

OUTSOURCING

A Seesaw Ride of Challenges and Opportunities

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Abstract

Outsourcing has become part and parcel of modern business organizations because of certain benefits - ranging from reduction in costs to better control over operations and performance. Both outsourcing seekers and providers across the globe are in the beneficiaries' list - albeit with the supreme dominance of US and India in that order. The aura of outsourcing is growing day by day and so are the countries coming under its influence. The paper attempts to analyze the challenges and opportunities in outsourcing amidst the strengths and weaknesses of these countries. Outsourcing has something for all – irrespective of their being from the first, second or third world. Scale, however, is tilted more towards the developing ones. More and more countries are now in the fray to test their fortune in outsourcing. With their interest and initiatives abound, it still remains to be seen as to which patterns and models are applicable in this regard. However, the 'survival of the fittest' will always be there.

Key Words: Outsourcing, BPO, Globalization, Information Technology, Offshore Services, Gross Domestic Product, Intellectual Property Rights & Call Centers

Introduction

The present era of globalization can not be conceptualized without outsourcing because of its being instrumental in making available the products and services globally. Many countries across the world look forward to it as an opportunity to be grabbed with both hands. Although it confers discriminations among the nations by creating a divide of seekers and providers but it also offers a win-win situation for all. The scope and implementation of outsourcing is increasing day by day. While outsourcing was originally used as a tactic for reducing costs of simple back-room functions such as payroll processing, many businesses now outsource more complex tasks such as IT to get access to industry's best practices and cutting edge technology. Over the past several years, there has been a gradual shift from cost as a dominant driver. Although the search for cost-savings is still paramount, yet the buyers of outsourcing services have identified two additional factors- better managing variable capacity and freeing up internal resources for purposes that are more critical.

Globalization is inevitable but its structure is certainly not static: in the future, it could easily become more diverse and perhaps even assume more appealing communitarian forms. With the rapid emergence of China and India, other globalization models will surely attract greater scrutiny, especially as the non-western world grows in size until these economies finally overshadow capitalist nations' share of world economy (Thomson, 1997). Understanding all the consequences of globalization represents a different challenge that is perhaps a more perplexing one.

Today international trade accounts for almost 20% of global Gross Domestic Product (GDP), up from 10% a decade ago. Market prices for many industrial products are determined globally - not locally. For many manufactured products including steel, airplanes, semiconductors, TVs and VCRs, market prices are set by the lowest cost producers (Schwart & Leyden, 1997). This along with the rapid dissemination of the internet, transnational networks set up by the immigrants in the US, and liberalization of emerging market economies created the conditions for major burst of outsourcing in 1990s, primarily in non manufac-

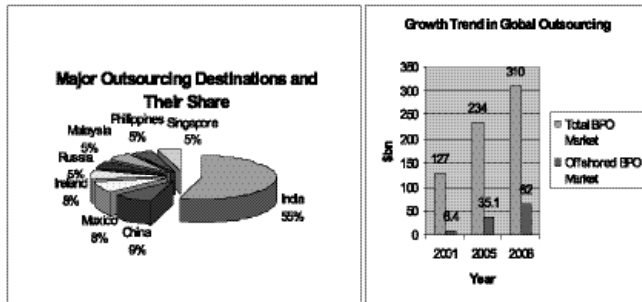
turing sectors such as telecommunications, retail trade, banking, and insurance.

The issue of outsourcing is omnipresent these days. Outsourcing can bring great gains irrespective of the size of business. It has got impetus mainly from the genuine worker concern (especially among IT workers), slow job growth, continuing evolution in global business models, and even political opportunism (Deloitte, 2003). A widely-quoted 2002 Forrester report estimates that over the next 15 years, 3.3 million U.S. service industry jobs – including 1 million IT service jobs – and \$136 billion in wages will “move offshore” (Mehlman, 2003) Countries across the world who dominate in the traits required for outsourcing can attempt capitalizing this opportunity as providers. The process of outsourcing is all set to benefit the developing countries as they always show their willingness to experiment with this charismatic engine of growth. However, the developed countries believe that the process of offshore outsourcing that brew global competition accelerates creative destruction, which can be good for innovative and market-based economies overall, but terribly difficult for displaced communities and individuals in the process. However, as service seekers they all are equally being benefited in certain terms.

