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Global Trends in Outsourcing and their Impact

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Introduction

This project sought to identify trends in the global business sphere of outsourcing and its various subsets. This longitudinal study examines past research surrounding this complex topic and connects it with both current academic and professional opinion to target the problems that currently surround outsourcing, identify the strengths of outsourcing, and how a business may harness these strengths to their advantage. Outsourcing is important for every business, regardless of its size or location. Every continent is now recognized in some category for outsourcing and it is apparent that this is a sustainable, proven part of many companies strategic goals.

Outsourcing has significant importance to not only businesses that choose to engage in said activities, but also to the citizens of any country with involvement in outsourcing. As governments seek to increase their own prosperity, they may in fact hinder modern economic best practices such as free-trade and the autonomy of business through elaborate taxation and legislative measures. Outsourcing is a function that combines the complexity of logistics, investing, and contract management. Businesses now face a growing array of factors influencing outsourcing and it is imperative that they understand the nuances of outsourcing so they that they may readily adapt to a rapidly changing global economy. The data shows that the forces driving organizations to globally integrate are not easing, but rather, emerging trends signal the continuation and deepening of these new business practices.

Problem statement

This project identified what problems and benefits existed with outsourcing and offshoring. This is a longitudinal study will connect the research done in the past and connect it to the present while looking to the future. Questions about the security of data were raised after

high-profile thefts involving consumer data from companies like Digital River, Inc. from New Delhi, India or the deaths of over twenty individuals after taking the drug Heparin, whose manufacture was outsourced to a Chinese company. This project also explored other factors that have contributed to India no longer being the preferred destination of outsourcing. Other questions investigated include; 1) are cash flow and cost savings are still the primary reasons for outsourcing, 2) are sensitive products and data no longer suitable to outsource due to safety concerns, 3) after the onset of the economic recession in the United States, did outsourcing see a rise or fall, and 4) what is important for successful outsourcing? 5) Lastly this project examined the trends in outsourcing, and outlined the driving forces behind these trends in order to identify motivation behind these activities to provide an outlook on the future trends of outsourcing and make recommendations for outsourcing activities.

Methodology

This project sought to identify ongoing and future trends in outsourcing by examining past research, investigating current trends, and drawing conclusions about the future of outsourcing.

1) Literature Review: Firstly this project provided an overview of research done previously, and then compared that to present day academic work.

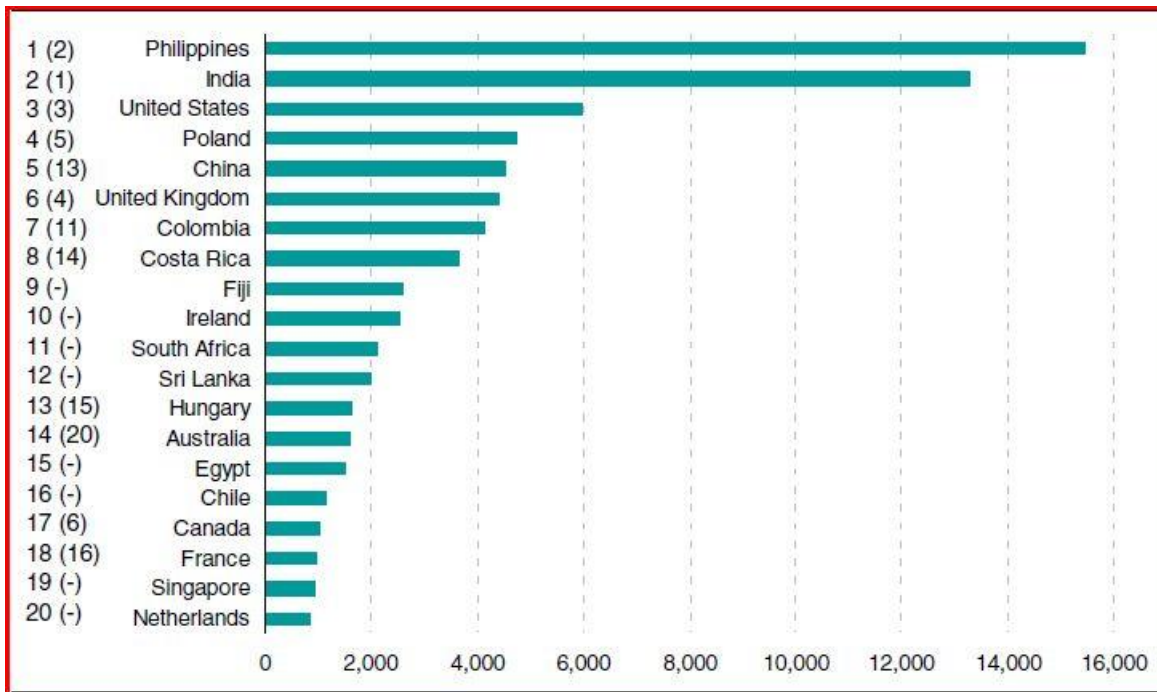
2) Several large scale, and current, studies were analyzed to understand the current status of outsourcing, offshoring and human resource activity. These include IBM's Global Location Trends reports, as well as their Global Investment Locations Database and Chief Human Resource Officer study. From these databases, we saw trends and movement in the global economy.

- 3) Conclusions about trends in outsourcing
- 4) Recommendations

Results

These results were derived from IBM's Global Investment Locations Database (GILD) which continuously records investment project announcements around the world. This database currently has collected over 100,000 investment projects since 2003, allowing detailed insight into global trends in corporate location decision making.⁹

Figure 1, Top ranking destination countries by estimated jobs in business support services - 2009(08)⁹



This figure shows the top ranking destination of outsourcing in terms of estimated jobs for business support services outsourcing in 2009. The countries previous position in 2008 is in

parentheses. The Philippines overtook India as the number one destination, and several other countries have become outsourcing hotspots like China, Costa Rica, Fiji, Ireland, South Africa, etc. who all have had significant increases in estimated jobs.

Figure 2, Top ranking destination countries by estimated jobs in production - 2009(08)⁹

