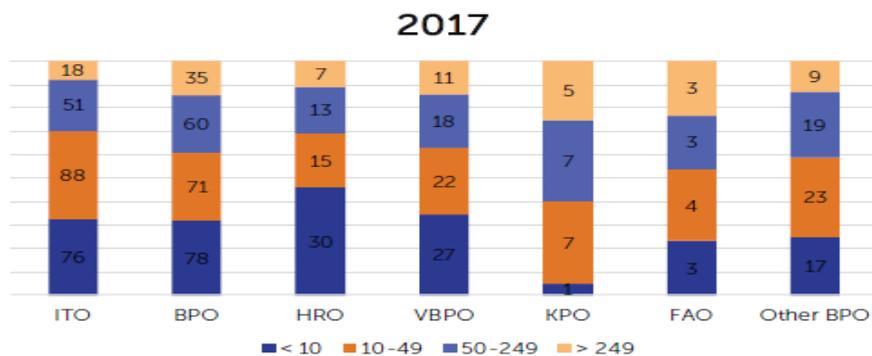
Source. BOA (2018). Bulgarian Outsourcing Industry Report.

Segmentation of outsourcing companies in Bulgaria

BPO companies outsource call centers, financial and accounting processes, human resource activities, data processing, research, and other internal processes. On the other hand, ITO encompasses development, software support, networking solutions and other IT-related services.

Figure 4

Segmentation of outsourcing companies by number of employees

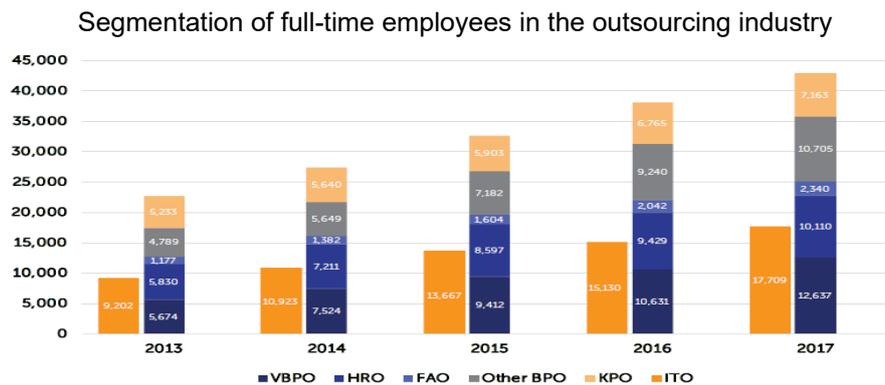


Source. BOA (2018). Bulgarian Outsourcing Industry Report.

The outsourcing workforce

83% of the companies are based in Sofia (399 companies in total). Other cities hosting outsourcing companies are Plovdiv, Varna, Burgas, Ruse, Veliko Tarnovo, Stara Zagora, Ruse, Gabrovo and Blagoevgrad (Figure 5).

Figure 5

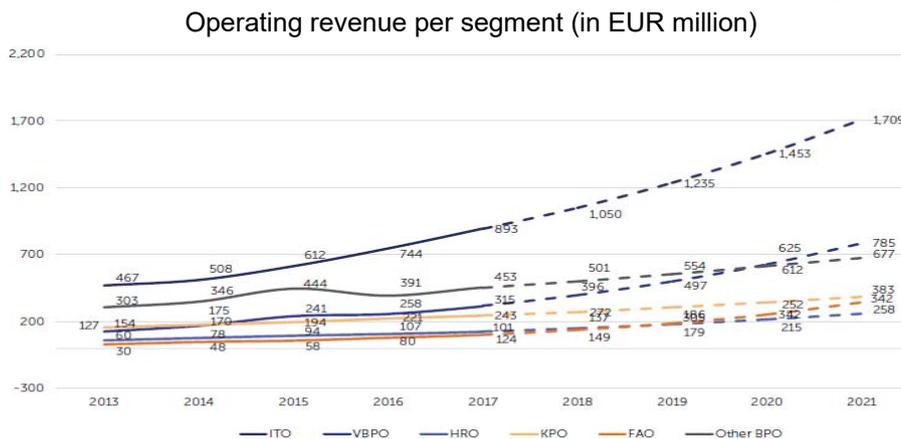


Source. BOA (2018). Bulgarian Outsourcing Industry Report.

Revenues and costs in the outsourcing industry

In recent years, the outsourcing industry has continued to increase the pace of its operating revenue growth. 2016 marked a growth of 9.6%, and during 2017 the number rose to 18.2%. BPO generates revenues of EUR 1.2 billion or 58%, while ITO's revenues go up to EUR 893 million or 42%. The average revenue per employee amounts to EUR 35,103 (BOA, 2018).