India, in the recent past, has emerged as one of the most popular destinations for IT solutions across the globe. Owing to that several U.S. and European companies have located their back office operations in different Indian hubs. The factors cited for driving the increasing momentum of outsourcing industry in India are: availability of highly skilled manpower, cost-effectiveness, proximity to fast-growing Asian markets, benefit of follow-the-sun schedules, and information security solutions. While the cited inhibitors are: inadequate infrastructure, security and intellectual property laws, quality of higher education and political risk (Report on R & D Outsourcing 2005). Several other countries are going to put their candidature for outsourcing. This may change the present equilibrium providing India an altogether more than 55% share in the total outsourcing business. The tussle between the would-be destinations is being presented in this paper with reference to their strengths and weaknesses. Their future has been analyzed with reference to global trends in outsourcing amid a plethora of challenges and opportunities.

Global Trends in Outsourcing

The global trends indicate that Outsourcing business has enormous potential for the participating nations. There are huge possibilities of increasing the size of the cake in terms of total outsourcing market and also of increasing the number of contestants for such market. The business is all set to move broader from the domain of cost differentials though just off shoring jobs to incorporate more mergers and acquisitions among organizations. Global spending on IT services is expected to reach \$585 billion according to estimates by the United Nations Conference on Trade and Development (www.diamondcluster.com/12 July 2005).



Source: Computer world and InterUnity Group Inc., Concord
(in <http://www.it-careernet.com/itc/OS/globalmarket.htm>)

Communications & High Tech companies have the most to gain from the interrelated trends as these are in a position to ensure a complete off shoring package in terms of Business Process Outsourcing (BPO) and Web Services related to diverse products and services—from integrated software to servers to firewalls to network services—in order to drive improved business performance (www.accenture.com 10 July 2005). The surge in off shoring has been made possible by rapid advances in communications technology. Similarly, advances in videoconferencing have made it easier for executives in the United States to maintain business relationships with contractors, executives, and employees in other countries (<http://encarta.msn.com/encyclopedia> 8 July 2005). In addition, the development of standardized business software has helped standardize corporate practices and documents, making it easier to pass off work from one country to another.

While India has turned out to be the most mature offshore and outsourcing market in the world, Russia and China are emerging as upcoming providers of offshore outsourcing services. The IT outsourcing market is undergoing a radical transformation from specialized software development services to the more elaborate "transplantation" of entire IT infrastructures or company departments to offshore locations - a development that is expected to gain significant momentum. As a part of their medium to long term IT strategy, the organizations in the first world are chalking out their strategies towards either establishing offshore subsidiaries, delegating business functions to offshore IT companies or by partnering with them through a variety of buy, build, or source models.

With the opening up of the Indian economy, the country's information technology industry has been the biggest beneficiary. Between 1995 and 2000, the Indian IT Industry recorded a compound annual growth rate of 42.4 percent. Since then, software continues to contribute a major portion of the Indian IT industry's revenues. Interestingly, India's exports of computer software beat the global recession in 2001-02 (April-March) to

grow by a healthy 31.4 per-cent. The steady growth in exports of software is essentially a result of the export success stories of some of the large Indian IT companies who have also been penetrating the non-traditional markets like the EU, Australia, Japan and China, and the increased receivables from IT-enabled services like back office operations (Sachs & Bajpai, 1997). It is worth mentioning that 32 out of 58 Indian companies have voluntarily pursued the highest rating level of the Capability Maturity Model (CMM), the standard for assessing the quality of system and software development contractors in the United States.