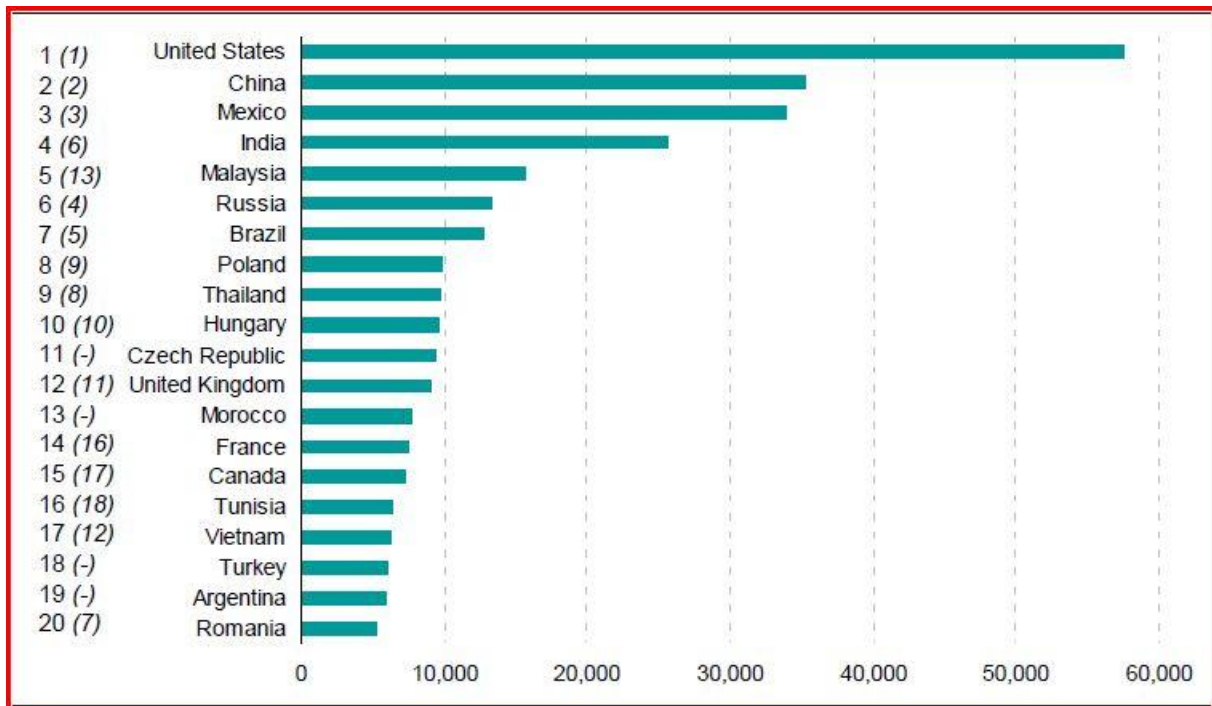


Figure 2 shows the top ranking destination of outsourcing in terms of estimated jobs for production outsourcing in 2009. The United States holds firm as the top ranking destination for activity for both 2009 and 2008. This is in sharp contrast with Figure 8, which shows the rankings in 2007, where the United states is a distant fourth behind China and Mexico.

Figure 3, Top ranking destination countries by estimated jobs in R&D - 2009(08)⁹

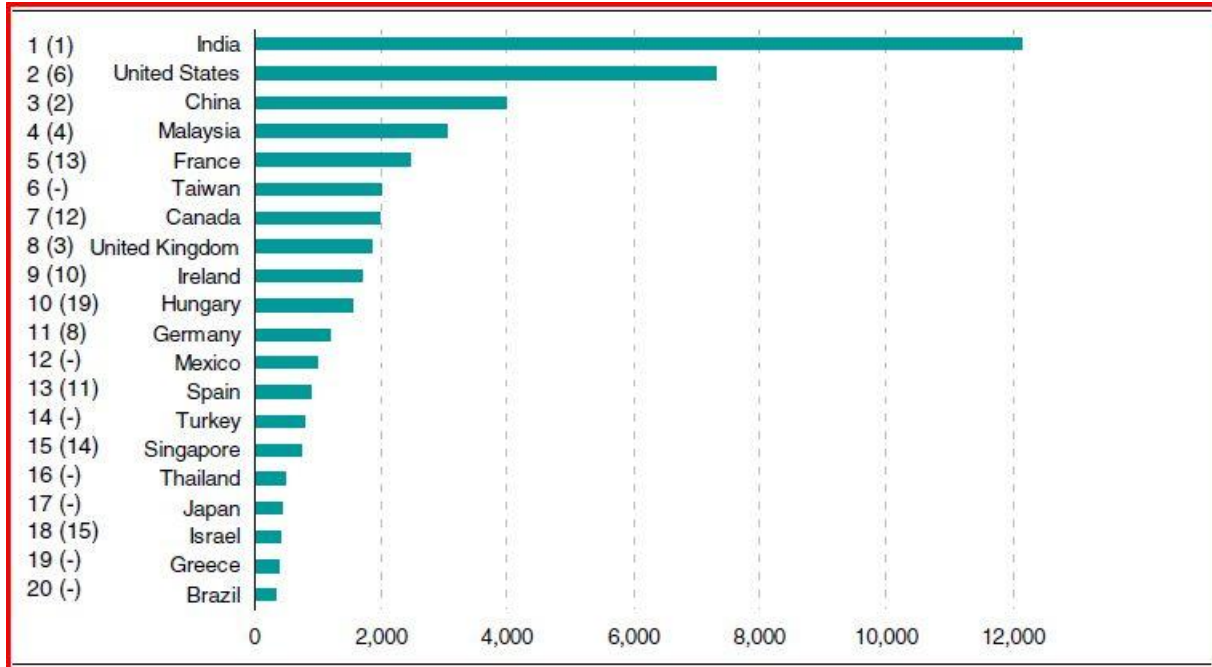


Figure 3 shows a continuing trend in outsourcing activities where previous leaders are being usurped by more mature countries, which are presumably safer, such as the United States and France, during times of economic uncertainty.

Figure 4, Top ranking destination countries for investment from Chinese and Indian companies - 2009(08)⁹

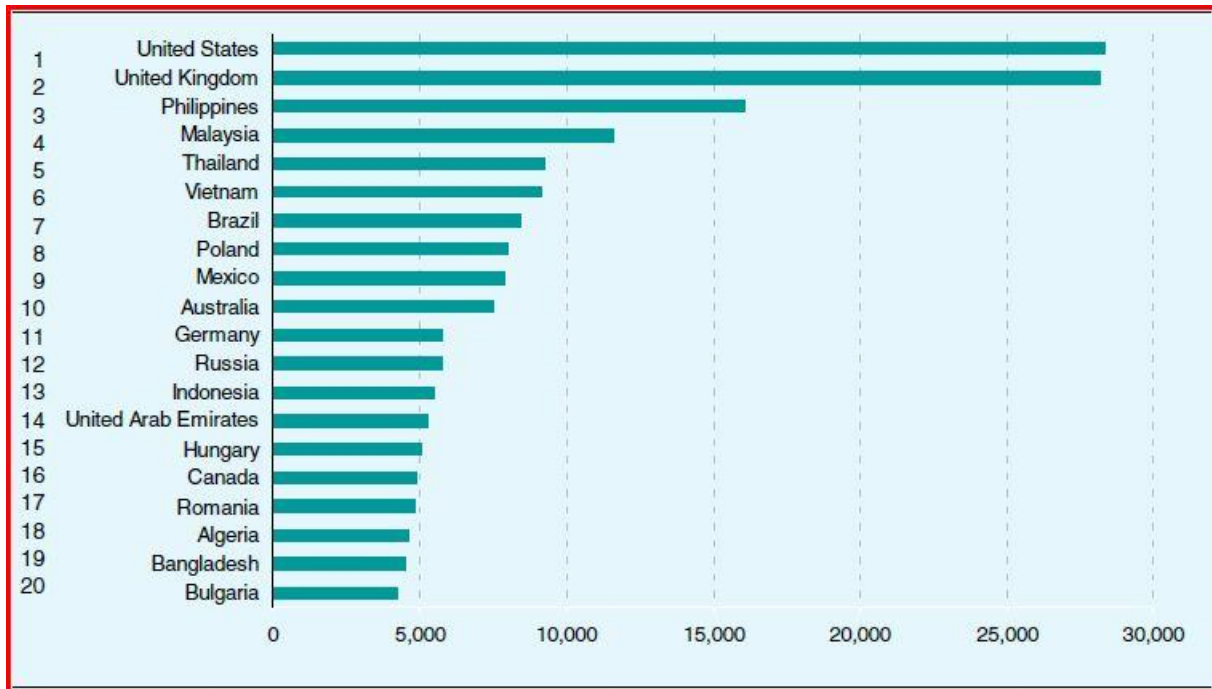
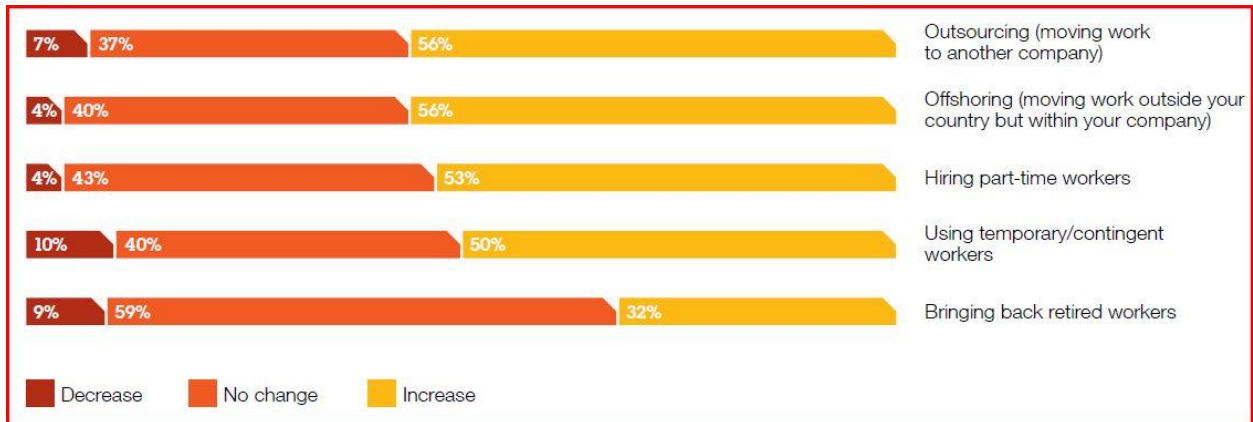


