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## **Outsourcing : Its Impact on American Jobs Market**

In 2004 the democratic presidential candidate race was zeroed down to which candidate proves his protectionism in eyes of average Americans, who are worried about the increasing number of jobs loses due to outsourcing and off-shoring. To sum up the sentiments management thinker Tom Peters puts it in one of his presentation (Tom Peters 2004) –“when I was young my mom use to tell me finish your food, people in India and China are dying of hunger. Today I tell my daughter finish your homework, people in India and China are looking for your job”.

Outsourcing and off shoring has become the latest rage in corporate America. Companies are resorting to outsourcing to cut costs and be competitive in the market. This focus on outsourcing has led to shipping out of thousands of American jobs to far fetched place like India and China.

Today Young peoples sitting in their offices in Bangalore and Dublin are answering average American's insurance queries, planning their taxes, helping them fixing their computers, providing information regarding their credit card accounts and helping them in planning their debts. The surge doesn't last there it has now started threatening the white collar jobs which was once considered Americas birth right. So what will be the future for American jobs market, will it be as doomed as the candidates in the presidential race made to believe us or we have to dig deeper to find the real truth.

### **What is Outsourcing and difference between Outsourcing and Off-Shoring**

Outsourcing and off-shoring are taken one for another but there is a fundamental difference between outsourcing and off-shoring.

Outsourcing is defined as the exporting of non-core business operations or jobs from internal production within a business to an external entity which specializes in that specific operation.

Decisions regarding outsourcing are often made to lower operational costs or to focus on business core competencies.

Off shoring is when the company sets up its offices in foreign land to avail the resources, tax benefits or human capital. Unlike outsourcing, in off shoring operations and jobs are managed by the parent company rather than getting it done from external entity.

A related new term is out-tasking: it is typically on an annual contract, or sometimes even a shorter one. It involves continued direct or indirect management role play in decision-making by the parent company of the out-tasking business.

### **Why do we Outsource**

Outsourcing is not a new phenomenon; it is with us since time immemorial. Europeans started outsourcing sugar from Latin American countries by employing local people. In modern economies it has its root in theory of comparative advantages by traditional economist David Ricardo (Ricardo, 1817). As the theory propagates that one should spend one's energies on things in which it has comparative advantage. It will ensure maximum utilization of the resources. Similarly outsourcing enables the business to focus its energy on its core competencies and avail the benefits of others dexterity in operations, in which other companies have efficiency. These efficiencies could be process related like company A is better than Company B in making T-shirts, or they can be formulated like one government providing more tax holidays than another so the first country become preferred destinations even though the

actual cost of getting a T-shirt made is comparatively higher than the second country. According to the McKinsey consulting analysis off-shoring creates net additional value for both outsourcing economy as well as in-sourcing economy, taking India as example it says that for every dollar off-shored, the U.S. economy accrues between \$1.12 and \$1.14 while the India captures just 33 cents. US economy benefits from combination of reduced costs (58 cents), purchase from US Suppliers (5 cents) and repatriated earnings (4 cents). In addition some 67 cents for directly retained benefits and 45-47 cents from re-deployment of labor in high end jobs

### **Advantages of Outsourcing**

Companies like Dell and AT&T has received a lot of negative publicity for locating their customer support system off shore and thus taking away American jobs, but the companies still went ahead with outsourcing. So the big question is what are the advantages or benefits which are driving most top companies today to outsource their business processes from foreign shores.

- Business Cost Sharing - Large businesses continue to outsource as costs are shared by the third parties. As the third parties have their own area of specialization, they keep on investing in those facilities. It saves the American company to invest in that infrastructure.
- Reduce Costs – One of the most tempting reasons to outsource is that the third party will provide better service at lesser cost. This is one of the most significant reason why outsourcing is going to third world countries where labor is inexpensive compared to developed world. In third world countries where growth and prosperity level is low, companies are able to significantly reduce their wage bill by paying less salary to people

for the same work which was done by a worker in developed country for higher salary. Is it exploitation – to answer it plainly in most cases it is not, as the income level these companies provide is relatively higher than the prevalent income level in those countries.