Meanwhile U.S. corporations continue to offshore their operations to India. International Business Machines (IBM) Global Services, for example, is India's fifth largest employer, with 10,000 staff performing IT services and software work. GE Capital Services is even bigger with 16,000 staff doing back-office work in India; Oracle has 6,000 Indian staff performing software and services work, and Electronic Data Systems Corporation (EDS) has 3,500 staff doing IT services work in India (Business Week December 2003). Moving away from call-centers and other low-end services, firms are now beginning to exploit the intellectual caliber that is available in India. Patterns of high-end outsourcing are evident from the large number of established Research and Development (R&D) outsourcing centers in India. The R&D outsourcing market for IT in India is estimated to grow more than \$8 billion by 2010 from \$1.3 billion in 2003, at a Compound Annual Growth Rate (CAGR) of 30%, according to Value Notes' research (Reprt on R & D Outsourcing 2005).

Under the non-voice BPO, - insurance claims processing, is coming up well with many big horizontal business process outsourcing areas such as Human Resource(HR), Customer Service, and F&A. However, as a vertical, it is often clubbed with equally strong cousins banking and financial services and referred collectively as BFSI-an abbreviation for Banking, Financial Services & Insurance. In the target markets like North America and Western Europe, each of the sub verticals-life, property and casualty, health and accident, and reinsurance-is getting quite mature by itself. The total life insurance market in the US was estimated to be \$147 billion in 2004, whereas health and accident was estimated to be \$128 billion in the same year. Property and Casualty, the biggest segment, accounted for more than \$463 billion in the same period (Das, 2005).

Moving out of its conventional form, outsourcing is spreading its wings to the non-conventional areas like forest. Developed countries like the US, UK, and Japan are outsourcing forest cultivation to countries like India (Gupta, 2005). Religion is the surprisingly new to capture the outsourcing imagination. Non Resident Indians (NRI) in US have started performing their religious rituals using sites such as www.cyberastro.com. Cyberastro holds virtual yagnas (an elaborate Hindu ritual) and other smaller rituals online, which NRIs abroad can observe on their computer screens (Warsi, 2005). The rates for these rituals vary, starting at about \$45 for an individual and going up the scale. Healthcare BPO that includes imaging, disease management, claims processing and pathology tests concerning new drug tests, are hot sops in the global outsourcing business. Though the markets find greater customers presently in US and UK, other European countries like Germany and France are the emerging ones (Global Business Market, 2005). At the same time Market Research Outsourcing (MRO) is another emerging field in the domain with analysts expecting the \$17-billion global market research industry to send about 10-15% of its offshore business to countries such as India.

Not only offshore, but the outsourcing is all set to change the business equations within the countries. There are countries that exhibit equal potential as both outsourcing seekers and providers contrary to the pure ones. US and China are prominent among these. The Chinese domestic IT outsourcing market according to McKinsey is 90 per cent of the total IT outsourcing market (Bhambal, 2005). Though Chinese firms are fussy about giving works to their home organizations, however this can only help short term businesses not the Multi National Corporations (MNCs) which are long term players. MNCs consider Intellectual Property Rights (IPR), data security, regulations issues and cultural compatibility as key concerns for outsourcing in China. Some countries believe that attempts to tap the global village's resources are not always needed, and sometimes a company can find it is actually cheaper to keep work at home. Deciding whether a project will be outsourced or kept in-house depends largely on performing due diligence (Millard, 2005).

An Analysis of Global Outsourcing Market

By 2015, analysts predict that more than 3 million white-collar jobs in the U.S. will be farmed out to other countries, up from about 300,000 today (DiCarlo, 2005). This applies to the other outsourcing service seekers other than US albeit with different intensities. Who gets larger share from this tantalizing opportunity remains to be seen. To answer this question a detailed analysis of potential outsourcing destination is necessary. This section attempts to give some valuable insight in this regard.

For years companies have looked to India for outsourcing many of their IT functions. Even now firms have their interest in India, but they are also starting to move their investments to China. China is catching more companies' attention these days for several reasons. First, labor is even less costly in China than in India, but at the same time less developed. India has some expertise in newer systems, such as Siebel, that China cannot currently match. Second, operationally, China is 15 hours different than California as opposed to 12 hours difference with India. This means engineers can spend more time collaborating between offices.