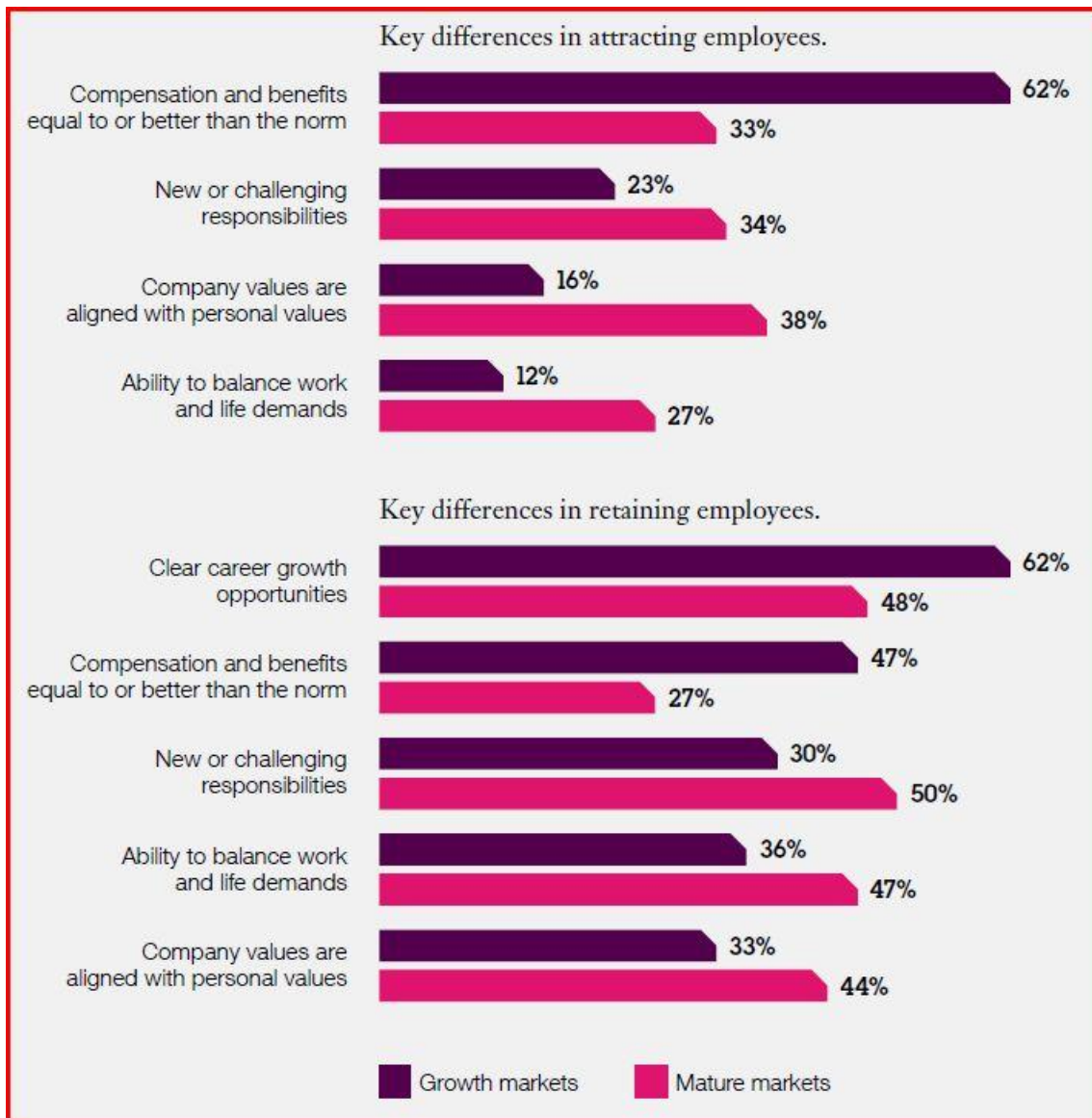
Figure 4 illustrates a new concept called the boomerang effect. This concept seeks to explain that jobs outsourced to a foreign country are not a total loss, as the investment of jobs in the foreign country is often partnered with foreign direct investment (FDI). India and China are popular destinations for outsourcing activity, i.e. jobs, and direct most of their FDI back to the United states.

Figure 5, Anticipated Human Resource Activity 2010⁷



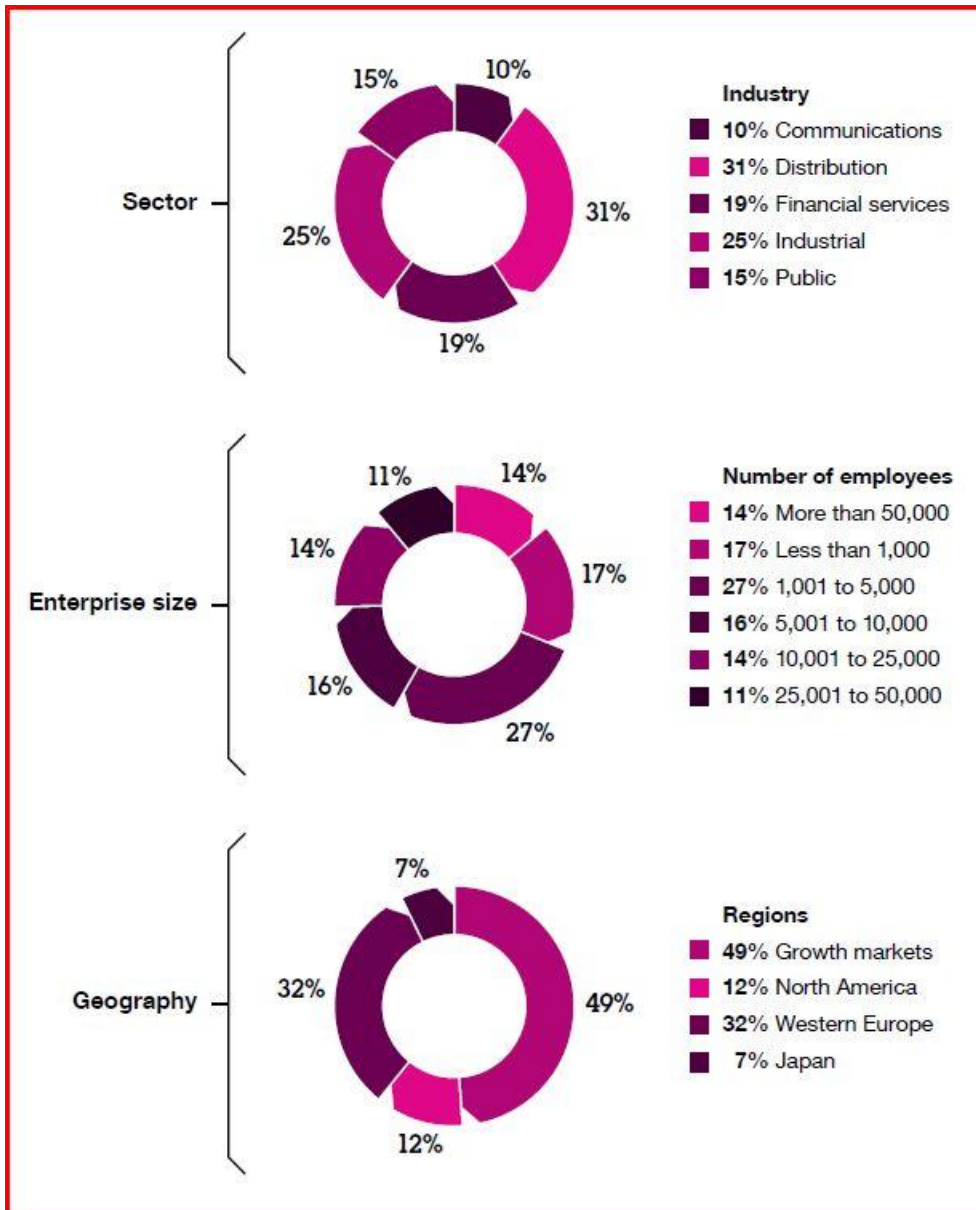
This chart from a 2010 study surveying over 700 Chief Human Resource Officers shows that outsourcing and offshoring are still very pertinent topics with no signs of decreased outsourcing/offshoring activity.

