Case Studies on

Outsourcing Trends

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OVERVIEW

For years, ‘sourcing’ has been just another word for procurement – a financially material, but strategically peripheral, corporate function. Presently, globalisation, aided by rapid technological innovation, is changing the basis of competition. It is no longer a company’s ownership of capabilities that matters but rather its ability to control and optimise its critical capabilities and tap the resources available. The ‘forward-thinking’ companies are simplifying their value chains, thus bringing about flexibility in their organisational function. The question is no longer whether to outsource a capability or activity, but rather how to source every single activity.

Since the Industrial Revolution, companies have grappled with how they can exploit their competitive advantage to increase their markets and their profits. During the early years of the 19th century, the making of covered wagon covers and clipper ships’ sails was a job outsourced from the US to the workers in Scotland, with raw material imported from India.

But the 20th century witnessed a change in the functioning of various organisations. The model for most of them was a large integrated company that can ‘own, manage, and directly control’ its assets. In the 1950s and 1960s, the rallying cry was ‘diversification’, to broaden corporate bases and take advantage of economies of scale. By diversifying, companies expected to protect profits, even though expansion required multiple layers of management. Subsequently, in the 1970s and 1980s, organisations attempting to compete globally were handicapped by a lack of agility that resulted from bloated management structures. To increase their flexibility and creativity, many large companies developed a new strategy of focusing on their core business, which required identifying critical processes and deciding which could be outsourced.

Hence, in the 1970s, the software companies in the US started exporting their payrolls to the service providers outside the company for processing. This trend continued in the 1980s, where accounting services, payroll, billing, and word processing all became outsourced work. But most of this work was outsourced to service providers in other states, not overseas, and the reasons for outsourcing had more to do with small efficiencies than reshaping the economy. It was not until the late 1980s that outsourcing began to emerge as a potentially powerful force in transforming global economies. Meanwhile, in technology circles, the focus on outsourcing turned from its efficiency to its economy and productivity. Early outsourcing to overseas providers by corporations like Kodak and American Standard, began to capture public attention.

By the 1990s, in order to bank on the benefits of outsourcing, business segments like information technology, human resources, facilities and real estate management, and accounting started being outsourced. Many companies also outsource customer support and call centre functions, manufacturing and engineering. Consequently, a debate has ensued concerning the benefits and costs of the practice as well as how to categorise it as a phenomenon.

The decision to outsource is often made in the interest of lowering firm costs, redirecting or conserving energy directed at the competencies of a particular business, or to make more efficient use of global labour, capital, technology and resources. Outsourcing is essential in meeting both, instantaneous cost savings and long-term strategies – two benefits that improve business value.

The main reason for outsourcing is savings in labour costs and the availability of skilled people in developing countries like India, China, Philippines, Mexico, and Argentina. Simply put, outsourcing allows business leaders to leverage strategic plans in order to accomplish:

Speed to market: Utilise state-of-the-art technologies to begin operations in weeks rather than months.

Market competitiveness: Acquire world-class expertise that results in industry-leading methods, while accommodating the ever-changing market.

Increased revenue: Reinvest cash and manhours in areas offering the greatest return on investment (ROI) while taking advantage of up-to-date technology infrastructure.

Boosts financial strength: Improve ROI by removing non-core assets, and by allowing an accurate prediction of future cash requirements.

India: The Preferred Outsourcing Destination

Amidst competition from other developing countries, India was one of the developing countries to benefit from the offshoring trend as it had a large pool of English-speaking and technically proficient manpower. India's offshoring industry took root in low-end IT functions in the early 1990s and has since moved to back-office processes such as call centres and transaction processing. In the late 1990s, India's abundant and low-cost software engineering talent, combined with massive demand from the Y2K problem helped India to move up the value chain to attract large-scale software development projects from US-based customers. Currently, India's engineering talent has made India the offshoring destination of American high-tech firms, led by HP, IBM, Intel, AMD, Microsoft, Oracle, and Cisco. Each of these companies promised to invest at least $1 billion[1] in India, to supposedly retain market share in the face of competition and cost-cutting measures of competitors and industry in general, at the expense of investment in the US.