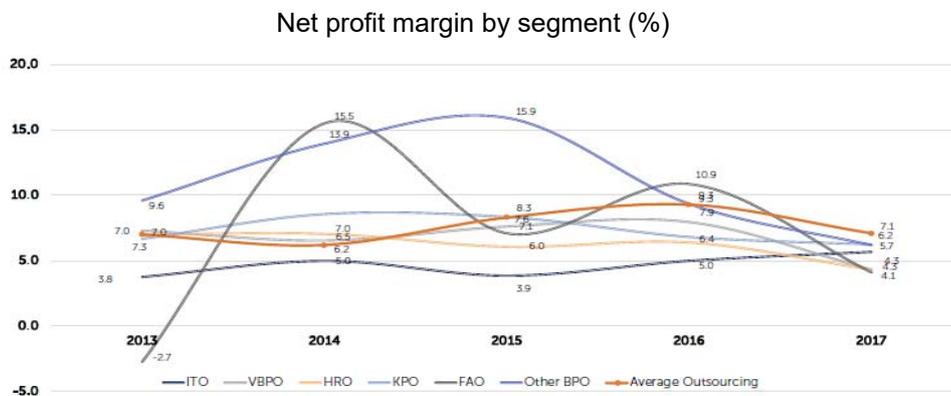
Figure 6



Source. BOA (2018). Bulgarian Outsourcing Industry Report.

Regarding the cost structure of outsourcing companies, the labor cost remains the highest and it has been continuously rising over the last few years, as salaries in the country are catching up with those in the rest of Europe. The main reason is due to the competitive labor market where there is a constant need for well-educated professionals and companies are willing to pay more to attract them. As a result, salaries are always on the rise, especially for IT specialists. Social security contributions, tax expenses, facility expenses, and office rent also contribute to the decrease in the profit margin of outsourcing companies. The total profit for 2017 equals EUR 116.9 million, or 5.5%.

Figure 7



Source. BOA. (2018). Bulgarian Outsourcing Industry Report.

Opportunities and challenges for the outsourcing industry in Bulgaria

Industry perspectives

The perspectives for the Outsourcing industry in Bulgaria remain positive in the forecasts, as this is the most dynamic sector, which continues to grow and create new jobs. The Bulgarian Outsourcing Association forecasts that the industry will generate EUR 4.0 billion or 7.9% of the GDP by 2021 and will continue to create new jobs, estimated at 79,000 full-time employees by 2021.

Bulgaria continues to establish its profile as an outsourcing hub in the CEE region (Questers, 2018). According to A.T. Kearney’s report on outsourcing for 2017, Bulgaria is ranked #2 in Europe after Poland (Sethi & Gott, 2017). In terms of the business costs, the positive factors such as the low cost of doing business, the political and economic stability, the good infrastructure (internet speed, first-class office space, low electricity prices, etc.) remain stable.

Stepping on a very well developed educational system of high schools and 51 universities spread across 15 cities, the outsourcing industry has good opportunities in terms of producing a capable workforce. The Ministry of Education and Science stated that out of all 55,000 university and college graduates each

year, 28,000 of them are suitable for the outsourcing industry, having a background in languages, economics or IT. There is a tendency for the universities to tighten their connection with the business and have a dialogue on what the companies need. A very good example is the new Master's Degree program in Outsourcing which was established at the University of Plovdiv in the fall of 2018.

On the other hand, outsourcing jobs are no longer associated only with call centers and the professions in the industry are becoming not only well paid but also attractive in terms of career development for the young professionals entering the workforce. This also has a positive impact on the emigrant crisis Bulgaria has been suffering over the last decades and leads to a decrease in the number of graduates not willing to look for jobs in Bulgaria. Many Bulgarians who have studied or worked abroad are choosing to return home and apply for outsourcing jobs in Bulgaria. This is especially true when we speak of jobs in the IT sector, where the salaries are catching up with those in the other European countries. The recent Brexit is another opportunity for UK companies to find it cheaper and more efficient to outsource their processes to Bulgaria.

Another good opportunity to list is that of the diminishing boundaries between BPO and ITO (BOA, 2018), which is a sign that more complex processes and activities are being outsourced to our country. These are high value-added knowledge transfer services. In addition to that, in recent years more outsourcing businesses are being established outside Sofia, where 83% of the outsourcing companies are currently situated. This provides good opportunities for development for the other regions in Bulgaria and has a positive impact on the economy and the demographics in the country.

Industry challenges

Although Bulgaria has a relatively good talent pool of well-educated professionals, it cannot meet the fast pace of the constantly growing demand for outsourcing employees. In order to respond to the need for qualified employees of the new companies entering the market, Bulgaria needs to either attract a significant part of its young emigrants from abroad or it needs to adjust its educational system to respond to the needs of the business and annually produce more people who are educated in the field of outsourcing.

Another challenge that the vendors are facing is the fact that the profit margins of the outsourcing industry are declining. At the beginning of the outsourcing boom, a good number of the companies were able to make double-digit profits, while at the moment most of them realize profits of around 5%, which is the average for the industry. The shortage of qualified professionals impacts the salaries, as companies are offering higher salaries to attract those prospective employees. This is especially valid for the IT industry, where it is becoming more and more expensive to run the business due to the increasing labor cost and thus, Bulgaria is becoming a less attractive destination for outsourcing.

Another challenge strongly felt by outsourcing vendors is the fact that Sofia doesn't have the necessary infrastructure to accommodate the outsourcing boom.

Although there is enough built and developing office space, the country's capital is also in need of appropriate public transportation, housing, nurseries and schools for all the professionals attracted to work and live in Sofia. Currently, only 17% of the companies are based outside of Sofia and the government has a leading role in facilitating their better distribution nationwide.

In conclusion, Bulgaria will continue to be a promising outsourcing destination in the upcoming years. But still, continuing efforts are needed both from the government and the business to keep the outsourcing industry profitable and thriving.

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