Figure 6, Differences in Growing and Mature labor markets 2010⁷



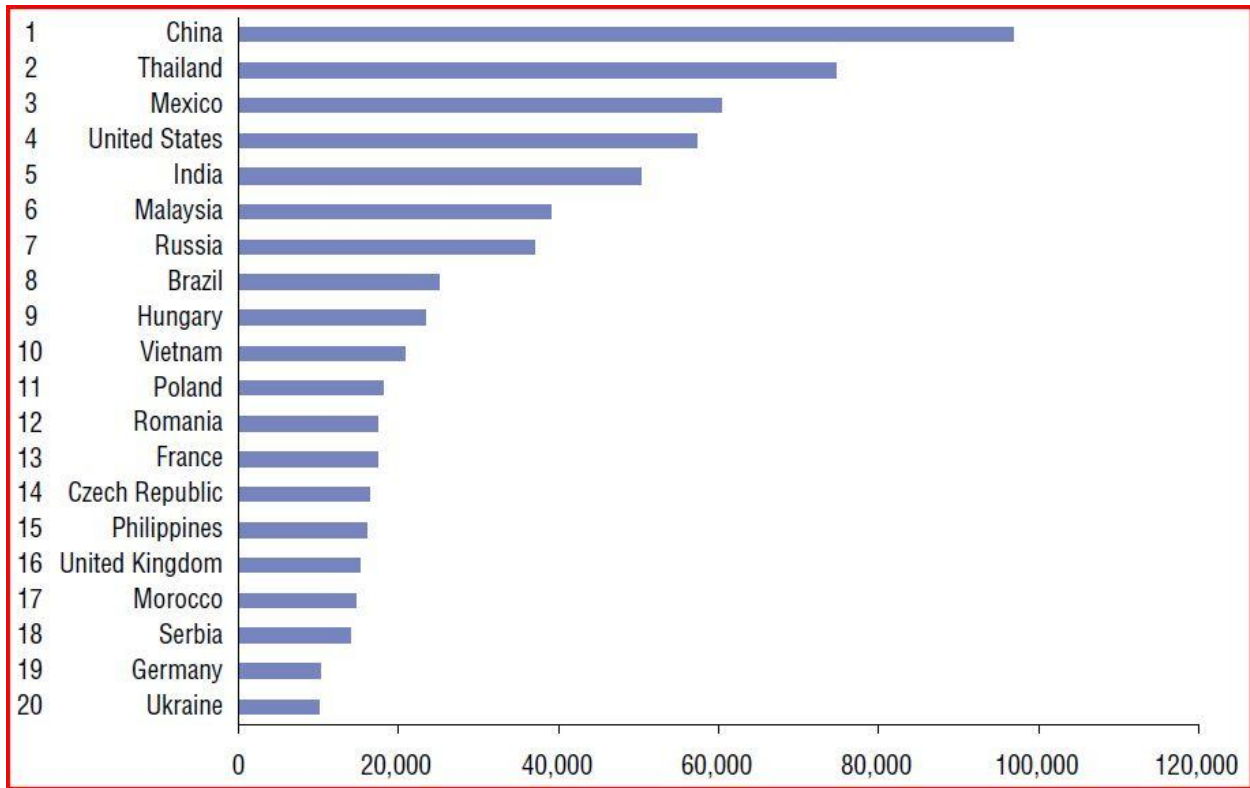
This bar chart shows why developing countries, like India, become less attractive for outsourcing/offshoring activity. The labor force's primary driving factors are compensation and career opportunities which helps explain the rising costs of outsourcing/offshoring to markets like India as the workers demand monetary compensation over other forms of job satisfaction.

Figure 7, Sources for CHRO 2010 Study⁷



The sources for Figures 5 and 6 show diversity.

Figure 8, Top ranking destination countries by estimated jobs in production - 2007¹



This bar chart highlights the trend reversal shown in Figure 2, no longer is China

considered the world's factory, as it once was prior to 2008.

Discussion

When discussing outsourcing it is important to define what is implied. Outsourcing is extensive term that encompasses many forms. For the purposes of this paper outsourcing is viewed as involving the contracting out of a business function - commonly one previously performed in-house- to an external provider². Offshoring is the act of outsourcing a function to a foreign country while retaining ownership. This can be thought of simply as opening a foreign office. For additional terminology, see the Glossary.

Suggestions for Effective Outsourcing

In one WPI undergraduate study by Kevin Barrett and Scott Misiaszek titled Suggestions for Effective Outsourcing³, they identified a trend in the outsourcing decision making process. In targeting the decision to outsource they keyed in on two major points in a company's decision to outsource. Their primary driving force behind choosing to outsource, and the method under which they pursue outsourcing. While their research was concluded in 2007, many of their conclusions are still contemporary and relevant in the fast-paced global economy because it provides a snapshot of the industry. By examining this past work, and comparing it to current trends we can make some conclusions about the future trends of outsourcing. This project outlined their points and stated the trends they found in their research. This allows us to update and confirm or adapt their trend model to what we see now in order to more accurately paint a picture of outsourcing in the future.

The primary concern illustrated by the report³ is understandably cost-savings. Furthermore, profits allow companies to grow, and profits can be increased by a reduction in expenditures. The authors argue that regardless of the size of the company, their primary reason to outsource was to lower expenditures, but in addition to this prime directive there were other ancillary motives for deciding to outsource. One principle of an effective company is to focus on what one is proficient at. This is referred to as a core-competency. In authors' work³, they suggest that a cause for outsourcing is to allow a company, faced with limited resources, to focus their labor and resources on their most profitable business functions. An appropriate example of this would be a circuit board manufacturer, they have the skilled labor and technical knowledge of how to cost-effectively build circuit boards, but they may have little experience and knowledge when dealing with end-user support. Outsourcing the end-user support to a company

that has workers trained to deal with less knowledgeable consumers, provides them additional benefit. This is because they won't have to hire or train additional support staff to operate telecommunications equipment or proper etiquette when dealing with upset or emotionally charged end-users.³

Outsourcing will allow a company to more effectively utilize its assets by allowing its labor force to focus on their core competencies, whether they be manufacturing, design, or consulting, and outsource those functions which are not to another company that has already proven to be a industry leader, such as information technology, end-user support, accounting or data management.³ This leads to another conclusion of their research, that there is a wide variety of permissible and effective choices for outsourcing. While information technology and fabrication work are popular choices for outsourcing. Any company which holds a core competency in a particular type of work may be a potential candidate for outsourcing to a company which excels in any of the other non-critical areas. A company that has many design strengths may benefit from outsourcing to a company that is proficient in cost-effective manufacture. In addition to the cost-savings motive that the authors identified³, they also found that outsourcing companies contract trial periods with outsourcers in order to identify whether or not a company is proficient, that is, holds a core competency. This can be seen as risk management. Similarly to investors, who diversify their portfolios to reduce their risk exposure, outsourcers identified in their surveys said that they only send a small portion of work to a potential outsourcer at first. This reduces their risk exposure by committing an initial small outlay of resources, and waiting to see if their actual returns on investment are near their initial projected return. If the outsourcer delivers a satisfactory product, both in terms of the cost-effectiveness and in the quality of the work, then the outsourcer will most likely increase its

investment into more outsourcing activities once the risk is determined to be outweighed by the benefit. These benefits are not wholly gained by signing an agreement or contract and sending money to the outside party. While outsourcing on paper may sound simple, having a third party takeover an aspect of your business that they are proficient in, requires some adjustments to the business model and management style of the outsourcer to be effective.