- Tax Benefits – As Outsourcing brings lots of jobs to the country where projects and tasks are outsourced, most government in these countries provide tax holidays and other benefits which makes outsourcing a viable option.
- Makes company competitive – As most companies are outsourcing today so the one which are not doing it have a cost disadvantage. To remain competitive against competitors, most companies these days resort to out sourcing. In fact this competitive benchmark usually leads companies to explore new foreign outsourcing destinations with better infrastructure and incentives. For example to provide cheaper clothes in 70's and 80's companies like Wal-Mart start outsourcing apparel from Japan and Korea. As the prosperity level grow in these countries and work force became relatively costly then before the companies moved to South East Asian countries like Indonesia, Vietnam and Thailand. In the mean time China developed its infrastructure and made it a more competitive place then by spreading their basket Wal-Mart moved to China. Today as a company Wal-Mart is the biggest trading partner of China and it actually exceeds some countries total foreign trade with China.
- More control over business outcomes – It may have started as cost reducing activity but today outsourcing is providing business executives a better scope to shape company's future. According to one of the recent survey of more than 800 health care,

manufacturing , retail and travel executives in the US and Europe by consulting company Accenture (*Advantages of outsourcing 2004*) , 86% said outsourcing provides them more and more control over business results in a variety of strategic areas, the most important being the ability to plan. "Industry leaders today view outsourcing as a prescription for change versus an antidote to rising costs," says John Rollins, a partner in Accenture's products operating group(*Advantages of outsourcing 2004*). More and more companies are outsourcing so that they can focus on their core competencies. Companies like Nike don't even manufacture a single shoe or garment. It outsources all these activities from its dedicated third party factories in South East Asia, China and South Asia. The Nike headquarters in US only focuses its energy on developing new design and sharpening its marketing juggernaut.

### **Disadvantages of Outsourcing**

- Political Risks – This is one of the most evident risks which a company has to face if it decides to outsource. The most hotbeds of the outsourcing revolution today carry a various level of political risk with them. For example – China is governed by a communist country, even though government proclaims to adhere to World Trade Organization laws but one can never be sure in a communist country as the government can over change a law overnight to benefit its own people. Other countries like Ireland, India, and Philippines etc at some point or other are marred by violence and other such activities.

- Growing dependence on the third party contractors – As the company dependence on the third party increases the relative cost of business also start increasing as the third party will start asking better share.
- Difficult to innovate – as the companies are dependent on third parties, it leaves lesser scope for a business to innovate business operations and get better than competitors. If the company wants to focus on a specific training and other such aspects, the third party will try to resist as it will put a hold on his business prospects with other business clients.

### **Outsourcing hotbeds in the world**

You mention the name of China and India in the community these days and one will receive a serious gaze as if these countries are taking away the prosperity and jobs of average American.

The most common reference I heard about is that incompetent people in the east are taking our jobs just because companies are able to get their work done in 20% of the amount it will cost to get it done by an American worker. So are all jobs going to China and India?

The answer is no, in fact it varies from industry to industry, so if you are a call center or an information technology worker, people in India and Philippines are competing for your jobs. If you are an insurance claim processor, Irish workers may be striving for their share and further facing competition from growing trained workforce in Poland and east European countries. If you are an aircraft engineer and designer, Russian workers may be more of a concern. And if you are a textile industry recruit then start looking for opportunities outside the industry as Chinese and Mexican companies will put you out of the job if they haven't by now.

### **Can these countries keep on having these comparative advantages**

Well as mentioned earlier it depends upon the comparative advantage of the country, my personal analysis is that outsourcing is a long term phenomenon and countries and companies which will succeed at it will be those which will treat it as a part of their business strategy.

Companies which just want to ride the outsourcing bandwagon with no long term strategy in place will fail miserably at it. Like all supply and demand issues the outsourcing future will also be decided by the demand and supply of available resources in a particular country. For example off shoring and outsourcing activities during the cold war were from the United States and England to Ireland and Israel. As globalization stepped in more and more countries opened their door to free economy this change led to the emergence of new players like China, India, Philippines, Russia and South Africa

Among these China emerged as the leader in manufacturing section while India is excelling in information technology. India today is considered one of the most employer-friendly countries for outsourcing because Ireland and Israel have almost saturated their surplus labor pools and salaries in those countries have started rising. While in India educational system churns out almost 3 million College graduates every year and they earn approximately one-tenth to one-fifth the salaries of their Western European or American counterparts.

As the cycle in previous outsourcing hotbeds proved that once the pool starts saturating and prosperity level increases the economy moves toward two things

- One higher salary for the working class as they require more money to sustain their life style.

- Secondly the countries will move towards higher end products. For example in 50's Japan use to manufacture clothing and garments for American market. As the Japanese economy developed it started churning out silicon chips and the made forage into automobiles and electronics. Today Japan is the second largest market in the world and it outsource most of its clothing and garments requirements from China, Japanese owned factories in Taiwan and Korea are producing chips for Japanese electronics. Today some of the biggest names in electronics in American market are Japanese. What started as a Akio Morita revolutionary Walkman today blossomed into Play Station 3 , next generation gaming console.

