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The global outsourcing medley of the 21st century

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ABSTRACT

Outsourcing is now increasingly used as a competitive weapon in the global economy of the 21st century. We know from the past that globalization, is nothing new. It continues to affect people and businesses in every country of the world, spurred on by the trend in global outsourcing, in which companies are recognizing that expertise can be cost-effectively sourced from clusters around the globe.

With the emergence of innovation at the top of the corporate agenda, we see how the boundaries of outsourcing move closer towards the heart of the company's intrinsic value and closer to its business strategy; raising questions about what makes up the very essence of an enterprise and the potential to gain competitive advantage or the risks of losing it, under the pressure to reduce costs through outsourcing.

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INTRODUCTION

Global outsourcing has gained widespread acceptance as a crucial aspect of business strategy. Comprising an engaging medley of models, best practices and expectations, the general idea of outsourcing is that a business should focus on those areas of its operation that are critical to its success and where it has a competitive advantage, whilst other areas of its operation should be outsourced to organizations operating in countries that can provide labor at relatively lower costs.

In a developed economy, the critical success factors to a leading business are likely to require intellectual qualities based on unique knowledge in areas such as innovation, branding and technology. By outsourcing routine business functions such as manufacturing, customer service desks and IT software development, companies can reduce costs, focus on their core business and benefit from the global service capability of its service providers.

Outsourcing is heavily intertwined with globalization. History reveals that globalization is nothing new and is based on the premise of redistribution of labor. The industrial revolution of the 18^{th} and 19^{th} centuries witnessed the shift of such industries as textile manufacturing from India to England, ending in collapse with far reaching social and economic consequences. In turn, the industrial revolution of the 21^{st} century is witnessing the evolution of a knowledge economy in which technology is enabling the redistribution of labor through the mechanism of outsourcing, spearheaded by demand from companies in the West for English speaking, Indian IT and BPO services which are allegedly generating between $15 billion and $18 billion per year.

Driven by the location independence of labor and the growth in mobile information workers; call centers and software houses have been closing in the West, and now high-skilled professions, which once epitomized the competitiveness of Western economies, are flowing to low wage nations such as India and China to be welcomed by a highly educated and skilled workforce. The pool of jobs once thought to be impossible to outsource is moving around the globe.

In the meantime, service providers and recipients, focus purposefully on the successful implementation of demand supply management, and the applicability of selecting the right business model to suit the right sourcing scenario, in their attempts to create value from the multi-million dollar outsourcing venture.

This paper explores two themes; firstly, how global outsourcing has gained widespread acceptance as a crucial aspect of business strategy in the global knowledge economy, and secondly, how the boundaries for the acceptability of outsourcing are still unclear, as the outsourcing paradigm of the 20^{th} century is shifting towards the dislocated ‘aroundsourcing’ paradigm that is emerging today.

Technology as driver of globalization

Globalization, the creation of international strategies by organizations for overseas expansion and operation on a worldwide level, has historically been led by US, European and Japanese companies, through sourcing products and services from developing countries. According to Kotler (2001), “today’s economic landscape is being shaped by two powerful forces – technology and globalization.”

The global information infrastructure built during the 1990’s and secured when the IT industry passed the Millennium milestone, resulted in the rapid movement toward a network of companies and internal operations, running every hour of the day somewhere around the globe, all connected in real time by IT, and all staffed by highly trained professionals.

Ritchie (1996) sharply differentiates between globalization and globalism: “Globalism and globalization sound similar, but when you look more closely it is clear they are opposites.” He defines globalization as “the process of corporations moving their money, factories and products around the planet at ever more rapid rates of speed in search of cheaper labor and raw materials and governments willing to ignore or abandon consumer, labor and environmental protection laws.” He continues, “as an ideology, it is largely unfettered by ethical or moral considerations. In contrast, globalism is the belief that we share one fragile planet the survival of which requires mutual respect and careful treatment of the earth and of all its people.”

The influence of technology on globalization is referred to by Friedman (2005): “It is now possible for more people than ever to collaborate and compete in real time with more other people on more different kinds of work from more different corners of the planet and on a more equal footing than at any previous time in the history of the world – using computers, emails, networks, teleconferencing, and dynamic new software.”