India's offshoring sector, the world's largest and fastest growing, is dominated by IT services, which play a major role in the country's overall economic growth. By 2007–2008, it is estimated that workforce will consist of about 1,450,000 to 1,550,000 people, and the industry will account for 7% of India's GDP.[2]

[1] Jain Manoj, "About Offshoring of Services", http://bpodiscuss.blogspot.com/2006_02_01_bpodiscuss_archive.html, February 1st 2006

[2] "Labor shortage threatens India's leadership position", http://www.sharedservicesbpo.com/file/2637/labor-shortage-threatens-indias-leadership-position.html, September 10th 2005

Yet, clouds are gathering on the offshore horizon. Research by the McKinsey Global Institute (MGI) shows that India's vast supply of graduates is smaller than it seems, considering their suitability for employment by multinational companies. In the country's most popular offshoring locations such as Bangalore, rising wages and high turnover among engineers – the professionals most in demand for IT services – provide evidence that local constraints on the supply of talent already exist. And just as these bottlenecks are developing, other low-wage countries, such as China, Hungary, and the Philippines, are gearing up to challenge India's lead.

But the end of India's offshoring bonanza is not necessarily at hand. India has other attractive qualities beyond low-wage professionals for companies that want to offshore their operations. In 15 years of offshoring, the country has developed a stable of world-class IT service vendors that can save foreign companies the trouble of setting up their own offshore centres. And it has a large supply of qualified talent in areas outside IT, such as R&D, finance and accounting, call centres, and back-office administration.

Outsourcing is clearly not just about payrolls and call centres. Outsourcing has spread even to the medical sector. The research and development of the daily dose of medication was outsourced to Indian chemists who were originally schooled in the US. The insurance company which covered the cost of medication, was also outsourced. And medical clinics (actually a franchise of a larger firm, which is a branch of an internationally managed care outfit) outsource the administration of your confidential medical records to Russia.

Offshoring has been a controversial issue, spurring heated debates among economists, some of which overlap those related to the topic of free trade. On one side, it is seen as benefiting both the origin and destination country through free trade, providing jobs to the destination country and lowering cost of goods and services to the origin country. This makes both sides see increased GDP. And the job increase in both countries, since those workers in the origin country that lost their job can move to higher-value jobs in which their country has a comparative advantage.

On the other hand, job losses and wage erosion in developed countries have sparked opposition to offshoring. Experts argue that the quality of any new jobs in developed countries is less than the jobs lost and offer lower pay. Economists against offshoring charge that currency manipulation by governments and their central banks causes the difference in labour cost, creating an illusion of comparative advantage. Further, they point out that even more educated, highly trained workers with higher-value jobs such as software engineers, accountants, radiologists, and journalists in the developed world have been displaced by highly-educated and cheaper workers from India and China. Not surprisingly, many US executives cite the low US unemployment numbers as positive proof that offshoring is not deleterious to the US workforce, or to the nation itself. It could be argued that one of the problems in using unemployment numbers is that the figure does not factor shifts from high wage, high skill jobs to low-wage, low-skilled jobs. So, if an equal number of citizens that once worked in high-skilled jobs find a job for skilled work, the unemployment number will remain the same. Most importantly, the argument does not contemplate nor reflect any effects that may occur 10 years to 20 years from now.

The hue and cry over offshore outsourcing in the United States of America has increased exponentially over the last six months. Many economists and union leaders say these job losses will leave a significant percentage of workers worse off. A study by the Institute of International Economics found that one-quarter of factory workers who were laid off from 1979 to 1999 found new jobs that paid at least 25% less than their old jobs. But other economists and corporate executives say that as the economy modernises and new industries develop, some workers who lost their jobs to outsourcing will find opportunities in higher-paying sectors, such as biotechnology, alternative energy sources, and the emerging field of nanotechnology.