Some of the largest problems with outsourcing practices identified by the report³ stem from the inherent nature of the process. They stated that companies who choose to outsource may not realize their anticipated or promised gains because of the loss of oversight and control of an outsourced project or business function. Many of the interviewees in their study said that lack of proper feedback loops can result in the delivery of an actual product that deviates from the anticipated product. This stems from the basic nature of outsourcing, the removal of a business function to a third party, which typically results in a conflict of interest. This culture difference derives from the loss of control since operations are now far away and rely heavily on the vendor. Complete trust in the vendor's abilities is necessary but risky. Companies that choose to outsource and their chosen outsourcing vendors see outsourcing from two extremely different philosophies and if they fail to integrate each other's parameters of the relationship then that relationship may fail. Outsourcers biggest mistake, is that they expect vendors to behave in a manner similar to their own employees.³ This irrational thought process leads outsourcers to believe the vendor has their interests as their primary goal, which is obviously not true, while an outsourcer asks that its employees put in the extra effort to produce a polished and refined product, the outsourced vendor sees the contract's boundaries as the extent of their work. If additional work is discovered to be needed then the vendor views that as additional work and will most likely require additional payment. The authors argue that it all comes down to

incentives.³ A vendor will not be paid to go above and beyond the necessary work needed to complete the project and produce an exceptional product. Additionally if the vendor determines that a project will not be as profitable or beneficial as another project, it will focus on the more profitable project. Companies will usually focus their attention to aspects of their business that give the highest return on their investment. These different priorities between the vendor and the outsourcing company can lead to different expectations. Failure to properly outline a project's goals and specifics can lead to a poor business relationship.

Comparative Advantage

In addition to the absolute advantage of cost-savings provided by outsourcing a business function to a vendor, that is a overall reduction of cost for the outsourcing company, there also is a comparative advantage in trade that is often overlooked. Comparative advantage explains how trade can create value for both parties even when one can produce all the goods with fewer resources than the other. This is the main concept of the pure theory of international trade. Comparative advantage acknowledges that one country may be able to produce goods most efficiently and cheaply, but this doesn't mean they should expend resources to make all those goods. Comparative advantage is analogous to outsourcing in this way. A company may be able to manufacture its products in house at a globally competitive price, however it may not wish to do so in order to minimize their opportunity cost. Instead of diverting resources to manufacture a product, they can invest those resources into a business function that provides a higher marginal utility. They may have expertise in marketing and design, thus outsourcing other functions to a vendor, allows the outsourcing company to minimize its opportunity costs.⁴ This is the second part to the two-fold savings that outsourcing provides. This aspect is often overlooked by offshoring's detractors. They often focus on the job loss and fail to internalize the absolute and

comparative cost-savings advantages that outsourcing provides not only to the business sector but the global economy.

Effects on Domestic Job Market

While the topics of outsourcing and offshoring are important topics for the American people, and has been covered in two previous reports,^{3, 15} the political impact and ramifications of the decisions made by legislative and private sectors cannot be overlooked. This report enriches the work previously done by examining the public and private sentiment towards outsourcing and offshoring, which since the original publishing date has seen interesting developments. Congress has become a forum as protectionists and free-trade advocates jockey for political dominance. These legislative acts have been met with close voting margins and have ramifications for the people of America. Whether they be tax exemptions or restrictive immigration laws it has been shown that the political impact of outsourcing has reach beyond the business environment. Restrictive immigration laws and tax exemptions will change the cultural composition of the U.S. and increase the costs of goods and services.

While evidence suggests outsourcing and offshoring are beneficial to the American people, it is still viewed with hostility, even viewed as a 'bad word' among leaders like President Obama and the leaders of the AFL-CIO.¹⁹ A Wall Street Journal poll found that 53% of Americans feel that free-trade agreements have hurt the economy, and politicians are quick to embrace this sentiment¹⁹. This past fall the Senate voted 53-45 to raise taxes on companies who move operations abroad and lower payroll taxes for those who don't. The common perception is that outsourcing and its cousin, offshoring, is a "zero sum" gain, but this is not how the dynamic global economy works. Like it or not, we have a global economy and the reality is, it will stay a global economy. The politics surrounding outsourcing have been demonized by the public and

toxic reports stating the ill effects on the economy despite academics attempts to dissuade them. In 2007, Matthew Slaughter, an economist from Dartmouth's school of business published a study on the hiring practices of over 2,500 U.S based multi-nationals.²⁰ This study highlights the hidden benefits of outsourcing and offshoring that are hidden behind political and emotional sentiments held by the American public. Other academics, Pierre Martin of the Université de Montréal and J. Bradford Jensen of Georgetown University, gave talks on March 12th of 2008 at the Canada Institute and the Program on Science, Technology, America, and the Global Economy (STAGE) illustrating how facts on outsourcing have been twisted to suit political groups²⁰. In their talk they referred to studies that showed between 1995 and 2002, an average annual rate of 220,000 jobs per year were sent overseas, which is a insignificant percentage of the 153.1 million workers in the U.S. labor force as of 2007, yet granting tax exemption to non-outsourcing companies will have a significant impact on our problematic national debt.²⁰

Outsourcing and offshoring of business functions continues to attract considerable attention in policy debates and the media here in the United States, yet the political economy of offshoring remains understudied. The effects of offshoring on the labor market are unclear to academics, yet there are highly charged political groups that claim otherwise. Labor advocacy groups, such as the AFL-CIO, claim that offshoring activities hurt the American economy. AFL-CIO's president Richard Trumka supported the Creating American Jobs and Ending Offshoring Act which sought to end subsidies and tax incentives for American corporations "to move forward to an economy that works for everyone."⁵ The topic of offshoring first became popular during the 2004 election campaign as candidates vied for popularity. Is offshoring really harmful to an economy that works for everyone? As offshoring became a popular choice for American businesses we saw how labor groups tend to react negatively to offshoring.⁶

The Boomerang Effect

The emergence of offshoring as a practical business solution facilitated by the rise of practical global communication technologies requires a revisit to how trade influences wage inequality. Offshoring of production and business support functions has led to the loss of low-wage labor intensive activities. Offshoring's detractors had focused on the loss of labor intensive manufacturing jobs and jumped to the conclusion that offshoring hurts Americans. Sending jobs to a foreign country like China or India frees up American resources for more skill intensive jobs. However this is not the biggest benefit the domestic job market receives from outsourcing and offshoring. Behind the cost savings of getting a product at a reduced cost, there lies the Boomerang effect. The boomerang effect is an often overlooked benefit of outsourcing to foreign countries.

According to one longitudinal study, over 36,000 jobs were lost in 2009 to China and India in the outsourcing sectors of research and development, and business process outsourcing (Figures 1 & 2).²⁰ However the boomerang effect sheds light on the benefits of losing 36,000 domestic jobs overseas. When we look at the destination of Chinese and Indian investment, we can see that nearly all of those jobs are returned through foreign direct investment into the U.S. economy (Figure 4). Typically this foreign re-investment leads to consultancy or foreign offices being created in the domestic labor market. Tracking investment trends in recent years have shown that as the global economy becomes more integrated, it also becomes more complex and uncertain, making direct correlation difficult. A survey of 700 Chief Human Resource Officers conducted this year showed that outsourcing and offshoring are here to stay with a majority saying they planned to increase both activities (Figure 5)⁷. As these countries rise in prominence

on the global economic stage, their importance as sources of foreign investment for the U.S. grows.