In addition to technology, several other factors play a key role in globalization, including political developments such as the fall of communism, transportation developments and cultural awareness. These factors provide opportunities for companies with the opening up of new markets, improved customer harmonization as a result of the increase in shared cultural values, and a superior competitive position with lower operating costs in other countries and access to new raw materials, resources and investment opportunities.

Global outsourcing at arm’s length

Outsourcing is widespread, with U.S. companies leading in outsourcing services globally. IBM, EDS, Solectron (manufacturing) and Aramark (food and facilities) have extensive global operations. At the same time, American companies are outsourcing to global providers, such as Siemens and Capgemini. Whilst Accenture, the global consulting giant, has based its worldwide head of business-process outsourcing in Bangalore and will soon have more employees in India than in the United States.

One of the key advantages of outsourcing for a company in the home country is in sourcing skilled labor offshore (or nearshore) at relatively low costs compared to equivalent labor in the home country. The economic theories of relative wages and specialization provide insight into the mechanism for global outsourcing, in which the pattern of specialization is beneficial to both the country in which the company is based and the country from which the cheaper labor is sourced. The economist, David Ricardo (1772-1823) is credited for the principle of comparative advantage to explain how it can be beneficial for two parties (countries, regions, individuals and so on) to trade, if one has a lower relative cost of producing some good. Equally, this principle is applicable to outsourcing.

Until now, relationships amongst recipients and suppliers of outsourcing services have tended to be relatively at 'arm's length' from the perspective that the focus has been on the outsourcing of non-strategic activities, but rather routine projects and services. But it's only a matter of time before IT service suppliers get closer, as they attempt to move up the value chain. The boundaries for outsourcing's acceptance are still unclear as service recipients grapple with decisions on how close they should allow suppliers to come and what impact customer intimacy could have on the organization's competitive advantage, both in negative and positive terms.

After all, IT service suppliers can build a brand base in their local markets in Asia and enter the U.S. and European markets under their own name at a lower price point. Furthermore, in a pure outsourcing strategy, the emphasis is almost invariably upon the home market and there is limited evidence to suggest a strategic approach to globalization, whereby the company uses the relationship with the supplier to enter growing foreign markets around the world, jointly developing a global selling network in addition to a global labor network. Yet, it could be argued that this is exactly where real value can be gained from outsourcing for organizations wishing to expand their global presence.

A study from Deloitte (2005), points out how fractured and sub-optimized most global companies consider themselves to be and suggests that manufacturers must begin to take a "comprehensive, holistic approach" to fixing global supply network problems or risk even greater inefficiencies as globalization and complexity increase.

Innovation sourcing

When Western corporations began selling their factories and farming out manufacturing in the 1980's and 1990's to boost efficiency and focus their energies, most insisted all the important research and development would remain in-house. However, the perception that current R&D spending isn't creating the expected returns and that innovation could be cost effectively outsourced, moves the boundaries of outsourcing closer towards the heart of the company's intrinsic value and closer to its business strategy.

Until now, by outsourcing routine work to low cost suppliers, service recipients have been able to invest in more quality time for the definition and design phase of solutions, pilot projects and innovation – all factors that increase the potential to gain competitive advantage. However, those companies dissatisfied with the results, the door is now open to outsource innovation any time, any place, anywhere around the globe.

According to Friedman (2005), innovation can happen anywhere, and hence, "it's now all about aroundsourcing." In the context of globalization, we see Friedman's theory applied as companies are recognizing that expertise can be cost-effectively sourced from clusters around the globe, for example, China demonstrates strengths in carrying out work relating to hardware, India demonstrates strengths in the management of global helpdesks, Thailand in software design, whilst the Ukraine's particular strength is in algorithms.

Porter (1990) explores the concept of clustering as a basis for a nation to identify those industries where its factor advantages today provide some competitive advantage, but where other determinants of national advantage are also present. He refers to the Italian tile industry of the 1950's, when Italian firms were initially dependent on foreign sources of white clay and production technology for manufacturing tiles. These firms became increasingly innovative as their production experience accumulated, and knowledge was spread rapidly throughout the region due to worker mobility and the close-knit proximity of the local tile producers. The firms learned how to modify imported equipment for use with the local red clays and by the mid 1970's Italian firms had emerged as world-class producers of kilns and presses.