The corporate top brass and experts, however, have staunchly defended their decision to outsource, stating that the job shifting to developing nations with well-qualified human resources is necessary for the US companies to retain their competitiveness. While the pain is real for the people who have been rendered jobless, some politicians have chosen the issue to play on the minds of the populace, accusing outsourcing as a potential source for recession and jobless growth.

Innovations in outsourcing have yet to be exhausted – outsourcing can boost developing world economies. But the world is a finite space with limited natural resources, including human resources. Ironically, it is humankind's ability to innovate that may account for the eventual demise of outsourcing, as we mechanise more and more work – technology is changing manufacturing and retail jobs radically. Hands-on work is being outsourced now, but new innovations may eventually make the workplace as we currently understand it, obsolete. "We may one day be able to punch out and go home – forever."[3]

The Future

For some, globalisation is about opening up free trade between countries that is, creating new opportunities for nations and benefitting workers in both, developed and developing countries. For others, globalisation is yet another way for the big companies to line their pockets at the expense of the poor – a non-sustainable system that excludes developing nations. However, the management challenges will grow more urgent as rising global salaries dissipate the easy cost gains from offshore outsourcing. The winning companies of the future will be those most adept at leveraging global talent to transform themselves and their industries, creating better jobs for everyone.

Eighteen cases included in this book highlight the impact of outsourcing and offshoring on various industries across the globe. It introduces the reader to different kinds of strategies these companies adopted to expand their businesses. This book looks at the major points on either side of the issue – the advantages that companies have due to outsourcing and

[3] Kelly Terri, "A Brief History of Outsourcing", http://www.globalenvision.org/library/3/702/, December 7th 2004

whether outsourcing would succeed in bringing equilibrium in the global economy as a whole. A vital issue for discussion could also be the free trade versus protectionism debate and whether a country can survive by sticking to any one of the two views.

The case on *Outsourcing Innovation: Opportunities and Challenges* introduces the reader to understand the emergence of new trends of outsourcing that gradually manifested itself in diverse fields like electronics and mobile devices, investment research and pharmaceuticals. Despite its widespread advantages, outsourcing innovation has its share of challenges, threatening companies with loss of their edge over innovation that could cause the conglomerates to shrink. Explaining the fast spreading outsourcing of services by big multinational companies, the case *Genpact, GE's Outsourcing Arm: Global Expansion Strategies* elaborates on the global expansion strategies of Genpact to low-cost countries like India, Mexico, China and Hungary.

Since the late 20th century, Business Process Outsourcing (BPO) to the developing countries by the companies of the developed nations had become more of a necessity than an option. Going further, cases like *India as an outsourcing destination*, *Indian BPO Industry: A Changing Landscape*, depict India as a major global outsourcing destination with its high intellectual capital, a huge population of English-speaking graduates, lower compensation costs, strong information technology infrastructure and a sustained government support. To strengthen its competitive edge and further maintain and develop its core competencies, India was required to quickly move up the value chain and provide tailored services suited for different customer needs.

However, the Indian companies are now facing the problem of increasing attrition among their workforce – from 10% in 2001 to 30%-35% in 2003. The case on *Indian Call Centers (A): Rising Employee Attrition* analyse this problem, and highlights its repercussions that could seriously affect India's competitive advantage of high-quality, low-cost service offering. The sequel to the above case *Indian Call Centers (B): Addressing Employee Attrition*, examines the major causes for attrition that include lack of job enrichment, erratic work timings, workload, work-related stress and ailments, etc. and evaluates the retention strategies adopted by various companies to contain the increasing attrition among employees.

Finally, the cases on *Comparative Cost Advantage and the American Outsourcing Backlash* and *American BPO backlash: The Highs and Lows*, talk about the criticism faced by the US government for offshoring various services. However, critics believe that export of service jobs or offshoring, was the major reason for job losses and proponents of offshoring believed that it was in US' best interest to take advantage of low-cost, skilled labour in countries like India.