### **How outsourcing influencing the American economy**

The growing tendency of companies in corporate America to go for outsourcing has seriously influenced the American job market. The fear and noises have almost the same decibel level as the one heard with the introduction of NAFTA ( North American Free Trade Agreement ) in early nineties. The fear at that point of time was that opening our borders for Mexican agriculture products will wipe of the agriculture industry in the country. It will flood US with Mexican workers all over and lots of manufacturing jobs in southern America agriculture and automobile sectors will be lost. Had these fears came true after the decade of free trade in North America. The free trade proponents believed it has created more jobs and the economy has grown at a faster rate then in the previous decade while the opponents believes it led to job cuts in manufacturing and textile sector, in which Mexico has become the largest clothing supplier to United States of America with in a decade. The truth lies somewhere in between.

## **Effect of NAFTA on US economy**

As free trade brings more opportunities it also brings new competitors. NAFTA opened the US manufacturer doors for exporting products to Mexico plus setting up their factories in Mexico to make them more competitive to European manufacturers. Overall sectoral analysis throws some light on the true picture

### **Textile Sector**

The protectionist most feared about the influx of Mexican garments in the US market resulting in job losses. Taking advantage of NAFTA , Mexico became the largest supplier of clothing and garments to United States with in a decade, but looking closely we will analyze that though it has taken away garment manufacturing jobs but it has increased jobs in spinning and weaving sectors of textile industry. The garment cut and tailored in Mexican factories is American. It provided a good value to our cotton farmers in the country. Additionally it created new jobs in retailing, transporting and hospitality industry.

If we look at it from country strategic prospective it kept away the dominance of China in US market. So it balanced our basket of clothing suppliers.

Low price clothing has also kept inflation rate at lower levels. Today when the protectionist are screaming from the top of their voices about pitfalls of outsourcing, I like to remind them that the minimum price of a 'Made in America' jeans can't be less than \$80 dollars, it is just because of outsourcing that we are able to buy it at \$12 in nearby Wal-Mart stores. (Jim McKay, Pittsburgh Post-Gazette, 2004)

### **Auto Mobile manufacturing sector**

Going through an article of New York Times economist Paul Krugman (New York Times 2005), he stated that Toyota has decided to start its car manufacturing plant in northern Canada instead of Southern and Central America. The reason the aptitude level of the Canadian workforce is higher than the American. The answer is simple when foreign investment is shying away because we are not investing in health care and educational benefits for average Americans then it will foul to cry that we are loosing jobs to off-shoring. First and foremost thing is to put our house in order.

### Agriculture Sector

Agricultural tariffs were reduced to zero for half of American exports to Mexico. The other half will be eliminated by 2009. On grains, dairy, and poultry, NAFTA eliminated Mexico's licensing requirements. The opening contrast to Mexican flooding the US market with its product it provides avenue for US food companies to develop business processes to subsidy flushed Western European farmers.

### Overall scenario

Compare to its NAFTA partners U.S. domestic exports to have increased dramatically—with real growth of 95.2% to Mexico and 41% to Canada—growth in imports of 195.3% from Mexico and 61.1% from Canada overwhelmingly surpass export growth

### Conclusion

How this outsourcing will influence the long term prospects of US economy is still to be seen but to put things in context, with or without outsourcing economies shed and creates new jobs every

year especially American economy which is the most robust economy in the world. Every years millions of American change or leave their jobs due to technological invention like ATM machines which reduce the number of banking executives needed, process redundancy like need for type writers etc. Job outsourcing is also not one way traffic, one countries outsourcing is other countries in-sourcing. In the manufacturing sector the US economy may be facing trade deficit but in service sector it has trade surplus.

Globalization is bringing new opportunities and challenges for companies and employees, it is also putting stress on governments to provide its citizen better education, improved health care and an overall better standard of living. Outsourcing is developing new markets for American products as these countries which are having rising per capita income and changing lifestyle. Outsourcing is a win win situation for both parties right now, all the protectionist are trying today is kill the American spirit of freedom and innovation. We became the largest economy in the world not because we were protected but because we opened our doors to foreign capital. Foreigners invested their hard earned money here and created jobs. Today we have similar opportunity to alleviate poverty from some of the poorest countries in the world. Just to put a test ask the Bangladeshi women who makes T-shirt for GAP and Wal-Mart. Government and corporate America must understand that they have a bigger responsibility that goes beyond boosting up the bottom line or fattening top management's collective wallet.

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