Companies that make extensive use of outsourcing are still cautious about innovation and impose strict confidentiality on suppliers. "It is still taboo to talk openly about outsourced design," according to a Business Week feature (Engardio & Einhorn, 2005) with Navi Radjou, an expert on corporate innovation at Forrester Research Inc. Meanwhile, the electronics sector is furthest down this road, with the announcement of Boeing Co. (BA) that it is working with India's HCL Technologies to co-develop software for everything from the navigation systems and landing gear to the cockpit controls for its upcoming 7E7 Dreamliner jet.

The boundaries for acceptance of the outsourcing of innovation are also unclear for companies regarding the message they send to investors. Outsourcing manufacturing, tech support, and back-office work makes clear financial sense. However, if a company depends on outsiders for design, then investors might begin to question the company's ownership of intellectual property, and how much of the profit from a successful product will ultimately be seen back in the balance sheet.

As Dave Ayers, vice-president for platforms and engineering at Lucent points out in the Business Week feature: "Outsourcing some development makes sense so that its engineers can concentrate on next-generation technologies. This frees up talent to work on new product lines. Outsourcing isn't about moving jobs. It's about the flexibility to put resources in the right places at the right time."

So what we are seeing is that the definition of what is core in outsourcing is shrinking to such an extent that such definitions may not even be relevant any longer, as the focus shifts towards a new paradigm. Outsourcing has reached a level of maturity enabling companies to potentially place any work, anywhere, around the globe.

The winners and the losers of outsourcing

According to an article by Giridharadas (2007) for the International Herald Tribune, Alan Blinder, a former vice chairman of the U.S. Federal Reserve Board and former economic adviser to President Bill Clinton, recently described outsourcing as a "third Industrial Revolution" that, by his estimate, threatens the jobs of 28 million to 42 million workers in the United States alone. "We have so far barely seen the tip of the offshoring iceberg, the eventual dimensions of which may be staggering."

The opponents to globalization have quite different visions, ranging from Marxist revolution to less defined objectives, such as the 'end to poverty'. Such arguments against globalization tend to be based around three premises which, according to economists Krugman and Obstfeld (1994), are argued to be misconceptions about comparative advantage:

1. *Productivity and competitiveness*: Free trade is beneficial only if your country is productive enough to stand up to international competition.
2. *The sweatshop labor argument*: Foreign competition is unfair and hurts other countries when it is based on low wages.
3. *Unequal exchange*: Trade exploits a country and makes it worse off if the country uses more labor to produce the goods it exports than other countries use to produce the goods it receives in return.

In an interview with Teather (2007) for the Guardian, when asked, if the benefits of globalization ultimately outweigh the negatives, Infosys CEO, Kris Gopalakrishnan, responded: "No. Even in the Indian context it is positive only for about 1.3m people. Well plus, of course, there is maybe five times that, maybe 5 million benefit from the extended economy. But then when you look at the rural economy ..."

Although the sweatshop labor argument is topical relating to many developing countries, in terms of economies of scale domestic spending power and quality of life, it is popular belief that many people in developing nations are being compensated well. As enterprises globalize, employees will in turn enjoy increasingly competitive salaries and benefits packages, particularly those employees willing to be lured by high salaries from one market to another or from one country to another.

However, there are many who are more than skeptical about globalization and the benefits of outsourcing, amongst them David Korten (1999): "There is a deep chasm between the promises of the new capitalism and the reality of social breakdown, spiritual emptiness, and environmental destruction this economic system is leaving in its wake." Radical as such proposals seem, they actually reflect processes that are steadily gaining momentum around the world, particularly in such nations as China and India.

Anti-globalization in India is historically rooted, as governments, unions, and businessmen have traditionally emphasized industrialization and self-sufficiency. Competition to this insular view came not from the ideology of liberal trade and capitalism, but from the followers of Mahatma Gandhi, who championed handicrafts and village industries as the economic path forward. India's economic growth, triggered by the boom in outsourcing, is cause for extensive discussions on social, economic, political and cultural levels. In the public sector, there are the ongoing trade negotiations, along with calls from the IMF and the World Bank to correct new macroeconomic imbalances and press on with reform; whilst in the private sector, calls for microeconomic reform and infrastructure investment are being heard, to allow India to take the giant leap that would position IT to alleviate its poverty.