Culture Differences

India was the clear destination for outsourced call centers at the time of previous reports, from the twentieth century until just recently. The Philippines has now become the call center capital of the world, overtaking India in terms of the number of people each country employed (Figure 1).⁸ Filipino President Benigno Aquino explains "in the past decade, the (growth in the) industry in the country has been nothing short of exceptional."² From a virtual non-entity in 2001, the Philippines has become the call center destination, not only in terms of employed workers, but also in terms of reported revenue according to Ivan Uy, head of the Filipino information technology commission.⁸ Benedict Hernandez, the president of the Contact Center Association of the Philippines said that "the Philippines, a former US colony, had an advantage due to its workforce being made up of English speakers who had accents and a culture that is closer to those of many Western callers."² When sourcing an offshore call center, it isn't surprising to see why a company would want to minimize accents and cultural differences with their target market. While the destination of business process outsourcing according to IBM's 2010 annual report on "Global Location Trends" has shifted to the Philippines (Figure 1), it might be a symptom of a larger trend in the global outsourcing market.⁹

In addition to these cultural differences that are critical for communication, there are other differences that can be potentially damaging if overlooked. In 2008, pharmaceutical company Baxter International sold an intravenous biologic anti-coagulant, known widely as heparin, that led to several deaths stateside after patients took the contaminated drug¹⁰. Heparin has been in use for over 70 years and is made out of tissue from pig intestine. Baxter

International applied its label to the drug after outsourcing the manufacture to Yuan Intestine & Casing Factory, the first stop in a long chain of a poorly regulated industry in China.¹⁰ This isn't the first time pharmaceutical manufacture in China has led to serious illness or death. Prior to the Heparin incident, the deaths of over 100 Panamanians from diethylene glycol found in cold medicine in 2006/2007 was attributed to a Chinese manufacturer,²¹ which does highlight the cultural differences between the United States and China¹¹. In the U.S. the Food and Drug Administration (FDA) exists to ensure the purity of items destined for human use. U.S. companies become so accustomed to the regulation of supply chains, that they do not suspect a reputable company to not know where its ingredients come from. These differences aren't only in China or always predictable. Ash Stevens, a contract manufacturing pharmaceutical company, has experienced these culture differences in business practices firsthand.¹² Ash Stevens' CEO Stephen Munk recalls his surprise after undergoing an inspection by the Japanese FDA equivalent, "the FDA spends the bulk of its time reviewing analytical data and labs. When we were visited by the Japanese Ministry of Health, they got on our roof and looked at our HVAC units... There are cultural and country differences in how inspections may proceed."¹³ From a fundamental methodology to a more broad status quo, companies seeking to outsource or offshore need to keep in mind that 'best practices' have different interpretations around the world.

Cultural differences in business practices can be properly controlled if proper oversight methods are employed. However as soon as a company views a vendor as having their best interests at heart, eventually the vendor and outsourcer will enter into a conflict of interests. Proper monitoring and oversight of the vendors business practices will allow for transparency that can stop unethical or dangerous activities immediately, before a poor quality or potentially harmful product reaches consumers.

Trends in Outsourcing

This project has discussed best practices for companies choosing to outsource which were 1) determine the business's core competency and non-essential business functions for outsourcing, 2) identify potential outsourcers and initiate trial contracts, 3) evaluate vendors performance, 4) continue partnership with close oversight and feedback channels. However it hasn't addressed changes occurring on the global scale. At the turn of the century when companies outsourced or offshored to a foreign country, there were only two major destinations; China and India. Over the last decade several new players have entered the global market as major players e.g. Philippines, Malaysia, Columbia, Poland, Malaysia, and Costa Rica.⁹ These new markets for outsourcing/offshoring activity fall into three categories, 1) Business Process outsourcing, 2) Research & Development outsourcing, and 3) Production outsourcing. (Figures 1-3)

Trends in Business Process Outsourcing

Business Process outsourcing is defined as activities that are instrumental to an effective business model, but are often in a support role to the business's core competency. Examples are human resource management, payroll and general accounting, as well as the commonplace IT and customer support functions in the form of call centers. The shift in business process outsourcing, that is non-manufacturing or research and development jobs, from India to the Philippines may be have been influenced by the affinity between Filipino culture and Western culture. (Figure 1) However to assume this is the sole driving force behind such a massive shift in jobs and resources would be premature and incorrect. India has become saturated with business process outsourcing and has naturally progressed economically as its labor market matures. The Indian labor force has developed a competitive workforce that is able to handle

more complex and critical functions that demand a higher wage. The Philippines offers a similarly attractive business environment for business support functions as India, but due to the recent entrance of the Filipino labor force, has not had the same labor cost increases in popular outsourcing destinations such as in India.^{7,8} As demand increases for such services, the cost of such labor supply will increase, leading to an increased cost of outsourcing of business process functions, like in India's labor market. This maturation of the Indian labor force can be seen in its solid grasp as the number one destination for research and development projects, typically large software development projects, almost double the number of outsourced jobs as the runner up, the United States.⁹ (Figure 3) India was not alone in their maturation of the labor force. China, which was once considered to be merely 'the world's factory', has seen its labor force develop not into Research & Development like India, but into the services industry. China is now the 5th ranking destination for business support services just behind Poland, a rise from the 13th position in 2008.⁹ (Figure 1)

In addition to maturing labor forces driving business process outsourcing from well established countries like India, a historical reversal of Shared Services Center from large campuses into more agile and competitive specialized centers. Previously offshoring or foreign outsourcing companies would house various business functions under the same roof. This means that human resource, accounting and call centers would be located on the same campus. However companies now are ready to embrace the opportunities offered by different locations to take advantage of the skills and costs found in different labor markets.⁹ This has resulted in a more decentralized outsourcing/offshoring practice as a labor force demonstrated its core competency.

Trends in R&D Outsourcing

The global trends in Research & Development outsourcing have seen a decline due to the inherent nature of R&D projects. R&D activities are typically investments with a long pay-back period. Because of this characteristic, companies put holds on longer-term investments until they are confident in a sustainable economic recovery.⁹ Companies seeking to reduce their uncertainty risk have scaled back their R&D projects in foreign countries. India is still the number one destination in 2009, but the U.S. has seen a surge, rising from sixth place in 2008 to second place in 2009 (Figure 3). It is important to note that only stand-alone R&D activities were looked at in Figure 3, on-site R&D to support local production were not accounted for. Similarly to the production sector trend, during times of economic uncertainty companies who outsource choose to do so closer to home or in more secure markets. This was a contributing factor to why the U.S. jumped up from sixth to second place in the rankings of top destinations for stand-alone R&D jobs. (Figure 3) This risk aversion applies to any business function that requires large capital outlays. For Research & Development projects, this requires a large initial investment of capital with potentially no return. Similarly in production offshoring, and sometimes outsourcing, which requires a large initial outlay in terms of physical capital, there was a retraction from foreign markets. This can be seen in Figures 2 and 3.

Trends in Production Outsourcing

In contrast to the business services sector of outsourcing, which saw remarkably healthy growth, production outsourcing suffered further decreases in 2009 compared to 2008. This was not surprising as new investment in production typically only precedes anticipated market growth.⁹ What we see is that in the BRIC countries (Brazil, Russia, India, China), the decline was the most pronounced. This is in contrast to the U.S. and Mexico, which saw an increase in

production investment in terms of jobs. Mexico was a very attractive destination, nearly on par in 2009 with China, and behind the number one ranked U.S. (Figure 2). This can be interpreted as outsourcers, during times of uncertainty, shift away from developing/emerging markets like the BRIC countries towards the Organization for Economic Co-operation and Development (OECD) member countries. The OECD contains such countries as Mexico, France, Germany, United States, United Kingdom and Japan, which are perceived to be more stable for investment.¹⁴ These trends support the notion that during times of economy duress, investment is placed into safe, predictable markets like the United States and countries that are intimately connected to them, like Mexico.

