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The Offshore Controversy

By AMC's Dr. Wendell O. Jones

In interviews that Computerworld recently conducted of twenty CIOs, most of the IT leaders interviewed reported no change in offshore outsourcing plans resulting from the job-loss controversy.

Concerned observers might view offshore outsourcing as a crisis—losing jobs to overseas workers, declining competence of domestic workers, and decreasing domestic incomes, while the hopeful see opportunities—increased productivity, decreased value chain costs and expanded global markets. Interestingly, the Chinese symbol for a “crisis” defines it as both a danger and an opportunity.

Offshoring is a natural outcome of globalization, and in the words of Alan Greenspan globalization became an emotional and contentious issue because... “our exceptionally complex system for the international distribution of goods, services and finance is not universally recognized as successfully enhancing standards of living—and promoting civil values worldwide. Globalization needs to be seen as offering opportunities. If we fail to make that case, renewed barriers to commerce could fill the void. Should that occur, a few might be better off. Surely, the world will not.”

Offshore outsourcing has created a flurry of controversy in recent months in the media and among U.S. politicians. Both seem to be characterizing it as India stealing jobs. Example articles include: “America’s Pain, India’s Gain,” (The Economist, January 2003); “American Legislators Are Accusing India of Stealing Jobs,” (BusinessWeek, June 2003); “Tech Jobs Leave U.S. for India, Russia. Who’s to Blame?” (Associated press, July 2003); “The Ultimate Cost of Offshoring: Are We Sabotaging Our IT Future?” (CIO magazine Special Report, Sept. 1, 2003).

Within the last two months, articles have appeared on both sides of the Atlantic. The Dec. 15, 2003 issue of The Wall Street Journal, for instance, reported that IBM plans to export the work of 4,730 programmers to India, China and elsewhere. Similarly, an article in the December 7 issue of the Sunday Times commented on an earlier announcement by Aviva, Britain’s largest insurer, to transfer 2,350 jobs from Britain to India.

In interviews that Computerworld recently conducted of twenty CIOs, most of the IT leaders interviewed reported no change in offshore outsourcing plans resulting from the job-loss controversy. Therefore, it appears that the potential short and long-term gains of offshoring still outweigh concerns about possible backlash.

So long as offshoring provides economic benefit without undue risk, it is rational for companies to choose the offshore solution. Offshoring is a way to innovate, reduce costs and become more competitive. The more companies innovate, the more competitive they become and value gets passed on to consumers. When wealth is created for companies and consumers, the economy improves and society benefits. So long as the benefits exceed the risks, we can expect that offshoring will continue, but it may remain contentious and emotional for the foreseeable future.

In his Wall Street Journal article ("With Software Jobs Migrating to India, Think Long Term," October 6, 2003), Bob Davis argues that the smart thing is not to protect jobs that can be done more cheaply elsewhere but to do things that stimulate the creation of new jobs. He sums up the short-term and long-term implications in these words:

"U.S. companies turn to Indian firms so they can save money and increase profit. The greater their profitability, the more they can invest in new products... The more that software workers from India and other developing nations work in the U.S., the more they add to the intellectual and technological mix that produces fast-growing firms here. And the faster that India develops economically, the greater its potential as a market for U.S.-made goods and services

The smart plan for the U.S. is not to protect jobs that can be done more cheaply elsewhere but to do things that stimulate the creation of new jobs... If competition from India and other developing nations adds more long-term to innovation than it subtracts in jobs short-term, then U.S. workers should wind up big winners."

In a study by McKinsey Global Institute (MGI), the writers point out that economic value for the country using foreign suppliers would accrue through a combination of four ways: reduced costs, increased revenues, repatriated earnings, and redeployment of additional labor.

1. **Reduced Costs:** Cost savings represent the largest form of value capture. For every dollar spent offshore, MGIO estimates that 58 cents are captured as net cost reductions. The decreased costs subsequently lead to higher profitability. Initially, the savings flow to investors or are used to invest in innovations, and later, the increased savings are passed on to consumers.
 - a. In either case, according to MGI, offshoring will contribute significantly to increasing national earnings of the countries that take work offshore.
2. **New Revenues:** For every dollar of offshore spend, MGI estimates that offshore suppliers buy an additional five cents worth of goods and services from the US economy, thereby creating exports and extra revenue for the US economy. Suppliers in low-wage countries acquire U.S. computers, telecom equipment, and other hardware and software and services in the legal, marketing, financial and other areas.
3. **Repatriated earnings:** Several offshore providers are incorporated in the U.S. These companies repatriate earnings back to the US, estimated at an additional 4 cents of every dollar.

4. Redeployed Labor: Finally, MGI estimates that, as U.S. workers previously engaged in providing the outsourced services are freed up to take other jobs, the economy will capture 45 to 47 cents per dollar from the new jobs that are generated.

Although offshoring offers an opportunity for wealth creation, as MGI contends, the promise of long-term economic benefits for the nation and the world is not in itself enough to assuage the concerns of the many IT workers in higher-wage service sectors who have historically been immune from the effects of foreign competition. The promise of long-term value creation for the economy is not particularly comforting those who have lost a job and face the need to uproot and move to other locations or take lower paying positions.

In the past, 36 percent of the redeployed (displaced) workers experienced no loss in wages, but for 55 percent wages were at least 15 percent lower than before, and as many as 25 percent of redeployed labor saw pay cuts of 30 percent or more. These are real concerns that cannot be ignored.

From all of this, what might one conclude about the future of offshoring? It is reasonable to expect that vocal critics and skeptics about the efficacy of offshore outsourcing will be debated in the press and among politicians in the future. However, as long as offshoring provides economic benefits that outweigh the potential risks, it is rational for companies to choose an offshore solution.

Offshoring is another way for companies to innovate, reduce costs and become more competitive. The more companies innovate and reduce value chain costs, the more competitive they become and more value is passed on to consumers. When wealth is created for companies and consumers, the global economy improves and people around the world benefit.

It is not enough to just point to the past when factory jobs were shipped overseas. Back then, when concerns were expressed about manufacturing jobs going offshore, proponents argued that exporting labor-intensive jobs would make domestic companies more competitive and lead to growth in overall employment, higher productivity, and improved living standards. Proponents advised displaced workers to become better educated and develop skills more suited for the information age.

While the proponents were correct about higher productivity and living standards, the circumstances are different this time. Now the very jobs that are threatened are those of well-educated, information-age workers. These IT workers fear that they will follow the same beaten path of factory workers to the unemployment line or lower-wage work. Moreover, these IT workers are without organized representation in the workplace. Business and government leaders must take an active interest in this problem

Despite the long-term advantages for the economies of developed and underdeveloped countries alike, the short-term impact of many lost jobs for well-educated workers is a problem too serious to ignore. Business and political leaders in all developed countries should look for ways to motivate the private sector to provide

programs that assist displaced technology workers and help them find new opportunities.

Displacement of IT workers may well emerge as one of the most explosive issues of our time.

Dr. Wendell O. Jones is an AMC Executive Advisor with extensive management and outsourcing experience. He was awarded the 2000 World Outsourcing Achievement Award by PricewaterhouseCoopers for his decade of contributions to outsourcing practice. He is the author and co-author of a number of management and outsourcing articles and a Prentice Hall book, Outsourcing Information Technology Systems and Services and is regularly quoted in business and technology publications, including The Economist, Business Week, Investors Business Daily, Wall Street Journal, Fortune, Computer World, Software Magazine, InformationWeek, CIO, Wall Street & Technology, and Information Systems Management.