Einhorn (2005) in her article on how millions of Indians await the benefits of globalization states: "To realize the promise, politicians have to compete on the reform agenda – not against it." The official line from the former Prime Minister Atal Behari Vajpayee's Economic Advisory Council is unequivocal, arguing, "Globalization is an unavoidable process which is taking place independent of us. It forces us to cope with it. There is not room in a globalized world for an economy delinked from world trade and foreign investment."

Creating global supply chain networks

In spite of the skepticism, globalization can clearly create benefits for those countries and organizations interested to compete internationally. It opens up access to growing markets, choice, capital, knowledge, better communication tools, and the creation of a "method of collaborating horizontally – among suppliers, retailers and customers – to create value" (Friedman, 2005, p.129) through more effective supply chain management, an important factor in segmentation and targeting. Globalization has also changed the nature of marketing practices, especially in industries such as commodities, mechanical machine parts, travel and telecommunications. As quality and reliability is now taken for granted, price has become the determining factor, along with an increasing demand from consumers and IT service recipients alike for higher quality of services from outsourcing service providers.

The drivers behind increased supply chain complexity are getting stronger and include foreign trade regulations or domestic regulations such as Sarbanes-Oxley. However, if we return to the study of Deloitte (2005), companies across most industries rated themselves "near" or "at the bottom" in their ability to create effective global supply chain network structures. Clearly the challenge for the future is for ICT services providers to play a role in improving those global structures, instead of being mere outsourcers. "More than 80 percent of the world's most global companies are not capturing full value of their investments. Rather than take a holistic view in the design and expansion of their global supply chain network, most manufacturers focus on fixing individual pieces of the network. The result: suboptimal improvements, wasted efforts and frequently lackluster performance," concludes Deloitte.

As global outsourcing matures, those companies with the ability to provide services at an enterprise-wide level will likely achieve competitive advantage through creating alignment between business, operations and IT. Service providers will need to focus on global level delivery models and organizational structures in order to meet the required flexibility demanded by customers in dynamic global markets. To this end, the formation of global supply chains will be critical to the future development of global outsourcing.

CONCLUSION

Global outsourcing, the migration of low-skill service industry jobs to developing countries, has become a common practice for many transnational enterprises, gaining widespread acceptance in both private and public sectors. An increasing number of enterprises are also outsourcing functions in fields that once epitomized the competitiveness of Western economies, such as aeronautical engineering, investment banking and drug research. But when it comes to the outsourcing of innovation, the boundaries of acceptability move closer towards the heart of the company's intrinsic value and closer to its business strategy; raising questions about what makes up the very essence of an enterprise and the potential to gain competitive advantage or the risks of losing it, under the pressure to reduce costs.

From a supply perspective, enterprises in developing countries and emerging markets are increasingly reaching into the developed economies of the West, offering a talented workforce at a fraction of the price. Developed and developing economies are exploiting each other's markets, economies and labor forces in a new era of international trade, based on virtual networks and driven by a rapidly evolving global business and technology services culture.

Is outsourcing true globalization? The answer is no. Until now, there has been limited evidence of a globalization strategy on the part of enterprises and limited expertise needed to offload work to low-cost destinations. Some cynically argue that outsourcing is just a winning short-term balance sheet move, with potentially disastrous long-term implications if the relationship between the services recipient and supplier isn't more than skin deep. Whilst others argue, that outsourcing is an inevitable and necessary process, enabling enterprises to become truly global.

With the 'overnight shifting' of jobs, from West to East, some economists predict that outsourcing will trigger growth in professions that must be rendered in person, such as the police, caring professions, clinical medicine and the myriad of services which require unique local knowledge and cultural understanding.

Meanwhile, those disadvantaged by global outsourcing will protest and make known their issues. Local politicians may try to protect jobs and attempt to block the outsourcing of public sector work to offshore enterprises. There is still limited understanding of the impact of this new era of globalization, in the context of a world that is increasingly concerned with globalism. Still much goes unreported, for example, the extent to which local poverty in India is being driven down by economic boom, and the extent to which the outsourcing of energy-consuming data centers is driving down the CO^2 emissions of the global enterprises that pledge environmental sustainability.

The boundaries for outsourcing will remain unclear, as the demarcation between mission-critical R&D and commodity work is sliding year by year. Yet there is much familiarity in the outsourcing medley, as we look back to the competitive advantage achieved by the Italian tile industry and ahead to the emergence of the globally dislocated expertise clusters of the knowledge economy, as they work 24x7 to create a better world.

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