Having one fifth of the total world population, a strong education system, and strong government commitment towards technology orientation, China is emerging as a major competitor to the United States as well as India. China had a \$4 billion IT services export industry in 2003 and approximately 400,000 IT professionals, with about 40,000 new IT professionals coming into the workforce each year (41 Garter Symposium 2002). However, China's political climate and weak English language skills are significant risks for corporations. The current Chinese software market lacks maturity due to a lack of managerial and technical experience in developing and maintaining complex software systems for large organizations.

One key concern with China is the poor intellectual property rights protection. China's IPR violations cost U.S. firms some \$2.3 billion in lost trade in 2003. China leads in counterfeit goods production. Department of Homeland Security's (DHS) Customs and Border Protection seizure statistics show that 50% IPR related seizures involve goods from China. 15-20% of all products made in China are counterfeit, accounting for 8% of China's GDP (The Rise of India, 2003). Other challenges that complicate offshore outsourcing to China include bureaucratic red tape and complex multicultural project management. One area that India clearly leads China is in business process outsourcing. China lacks the expertise in such things as running call centers, processing invoices and human resources.

According to A.T. Kearney's 2004 offshore attractiveness index, Malaysia ranks as the third most attractive site for off shoring services in BPO. Although a small country with 22 million people, it is expected to challenge India in next five years. Malaysia's long-term economic development strategy relies heavily on creating a "Multimedia Super Corridor" (MSC), a '9 X 30' miles IT center that is expected to lead the country to a new level of economic and technological development. Through tax breaks and other investment-related incentives, the Malaysian government is actively seeking to attract foreign IT firms (Zeltin, 2005).

However, these efforts may outstrip the supply of skilled personnel: Malaysia's universities are producing less than 6,000 IT engineers per year, far fewer than the estimated annual demand of 10,000 (America's New Deficit, 2005). In addition, many skilled workers have been seeking higher wages in country like Singapore. To address the problem, the Malaysian government has included a university within its MSC plan, and is exploring university-industry partnerships to train workers outside of the college track. Indeed, comparative economic developing studies suggest the importance of education, training, and skill flexibility for countries, like Malaysia, that are pursuing IT-based economic development trajectories (Indian Software Activities 1997).

Philippines is the other important off shoring market that can be scrutinized as a threat to major outsourcing players in near future. Philippines has approximately \$1 billion export in IT services & business processes. Approximately 290,000 skilled personnel are considered to be the form of its outsourcing brigade. Philippines is targeting various activities such as- call centers, business process outsourcing, application development, maintenance and management, animation, and medical transcriptions, that may share global outsourcing lunch in future. Terrorism in the Philippines however is risky to firms in the outsourcing business.

In addition to Malaysia and Philippines, Russia is also emerging as a new entrant to claim its share in the cake. The Russian market for offshore services and software is estimated between \$100-\$200 million. This market is growing between 40-60% per year, although from a small base. Russia's software export industry consists of more than 100 firms and 8,000 IT professionals. Russia is expected to capture 5% market share of offshore service revenue, mostly from North American and Western European markets (www.it-careernet.com 2005). Russian human resource accounts for adequate level of English proficiency along its major hubs viz. Moscow, Novosibirsk and St. Petersburg. However, government initiative and incentives in support of outsourcing are missing in Russia.

Vietnam is also emerging as a contender in the outsourcing business. Pockets of excellence across sectors such as telecom, finance, Geographical Information System (GIS) and Computer Aided Design (CAD) are being claimed for Vietnam's strength in outsourcing. It's a little known fact that leading organizations such as IBM, Cisco, Sony, Nortel Networks and NTT have been successfully outsourcing to Vietnam for some time (www.offshoredv.com 2005). Quality human resource, education system with an implicit bias towards mathematics and logic, government's interest in promotion of IT and reforms, fiscal and tax incentives, liberal foreign investment laws, and stable business environment are the enablers while infrastructure, English language skills, low number of CMMI certified companies, and lack of support to intellectual property protection pose a significant challenge.

