

OFFSHORING – PROCESS, PAIN OR PROFIT

Report on the Workshop held under the auspices of the Adecco Professorship of Business and Society at London Business School, Monday February 28th 2005

The Event

An exciting and important workshop on Offshoring was held at London Business School on February 28th, focusing on the economic and business implications of offshoring. The event was sponsored by Adecco, and organised by Saul Estrin who is the Adecco Professor of Business and Society in the Department of Economics at London Business School. Speakers included academics, business people and members of the policy community with the lead address being given by Mr M. K. Shankaralinge Gowda, the Secretary to the Government of Karnataka, Department of Information Technology and Biotechnology. The state capital is Bangalore which has been the host for much of the recent spurt of offshoring activity.

Laying out the Themes

The London Business School Dean, **Professor Laura D'Andrea Tyson**, opened the Workshop. She developed the ideas first outlined in her BusinessWeek column (December 6th 2004). She stressed the human resource challenges for both the source and recipient countries. For the former, she noted that benefits from offshoring depend on two factors: the percentage of workers who, having lost their job from offshoring, find new ones (the redeployment assumption); and the percentage of wages paid in the new jobs (the recapture assumption). The evidence on these issues is limited at this stage, but evidence from the US and Europe suggests that redeployment is often proving harder than expected. For example, nearly one third of US workers who lose their jobs will not find other jobs within a year, and in Germany the redeployment rate might only be 40%. The central issue is therefore policies that act to raise redeployment and recapture rates and thereby reduce opposition to the crucial process of “creative destruction”, for example wage insurance programmes for displaced workers.

Saul Estrin, Adecco Professor of Business and Society, presented an overview of the themes and issues raised in the academic literature about the effects of offshoring. He commenced by attempting to define the process, an important activity because, while there has been considerable public interest in offshoring, the debate has been confused because different people mean rather different things by the term. In particular, offshoring is more than outsourcing, and indeed need not involve outsourcing; a firm may offshore by opening its own productive or service capacity overseas, as well as

by outsourcing to a foreign long-term contractor. He noted that offshoring has become of especial interest of late because it has developed beyond manufacturing-m sectors like automobiles or electrical machinery where the process has been common for many years, and into the service sector. This means that the jobs being transferred abroad are now more highly skilled. Even, offshoring is only feasible in sectors where it is possible to break the value chain into completely divisible segments, and where the transport and other transactions costs of moving the component segments of the chain around are low.

The amount of offshoring, though growing fast, is hard to measure but apparently remains modest because it cannot be applied to all sectors. In manufacturing industry, some sectors like automobiles have outsourced shares as high as 30% (in the UK) and 15% (US) but the average across all manufacturing is less, perhaps 25% in the UK and 12% in the US. While Forrester Research has argued that by 2015 there will be 3.3 million outsourced jobs in the US, Estrin pointed out that 30 million people change their job annually, so the total number in ten years is less than 10% of the job turnover in a single year.

Estrin distinguished between the effects of offshoring on firms, the source economy and the host economy. For the firms that chose to undertake offshoring, the benefits appear to be unambiguous. Such companies are able to take the division of labour further, obtaining higher productivity and enhanced profitability. Offshoring is clearly a potential source of competitive advantage for firm. However, it is about much more than cutting cost. Offshoring is most effective when it undertaken as part of strategic vision that identifies the firm's core competitive strengths and allows the firm to focus on these.

For the source economies, there was a trade-off between the short-term effects, in which offshoring firms gained profitability and competitiveness but workers lost jobs, and the long term ones, when workers were re-employed and there were no offsetting downside factors to the benefits of offshoring. However, policies were needed to ensure that unemployed workers found new jobs, and that they did not suffer greatly in terms of wages foregone.

Finally, for the host economies, Estrin argues the benefits were unambiguous. They obtained much-needed hard currency flows, foreign investment, jobs and the transfer of technology. The spillovers from foreign direct investment has been established as one of the key elements underlying long terms growth in less developed economies, and job creation is one of the most important policy tools to counter deprivation and poverty.

Jerome Caille, CEO of Adecco, added his views on offshoring from the perspective of the world's largest HR supplier, and a company dedicated to create policies that will improve the functioning of labour market globally. He confirmed from his perspective that the scale and impact of offshoring has probably been exaggerated. He estimated that only 1% of jobs were affected with only 5% of all job cuts related to overseas reallocations and only 1% in services. He saw great advantages from offshoring for both developed and developing countries. Thus the US can take advantage of the possibilities because of its flexible labour market, and obtains extra benefits because of the additional flow of business resulting from the spread of

purchasing power and the improved profitability. However, it was harder for countries with less flexible labour markets to gain these advantages, for example Germany where firms find it harder to flexibly redeploy abroad. He stressed the benefits for developing countries – job creation, knowledge transfer and praised the spirit of flexibility and determination in the host countries. He concluded by noting that Adecco was neither in favour nor against offshoring; rather they had a solution for both cases.