New Phenomena: Homeshoring

Homeshoring is a new emergent form of outsourcing. Homeshoring, sometimes referred to as homesourcing is best thought of as a combination of outsourcing and telecommuting. Homeshoring activities typically fall under the business process outsourcing sector. Homeshoring, which seeks decentralization of business activities in order to take advantage of different geography's local labor talents and costs, follows a trend identified in the business process sector. It has major advantages over traditional business process outsourcing that stem from improved global communications networks. Homeshoring workers are based out of their own homes, and often supply their own computing and telephone networks, reducing the carrying cost of office space. This meant that homeshoring for business allows companies to bypass many of the fixed costs that still plague offshoring and outsourcing. Stephen Loynd, a telecommunications analyst for IDC, of Framingham, Massachusetts said "the whole pie for outsourcing is growing, that means more work will be offshored but at the same time there will be more work that's homeshored."¹⁵ The virtual call centers that homeshoring can provide by

linking independent, geographically diverse, low cost services are extremely attractive to companies. Homeshoring is expected to rapidly grow with numbers as high as 300,000 projected for 2010.¹⁵ As more data is collected and analyzed, this new phenomena can be determined to be either temporary or a more permanent tool for businesses.

Conclusion

The initial reasons for outsourcing and its related activities, offshoring and homeshoring, still hold true. The primary directive for engaging in these activities is the cost savings they provide. Outsourcing and its related activities are just the latest tool that business leaders can call upon to achieve their strategic goals. The global economy has reacted and assimilated this new process, and in doing so, has outlined specific advantages and critical pitfalls that must be avoided.

Outsourcing saves money by allowing a company to focus its limited resources on its core competency. Companies that excel in design or research no longer have to blunder with inefficiencies as they enter marketing or production sectors. This makes outsourcing activities especially attractive for small and medium sized businesses that don't have the support and expertise in multiple sectors like large multinational corporations. By outsourcing business process functions, businesses maintain their comparative advantage in their core competency and reduce the opportunity costs associated with diverting resources into non-critical business functions.

Initially at the onset of the popularity of outsourcing and offshoring, the types of business functions that were outsourced was limited. At the turn of the century there only existed two main activities that were outsourced. These were primarily information technology support

services and high volume manufacturing contracts. However we can see that the range of possible activities has increased dramatically. No longer are IT support and high-volume manufacture the leading outsourced activities. They are joined today by a myriad collection of suitable candidates for outsourcing. Production of all volumes in pharmaceutical, food, electronics, and the traditional heavy industries are now viable. These are joined by the traditional IT support as well as end-user support in call centers. More nontraditional activities have joined the list of potentially outsourced activities like accounting, human resource and data management. Surprisingly, research and development activities have become favorable business areas to outsource as U.S. companies seek to focus on marketing and production. What we learned now looking back at the types of activities outsourced, is that many more things can be outsourced than originally thought. This has especially become easier as global communication networks have advanced. The integration that information technology has provided allows virtually any task to be completed anywhere in the world because it allows project managers to have oversight and feedback without red-eye overnight flights or having to wait for an update from an on-site manager.

While we saw that nearly any activity can be outsourced, not all attempts to do so have been met with success. Vendor relationships have failed due to the loss of adaptability and oversight. A common practice to avoid such failings is the use of introductory or trial contracts between the vendor and outsourcer. As discussed we saw that different goals between the two parties involved can lead to different expectations as to the final outcome. Many outsourcers admitted to testing the waters with a new vendor to see if the product delivered matches what was promised. These trial contracts can help to build a repertoire and dialog that is critical for a long-term partnership. However, even long term partnerships can have disastrous consequences

for businesses when expectations aren't met. Incentives to go above and beyond the contracted requirements are usually very limited, and, therefore, additional benefits aren't realized for a company that sends this to an outside vendor. Furthermore, as a relationship develops between an outsourcer and vendor, transparency in the vendor's activities falls down the outsourcer's priority list. This was seen when the oversight of critical business functions is lost. In the case of Baxter International, they no longer audited the supply chain and sourcing of materials.¹⁶ This ended sadly in the unfortunate deaths after contaminated materials entered the supply chain. This loss of oversight is indicative of one of the largest problems facing outsourcers.

The shift of outsourcing job's destination countries from India to the Philippines, a similarly aligned culture, leads to a more inclusive set of assumptions and expectations of good business practices. While initially the driving force that led to the Philippines becoming the call center capital of world was undoubtedly the familiarity with Western cultures, culture differences are more important than just having a mastery of the English language. For companies that outsource consumable product manufacture, product integrity and quality is especially important. If the geographic corporate culture is one based upon productivity, cost and on-time delivery and not that of quality and integrity, the outsourcing company may face legal repercussions. While in these cases, the contaminated products all came from the same source country, China, outsourcing these activities to a more developed and regulated country like Japan may not alleviate these quality concerns due to the cultural differences between the U.S. FDA and the Japanese Ministry of Health for example.

Outsourcing sector trends show that during times of economic uncertainty, high-investment and long-term investment outsourcing activities such as R&D and Production outsourcing are returning to more mature markets because of the safety and experience these

markets have. Conversely we see in the business process outsourcing sector a trend away from more developed markets, like India, where labor markets demand higher wages compared to new emerging markets. This is a trend that will surely continue as new geographic locations like Costa Rica, Philippines, Poland, Fiji, etc., enter the global market.

Recommendations

Growing trends show that businesses are seeking to be more agile to adjust to a more volatile global economy. This can be seen by the increased foreign direct investment in the form of outsourcing. Large static operations, like large shared service centers, lack the cost-effectiveness and ability to rapidly redeploy as different markets mature. However while outsourcing can be used to reduce overall costs and provide other benefits like 24 hour business uptime, oversight and feedback are paramount to a successful outsourcing operation. Therefore it is critical that businesses involved in outsourcing activities maintain control and oversight over their activities and redeploy when necessary. Alarms for a change in strategy occur anytime a company and its outsourced vendor no longer have the same goals and expectations, or a labor market matures. Outsourcing remains an effective tool for businesses to focus on their strategic goals by reducing cost. A reduced cost of doing business for American companies is beneficial to all Americans.

Appendix

Excerpts from Suggestions for Effective Outsourcing

Problem Statement

This IQP looked at the process with which companies decided to outsource and to whom, and through this the team saw the strict guidelines and objectives companies used to ensure proper conduct while maintaining the stakeholder's goals. The team found out what companies that choose to outsource rely on to ensure that they achieve their goals without mismanagement. Outsourcing is now an important part of organizational life. Current estimates of the world-wide scale of outsourcing range from \$300 billion to \$1 trillion. The market for IT outsourcing is smaller but significant.⁴ Outsourcing is evolving from being a solution to a shortage of a resource to having a fundamental influence on the business models of many organizations. Companies seeking to outsource need to apply the same business model, meaning they should seek a long term, results orientated relationship with an external service provider for activities traditionally performed, or capable of being performed, within the organization and maintaining a degree of management control over the supply of the service and in risk taking.

Currently, there are no set guidelines for companies seeking to outsource. There is substantial risk associated with outsourcing. Questions that were investigated were: what process do managers utilize when deciding what functions should be outsourced? What are the Criteria for selection of vendors? After organizations outsourced, did they realize all of their anticipated gains? What problems did they encounter? What types of companies are most likely to benefit from outsourcing? How likely are companies to participate in outsourcing activities again? What organizational structures are arising that aim to protect the stockholder's interests, and therefore the public? As the outsourcing

market continues to grow these questions needed to be investigated to provide a proper guideline for outsourcing.