The contribution of African continent has been the least in the outsourcing business. However, South Africa leads Africa's BPO sector performing call center services and all types of back office operations. World-class service levels of call centre staff, time-zone compatibility with Europe, high rates of fluency in English, a favorable exchange rate and an advanced telecommunications industry have all contributed to the growth of South Africa's call centre industry (www.southafrica.info 2005). East Africa has just made an entry with Kenya's first international call center. Mauritius is consolidating its plan to convert the country into a cyber island. The bulk of Africa's BPO activity is presently concentrated in two areas - the southern and northern regions of the continent, though countries throughout the continent, such as Ghana and Senegal, are also trying to build up BPO activity (www.networkworld.com 2005). Major thrust is on promoting low cost labor, offering tax breaks and building up their IT infrastructures. While Mauritius is emphasizing on physical infrastructure, Botswana is making a big push for BPO investments with guaranteed low corporate tax rate until June 2020 (Computer World 2005). In North Africa, Egypt is by far the best equipped to perform all aspects of BPO. Morocco has some activity in the call center arena, while Tunisia has the least amount of BPO activity in North Africa.

UAE is all set to attract good outsourcing business as an intermediary by offering the world's first outsourcing zone- Dubai Outsourcing Zone (DOZ) (www.offshoringdigest.com 2005) that offers a comprehensive infrastructure and environment for outsourcing companies to set up global or regional hubs servicing the worldwide market. DOZ's offering includes 100% exemption from taxes, the world's most reliable technology and communications infrastructure, a one-stop shop of support services and the best possible working environment. The zone is geographically positioned to cluster high-quality talents from countries like India, Egypt, Jordan, Philippines, Lebanon, Sri Lanka and Iran with high provisions against attritions affecting the competitors adversely in outsourcing business (Agrawal 2005). The collective effort of this intensity may change the power positions in the outsourcing world. However, Dubai is presently being affected by a very high telecommunication cost, which altogether, though temporarily, questions the viability of outsourcing as a whole.

Alternative offshore countries along with China, South Africa and Malaysia, 'nearshore' locales such as the Czech Republic and Hungary are also gaining market share (www.silicon.com 2005). More importantly, the Gartner report cautions that a host of emerging countries such as the Vietnam and Eastern European nations including Poland are also starting to challenge pioneers in offshore business process outsourcing (BPO) (www.money.cnn.com 2005). Outsourcing can significantly contribute in improving economic conditions of otherwise developing nations. The experiences of India are worth notifying in this respect. ICT sector, which contributes more than 3 per cent of the GDP (2002-03), has a vital role to play in economic development. India had a \$12 billion IT services export industry in 2003, more than 900 software export firms and approximately 415,000 IT professionals, with about 70,000 new IT professionals coming into the workforce each year (Frances, 2002). According to the study conducted by the Associated Chambers of Commerce and Industry of India (Assocham) and International Data Corp (IDC), the BPO industry has been growing at a fast pace of almost 60-70 percent annually and is likely to touch revenues to the tune of a whopping \$12.2 billion by 2006 up from \$2.4 billion logged in fiscal 2002-03

(www.sharedxpertise.org 2005). The players in the outsourcing world can gain significantly with this neo-engine of economic growth.

The Outsourcing Debate: Protectionism & Outsourcing – Causing Dilemma Among Seekers

With predictions that the IT outsourcing market will excel in future, a large number of companies are evaluating whether the potential rewards of outsourcing (e.g. reductions in costs, reallocation of resources to focus on core competencies, rapid technology deployment) outweigh the inherent risks associated with relinquishing control of a key business function to a third party. Moreover, the affair is not the one sided. There are several issues that range from protectionism to competitive pressures and ethics that require assessing these issues related to outsourcing from different angles.

Most countries of the world especially the US fear of severe losses owing to the off shore outsourcing as they feel that the new round of globalization is going to send upscale jobs- especially chip design, engineering, basic research and even financial analysis- offshore (Mehlman, 2003). The issue of protectionism being considered by the countries like US is a severe threat to the offshore outsourcing organizations. However, both the outsourcing providers and the seekers are to be affected by this action. The issue of protectionism in UK is not as severe as in the US; the UK government doesn't seem to support protectionism in Outsourcing (Hillary, 2005). UK exports 2.5 billion Pounds of goods and services to India, 2 billion Pounds to China, 1.5 billion Pounds to South Korea every year and feels that it is not going to compete with any nation on lower wages but on quality. Britain firmly considers protectionism as a road to recession, and does not seem to adopt protectionist policy against flight of jobs owing to companies setting up call centers overseas (<http://finance.indiainfo.com> 2005).

