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OUTSOURCING IN THE UNITED STATES MARKET

INTRODUCTION

Outsourcing also known as contracting out is a business decision to export some to all of an organization's non-core production operations to a third-party service provider that specializes in that operation.[1] The concept of outsourcing stems from the idea of comparative advantage first postulated by Adam Smith in his book "The Wealth of Nations". Smith suggested that individuals, firms and nations are better at producing certain goods and services and thus must concentrate on producing those over others. This idea is the root behind current developments in management theory; in particular the concept that each company has a few "core competencies" that it is specialized in.[2] Further this theory suggests that managers and key decision makers of a firm, should focus their scarce production time and resources to sharpen and perfect these core competencies, and hire other firms with their own core competencies to perform other tasks. Some of the firms with the required core competencies however can be found in other countries and thus the increased trend of off-shore outsourcing. Offshore outsourcing is the practice of hiring an external organization to perform some or all business functions in a country other than the one where the product or service will be sold or consumed.[3] New communications and information technologies with reduced costs and improved quality control capabilities have made it possible and even easier to hire firms outside of the country to perform tasks that are outside the core competencies of an organization.

WHY COMPANIES OUTSOURCE

The decision to outsource is made because it is favorable to the company in many ways. Some of them are:-

- ❖ It is economical as it frees up capital resources by allowing the company to save on operating costs. The company can reduce labor costs by hiring high quality labor with specialized skills at a much lower wage rate without sacrificing the quality of its finished product.

[1] http://en.wikipedia.org/wiki/Outsource

[2] Prahalad, C. K., and Hamel, G. (1990) "The Core Competence of the Corporation."
Harvard Business Review (May/June): 79–91.

[3] http://en.wikipedia.org/wiki/Offshore_outsourcing

- A company that chooses to outsource can save on time by off-loading non-core functions to the third party partner and thus the company can concentrate its scarce resources on core processes like strategic thinking, process reengineering and managing trading partner relationships and thus enhancing its strategic advantages.

- Outsourcing allows a company to spread risks and not have to take up the burden of keeping up with developments in Information Technology and still be able to retain control of strategic decision making.

- By consolidating and centralizing functions with outsourcing the parent company can improve efficiency providing its customers with the best quality products and services.

- Outsourcing also allows the company to establish long term relationships with world class service providers and benefit from their expertise, extensive investments in technology, and time tested methodologies at providing the same kinds of services for other businesses with similar requirements.

- On the whole outsourcing benefits the company because technology is changing so fast, it has to be leveraged and used to the maximum to deliver competitive advantage to a company.

TYPES OF JOBS THAT ARE OUTSOURCED

Outsourcing always involves a considerable degree of two-way information exchange, co-ordination, and trust. The outsourcing firm will need to manage the business relationship, share data, and work out problems as they arise.

To able to outsource a certain job or aspect of production, that task should be one that can be easily transferred from the mother company to the out-source centre and vice-versa. This transfer is done through telecommunications lines and the internet. Thus companies choose to out source customer support and call-centre functions. For the mother firm to be able to manage the outsourcing relationship successfully the tasks must be well-defined and easy to set up. Thus it is very convenient to out-source a task if it has to do with data processing or data gathering, such as filling out standard tax forms entering data, and transcribing legal or medical files and thus can be easily repeated. Also the task must be one that does not require direct contact with the consumer, such as answering predictable customer-service calls. It is useful to outsource only when the wage difference between the original country and the off-shore country is very steep.

Operations that are usually out-sourced are Information Technology, Human Resources, Facilities and Real Estate Management, Accounting, Customer Support and Call Center functions, and Manufacturing and Engineering.

HOW IS THE OUTSOURCE PARTNER SELECTED?

For a company that is looking to outsource, they would like to outsource to a company with a vision, competency and infrastructure that match those of the American outsourcing company. To determine a good match for outsourcing companies look at different factors:-

- The core competency of the outsourcing partner – Client outsourcers determine the expertise and business strategy of the outsourcing firm by looking to see if the skills the labor force are equivalent to skills that they are particularly interested in. To be able to determine the skill level of the labor force the outsourcing company looks to the International Standardization Organization's IT assessment criterion[4] to see how the outsource partner ranks with respect to this criterion.

- The equipment and infrastructure such as hardware, software, telecommunications and networking equipment that the outsource partner currently has invested in is looked at and if it is sufficient for the needs of the outsourcing organization.

- The experience this outsource partner has, by examining the accounts that it has previously dealt with. Testimonials from past clients can be looked at and if possible interviews with previous clients would be a good way to determine the experience of the outsource partner.

- The, balance sheets of previous years are scrutinized to determine the profits, growth rate and in general viability of the company and to determine if it would be profitable to partner with them.

- The mission and vision of the outsourcing partner – It is important for client company to be sure that the outsourcing partner will facilitate a team-work based relationship and will be willing accept and be able to implement their project strategies.

[4] The exact label for this criterion is ISO 8159.

- Also a site visit might be necessary and is usually advisable to be ascertain if the company has the equipment, man-power and expertise that they might have claimed that they had before the contract is given to them.