Many companies are encountering severe losses from a lack of management control, and, even worse, some are experiencing backlashes due to miscommunication especially ambiguous contracts. When outsource contracts are signed, the press reports expected outcomes, including reduced IT costs, better service, access to new technology, and an ability to refocus in-house staff on higher-value work, but there is substantial debate about the long-term consequences of such deals. There is no documentation of the proper method for initiation of an outsourcing process. The team has reached a more definitive answer in conducting research in many different areas.

The chart below summaries the answers each company gave for each question.

ECI Biotech - Mitch Sanders	Fidelity Investments - Dan Richards	Nagog Hill Partners - Richard O'Brien
1. - Cost savings - Human capital - Experts in the field	- IT expenses - Enables the support of new business products	- Use of money - Smaller burden of upfront costs - Use money and resources more efficiently
2. - Uses consultants - The consultants help decrease risk	- Analysis to see if it is applicable and useful - Decisions are made after discussion and presentation of data (costs vs. savings)	- Make or buy analysis - Quality of skills and experience
3. - Makes sure the people he is working with are experts - Starts people off slowly to see if they are worth the investment	- Sensible decision making - Night support is important - Gets more work done in a day than an eight hour day	- Managing outsourcing is critical - Involvement of every aspect of the process
4. - Use the best people - Feel that in the long run they save more money	- Security is most important - Want to be sure they are safe - Costs is of secondary importance	- Want someone with the resources for success - Expertise, someone who is ready for anything on the job

ECI Biotech - Mitch Sanders	Fidelity Investments - Dan Richards	Nagog Hill Partners - Richard O'Brien
5. - No changes -Used consultants to prevent any structural changes	- Had to change a few aspects of certain positions - Planned well so there were no layoffs	- Changes depend on how you manage everything - Control hiring practices so layoffs aren't necessary
6. - No real changes - They hire what they need - Use consultants	- Fair amount of retraining - Mostly cultural training	- Large amount of retraining - Cultural training and new ways to work with new partners
7. - Challenges are becoming increasingly smaller - Technology makes the world smaller and tasks easier	- Finding the right provider for the lowest cost. - Takes lots of research to find the right provider	- Culture and language are the biggest challenges to face
8. - Expertise is needed more in the beginning of a project - Bring back some services	- Depends on the situation - Believe in the saying "If it ain't broke, don't fix it."	- After maturing and learning they are able to bring back some of the services

ECI Biotech - Mitch Sanders	Fidelity Investments - Dan Richards	Nagog Hill Partners - Richard O'Brien
9. - Cost - Value - Delivery on time - Use outsourcing cautiously	- Communication - Chemistry - On-time task completion	- Supervising the process - Making sound decisions
10. - Unsure - The economy and industry has its ups and downs	- Long-term, the economy usually balances out - Economy is always changing and adapting	- Job loss - Outsourcing isn't entire to blame - Bad management and decision making
11. - Regulatory clinicians, saves lots of money outsourcing them - Use student resources to save money also	- Outsourcing touches all industries - There is no standard template for outsourcing	- Medical field is difficult to outsource

CONCLUSIONS AND RECOMMENDATIONS

This project has provided many answers to the team's questions. From the data gathered from literary sources and interviews with corporate officials, the team has been able to see a trend in the outsourcing decision making process. The big questions are why companies choose to outsource, and what is the method that is undertaken to accomplish the decision to outsource.

Obviously the biggest concerns to companies are profits and expenditures. From this "big picture" view, companies see outsourcing as a cost savings mechanism. The team found that, no matter what the size of the company, their primary reason to outsource was to lower expenditures. This was the primary reason, but from our analysis the team found other subsidiary reasons. Efficiency was also important. They want to get a bigger bang for their dollar, which means they will get more work and production with less costs in another country than if they did the same in the U.S. Another reason is time savings. By outsourcing, companies are able to give a portion of their labor to the outsourcing provider. This allows them to concentrate their time on other tasks, and in the business world, time is money.

Knowing that a company is going to outsource is a small portion of the big picture. Next companies must decide what tasks are going to be outsourced, and where these tasks will go. Each company has different tasks and work that can be outsourced so it is impossible to say that they all outsource IT or fabrication work. Although, it was found that companies believe in outsourcing work that will cost less elsewhere. They usually start off small, to see if the outsourcing process is actually going to work for them. They

look to see if they are actually saving money, and if they aren't losing any quality of work. If it appears to be going as planned, then they will usually increase the amount outsourced.

Companies look for experts and experienced outsourcing providers. With experience comes an ability to adapt to new situations, which allows for a higher chance of success. Outsourcing providers are also expected to have a certain degree of security to protect their clients' products or interests. It is also interesting to find that companies look for outsourcing providers that are in different time zones. This allows them to double productivity. So when one group is working the other is sleeping and vice versa. This means that instead of an eight hour work day in a normal setting, the company is getting two eight hour work days in one day, or 16 hours of work per day. This increases productivity, which saves money.

When the outsourcing starts to take place, companies may experience restructuring or retraining. Most companies find that if they plan well then they won't have many job losses. There is some restructuring, but retraining is probably the biggest part. There are many types of retraining that companies use. The most important one is cultural training. This is to prepare them for their future partners overseas. The other retraining that is prevalent in outsourcing situations is team work retraining. This is also to prepare people for working with new people in new situations. These types of retraining will ultimately result in savings. If people are able to work together better then efficiency will be increased, which results in cost decrease and savings.

At this time the team has a few recommendations that are ancillary and tangent to our project. More interviews should be undertaken to get a broader scope and a more

varied opinion. These interviews should also be taken from a variety of people from different industries and fields. The team also believes that outsourcing providers should be interviewed to get another perspective on outsourcing and its effects. The questionnaire should be more refined to get more in depth answers. By seeing the conclusions drawn from the data, the questionnaire questions should also be more tailored to test the conclusions our team has arrived at.

Glossary

Business Process Outsourcing⁹: is a subset of outsourcing that involves the contracting of the operations and responsibilities of back office business functions (or processes) to a third-party service provider. These can entail customer support, human resource, or accounting activities. It is primarily used to refer to the outsourcing of business processing services to an outside firm, replacing in-house services with labor from an outside firm.

Comparative Advantage¹⁵: the ability of an individual or group to carry out an economic activity, such as production, at a lower cost and more efficiently than another entity.

Core Competencies¹⁷: activities or practices, such as product development, determined by a company as critical to its long-term success and growth. Core competencies are typically based on skill or knowledge sets rather than products or functions. They provide return on investment and act as a barrier for other companies trying to enter a particular market. Many manufacturers choose to focus on core competencies and outsource production, or activity-based, tasks. Many OEMs decide to keep their high-level engineering and design

work as internal competencies, particularly as these might apply to new products and highly complex products.

Homeshoring¹⁵: also known as homesourcing, is the transfer of service industry jobs to electronically connected home-based employees. Homeshoring is essentially turning office jobs into work at home jobs. Homeshoring may or may not involve outsourcing, which is contracting for work to be done by a third party outside the company. If a company employs its own home-based workers, then homeshoring is not outsourcing.

Offshoring¹⁸: shifting a business function from one country to another. For a business, this can entail moving product manufacturing, service centers or operations to a different country. Offshoring is often used to reduce the cost of business, with the company seeking to move parts of operations to countries with more favorable economic conditions.

Outsourcing¹⁵: often viewed as involving the contraction out of a business function - commonly one previously performed in-house - to an external provider. In this sense, two organizations may enter into a contractual agreement involving an exchange of service and payments.

Production Outsourcing⁹: is a subset of outsourcing that involves the contracting of the operations and responsibilities of manufacturing business functions (or processes) to a third-party service provider. These can entail customer support, human resource, or accounting activities. It is primarily used to refer to the outsourcing of business processing services to an outside firm, replacing in-house services with labor from an outside firm.

Research & Development Outsourcing⁹: is a subset of outsourcing that involves the contracting of the operations and responsibilities of research and development business

functions (or processes) to a third-party service provider. These can entail customer support, human resource, or accounting activities. It is primarily used to refer to the outsourcing of business processing services to an outside firm, replacing in-house services with labor from an outside firm.

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