State and federal legislation in US to restrict global sourcing, is a growing threat to American competitiveness and U.S. taxpayers. While it affects the outsourcing solution providers in the form of a job loss, at the same time this threatens the outsourcing seekers by depriving them with the benefits of outsourcing. US has already shown its legislative reactions at the state level to prohibit offshore outsourcing of government work, through laws proposed in New Jersey, Connecticut, Hawaii, Maryland, Michigan, Missouri, North Carolina, and Washington. The issue of outsourcing is ubiquitous in the mainstream press these days. These publications have reported diverse concerns such as- raising a political storm against offshore outsourcing; efforts to block such outsourcing; skilled workers mounting opposition to Free Trade; and U.S. companies shifting high-wage work overseas-especially to India.

Owing to the rapid advances in outsourcing, countries like the US are experiencing an unprecedented surge in unemployment. According to the US Bureau of Labor Statistics, unemployment among electrical engineers hit 7% in the first quarter of 2003, while computer programmer unemployment was at 6.8%, both exceeding the national average for overall unemployment (Anderson, 2005). Some observers express fear that reduced wages or increased unemployment in technology jobs might discourage future generations from pursuing science and technology careers, however they could offer immigration opportunities to the U.S. and the "brain gain" that has been so critical to America's historical success.

It has been found in US that a state government effort to prevent a call center for unemployment services from re-locating to India resulted in New Jersey taxpayers paying, on top of the

original contract cost, an additional \$900,000 for 12 jobs. Saving 1,400 such jobs in the future would cost the state an extra \$100 million (Anderson, 2005). Global sourcing allows U.S. companies to remain competitive by concentrating on core functions, innovating and developing new products, lowering costs, and limiting risks. In addition, outsourcing globally enables an American company in information technology or financial services to operate 24 hours a day to meet the needs of a worldwide customer base, something that wage rates and work practices generally make prohibitive with U.S.-based employees alone.

Legislation against global sourcing has taken three forms: First, restrictive state legislation has emerged in North Carolina, Indiana, New Jersey, and Michigan; Second, at the federal level, legislation has sought to require that federal contractors perform work exclusively, or almost exclusively, in the United States.; Third, bills have emerged in Congress to restrict U.S. companies from using L-1 (intra-company transfer) visas under the belief that some L-1 visa holders have been involved in outsourcing that affected U.S. jobs (Anderson, 2005).

Keeping in view a business, social and regulatory perspective, not necessarily the cost, it is also being felt that while countries including India, China and the Philippines may be the best sourcing choice for certain services it may make more sense to keep certain work closer to home (www.accenture.com 2005). It becomes therefore necessary for non-US organizations to gear up for dealing with such unfavorable conditions.

Concluding Remarks

Outsourcing as a mechanism is gaining momentum across various nations of the world. There are many countries that bear higher potential for outsourcing but have either remained hidden or have taken the backseats. Outsourcing market is ever increasing. Out of the total expected BPO market, a large percentage of it still remains to be untapped. Though India acquires the lion's share in major outsourcing business, followed by China and other countries but the fight in future may take some different twists and turns. Being lucrative, many countries have been attracted to outsourcing and have started making sincere efforts to tap its potential. Altogether it is going to be a seesaw ride amongst the countries in terms of challenges and opportunities where the stake of every participant will depend on how well it adapts to the market demands and pressures. US and UK are expected to be the major outsourcing service seekers whereas India, China, Russia, Philippines, Malaysia and others are going to be the prominent offshore destinations offering services. However, the dominance of service providers will not remain so in future. Moreover the domestic outsourcing will also offer an imposing opportunity to the solution providers. While the mantra of cost savings will still be the most pressing reason for off shoring; performance, output and the other internal factors will play major role in the selection of outsourcing organizations or destinations. It still remains to be seen as to which patterns and models will be applicable in this regard. However, the 'survival of the fittest' will always be there.

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