Outsourcing from the US market to Indian markets for example is developed to the point where US organizations have a lot of helpful resources in finding an outsource partner. There are several companies as well as web-based resources that a company can look to for outsourcing guidelines. Some of these resources are case-studies and evaluations of outsourcing attempts by other companies. Also available are reports that state clearly some of the strategies of outsourcers that have worked and those that haven't worked.

THE AMERICAN PERSPECTIVE

Estimates in a 2003 McKinsey Global Institute study stated that outsourcing by US companies is likely to increase by 30 to 40 percent over the next five years and this will result in the loss of about 200,000 jobs a year in services over the next decade.[5] There has been a recent increased hype about outsourcing with headlines appearing in popular news papers such as

- "America's pain, India's gain", *The Economist, Jan 2003*
- "Is your job next ?", *BusinessWeek, Feb 2003*
- "Study sees 406,000 U.S. jobs shifted overseas in 2004", *Financial Times, Oct 2004*

Thus the American public's concern about the effects of outsourcing on the American economy is well-founded. The general belief is that jobs, dollars, skills, and experience are being exported to foreign countries, and the people in those foreign countries are thus making financial, socio-economic and developmental progress while the U.S. economy is stagnated. However the outsourcing innovation is not necessarily bad for the United States. A 2004 study conducted for the McKinsey Global Institute by Martin Baily, former chair of the Present's Council of Economic Advisors under President Clinton, and Diana Farrell, director of the McKinsey Global Institute, examined the effects on the American economy when an American firm out sources a task that costs one dollar to India.[6] In their study they stated that only thirty three cents of that dollar goes to India's economy in the form of wages paid to Indian workers and profits accrued by Indian firms. The remaining 67 cents returns to

[5] http://www.outsource2india.com/why_outsource/articles/benefit_outsourcing.asp

[6] Baily, M. N., and Farrell, D. (2004a*)* "Exploding the Myths about Offshoring." McKinsey Global Institute (April) (www.mckinsey.com/mgi/reports/ pdfs/exploding_myths/explodingoffshoringmyths.pdf).

American firms, in three ways. Firstly Indian firms spend five cents buying equipment, tools and services from American firms. Sometimes the organizations in India that perform the outsourcing are owned by American firms, so four cents in profits comes back to the United States. Finally, American firms that outsource to India save 58 cents of the original dollar and are able to get higher quality because they are able to hire very qualified people in India for much cheaper and spend more on supervision and training. In conclusion the outsourcing American company realizes tangible benefits of out sourcing such as lower labor costs, being able to focus on their core competencies, reduced capital costs, quicker project starts and finishes, reduced risk and worries, and higher efficiency.

It can be argued however that all of these benefits go to the firm. What about the American programmer who loses his job to an Indian? What about the American economy? Estimates made by the McKinsey study show that that between 1983 and 2003, two million manufacturing jobs were lost in the US but 36 million new jobs were created in services.[7] Also indications from statistics are that the number of jobs lost to off shoring is minimal compared with the mass layoffs prompted by corporate mergers and restructuring when the economy grows. It would be therefore wrong to assume that there is a fixed number of jobs in the US job market and thus when a US worker's job is outsourced he will remain permanently jobless. A flexible job market and the mobility of US workers will enable the US to generate new jobs faster than off shoring eliminates them. Further, a rise in corporate profits is good for the US economy as a whole. The benefits of offshore IT outsourcing added $33.6 billion to real gross domestic product in the United States in 2003[8] By 2008, real GDP is expected to be $124.2 billion higher than it would be in an environment without IT software and services offshore outsourcing.

Estimates made by Baily and Farrell taking into consideration the cost to American employees who lose their jobs to outsourcing, the gain to American economy as those workers are re-allocated to more value-added jobs and the financial gain to American firms as money is saved through outsourcing showed that a corporate dollar spent on offshore outsourcing ends up providing $1.12 to $1.14 in benefit to the American economy. This conclusion is contrary to the popular belief of Americans that foreigners are taking over jobs of the local average American and this is a major cause of the declining economy. However, looking at the big picture one can come to the conclusion that the American economy gains tremendously from out-sourcing. Most

[7] http://www.outsource2india.com/why_outsource/articles/benefit_outsourcing.asp

[8] Global Insight study sponsored by the ITAA (Information Technology Association of America)

importantly and of benefit to all those involved both the outsourcing nation and the nation that is outsourced to is that the playing field is leveled.

CONCLUSION

Out-sourcing just like all market economy upheavals like improved technology and international trade are efficient allocations of jobs, goods and services. This is because goods and services are re-allocated to locations where they can be most effectively produced. Thus in the face of such productivity enhancing innovations a dynamic market economy must conduct an effective balancing act. According to recommendations made by Baily and Farrell, on the one hand it must be flexible enough to accept such innovations because they lead to growing productivity and a higher standard of living. On the other hand, policymakers should consider what laws and regulations are needed to cushion and assist those who suffer as a result of these changes. If a society attempts instead to shun economic changes, like those from outsourcing, it can prevent some economic disruption in the short run, but at a cost of blocking overall long run economic gains.

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