Offshoring in India

Mr Shankaralinge Gowda, Secretary of the Government of Karnataka Department of Information Technology, Bioscience, Sciences and Technology offered a vivid explanation of why India in general, and his state of Karnataka in particular, had become the first choice for so many outsourcing companies in the past five years. He highlighted India's recent remarkable growth performance, with the economy increasing at more than 8% per year, based on sound fundamentals including a high savings rate and a huge domestic market. Perhaps most importantly for the themes of the Workshop, he highlighted the remarkable Human Resources for science and technology in India, where there are more than 18 million graduates per year, more than a million of them in engineering, and a further 16 million people obtaining engineering Diplomas. The shift of Western firms to India to take advantage of this tremendous concentration of skill, all of it English speaking, has of course been accelerated by the internet revolution, broadband and satellite communication which have so greatly cut the costs of global communication.

He reported that there were more than 15000 foreign companies in India already, all under ISO standards. The factors driving so many companies to India were clear: a skilled highly motivated and cost-competitive labour force, with a huge domestic market and the potential easily to export, and low corporate taxation. His own state, Karnataka, was leading the way. It is the knowledge capital of India with 15 universities, 1500 IT companies, 180,000 workers in IT. This number is expected to rise to 500,000 by 2008. He pointed out that the state government was doing its best to improve the business climate further, by creating special economic zones that were exempt from taxation, as well as trying to enhance even further the human resources of the state by a major training programme. The idea was to spread the flow of employment in offshored firms out from the current centre in Bangalore to secondary cities like Mysore, Mangalore and Hassan. To that end, the government planned to train another 1000,000 people in business skills across the state over the next two years.

Source Country and Industry Perspectives

Professor Richard Scase, academic, author and entrepreneur, provided an interesting perspective on the issue from the perspective of UK firms. He argued that there was no choice for companies except to redesign and outsource, because of the dramatic demographic pressures we face in the Britain, and in most other EU economies. There is a shortage of young employable people in the UK, and the problem seems likely to get worse in the next ten or twenty years. The reasons were changing patterns of fertility, with smaller families and women working and therefore delaying when they had children until later. Another important factor was increasing levels of

economic inactivity, especially among the older population, over 50. To maintain living standards in the future, countries like Britain would have to rely more and more on migrants, and on offshoring job.

He felt there remained very great potential for further offshoring. There has been a lot of discussion of private sector job redeployment, especially in services, but Scase argues that there was also a huge potential form offshoring in the public sector, itself a major source of job creation in the past few years. He believed that outsourcing could save £11 billion in the public sector.

He also noted that offshoring threw up many policy challenges for the developed economies. The underlying idea was that low skill jobs and even a number of higher skilled ones, would be sent offshore, reducing the labour supply shortages and creating employment opportunities for more highly skilled and better paid jobs. But that assumed that people had the skills and motivation to exploit these new opportunities. He pointed out that in the UK, 19% of the adult population is functionally illiterate and 24% of adults are innumerate. At the same time, increasing numbers of older people with skills are dropping out of the labour force. Policies were needed quickly to improve the skill base, and to extend peoples' working life.

The final speaker was **Andrew Kris**, the chairman of the Shared Services and Business Process Outsourcing Association. He provided a number of rich and stimulating examples of companies that have outsourced, and have enormously improved their performance as a result. From the fruits of his experience, he outlines the many ways that companies could gain from outsourcing- lower costs, improved internal structures, enhanced global competitiveness. However, he stressed that offshoring did not always deliver these things- it all depended on the ways that it was done. He argued that in his experience, more than half of attempts to implement offshoring g policies failed. He suggested a number of important and practical ways to improve a company's chance of success. The key point was leadership and clarity of communication. The leader implementing an offshoring policy should always make clear from the outset what is being planned to all affected parties, and engage them in the process fully. He pointed out that this did not only involve employees, though they are crucial; clients are also generally opposed to offshoring because they believe that it reduces control over operations and leads to a loss of expertise.

Panel Discussion

The workshop concluded with a panel answering directly the concerns of audience. This contained all the previous speakers and three additional members, who were each given, some time to introduce their perspective on offshoring. **Iain MacLean** is the National Secretary of the trade union Amicus that is the largest private sector union. He has been involved in some high profile offshoring cases. The union did not have a "one size fits all" approach to this complex issue and was not automatically opposed to offshoring. However, he noted that the case for offshoring is not universally accepted and that the number of job losses in the UK financial sector could be very high- up to 200,000. The main issue for Amicus is how the offshoring is done. They seek union consultation at the start of the process and a guarantee of alternative jobs being found for people whose jobs are sent offshore. They also support grants to assist people with retraining.

Ajit Isaac from Adecco PeopleOne Consulting in India discussed the companies experience in that marketplace, which has in general been both positive and rewarding. He developed some of the themes made by the India Minister, especially the high levels of technical training, the size and quality of the talent pool and the great advantages conferred for offshoring by the fact that English is a primary language of India.

Finally, **Patrick Dixon**, the CEO of Global Change Inc spoke passionately about the moral issues raised by offshoring. He argues that offshoring was the right thing to do for the source economies, because it raised growth. It was right for customers because it reduced prices. It was right for companies because it increased shareholder value, and at the end of the financial chain, shareholders were pension funds, and therefore, in the future, you and I. But it was also right for the host economies, which obtained jobs, income, technology, training and growth from the process. Thus, while offshoring might appear to raise many moral questions, at the end of the day all of these pointed in the same direction- that offshoring acted to enhance the welfare of its participants.