CHAPTER 1

Outsourcing: The Most Important Management Trend of the Past 75 Years

The global outsourcing race is on. If you are not outsourcing, your company may not survive. Your competition is earning points ahead of your market share and everything that goes with it. *Harvard Business Review* identified outsourcing as "one of the most important management ideas and practices of the past 75 years."[1] The ability for companies to achieve high-quality results at a lower cost while also reducing head count would most likely have been considered a business revolution some time ago.

At the macro level, the process is triggered by competing forces engaging in outsourcing. Simply by not engaging in it, you are losing out because others are getting into it.

The concept of outsourcing is not rocket science. It is simply about sourcing the most qualified talent at the most effective rates. It allows you to focus on what you do best—your core business. Do what you do best—let some tech nerds do their thing.

Cost is part of the equation, but more so than that is the amount of tech talent. Technology is moving fast; it is hard for people to stay current unless they are constantly learning. Western-educated people have a tendency to get bored easily with perceived low-end programming jobs. This allows both outsourcing firms and their clients to tap into markets where it is easier to structure teams of various sizes in day or night shifts.

Outsourcing is more than just a business process—it is also a matter of face (a very Asian concept). Potential outsourcing customers ask questions like "What are your capabilities in India?" China is clearly a better choice, but it is still a very novel concept that started to appear in 2003. We will spend a bit more time on that later.

Companies that already have extensive Asian market antennas and history are clear on China's position and outsourcing potential and moving into the China market. The majority of companies that have experienced this shift away from India and toward China are making aggressive plans to grow further. Others are afraid simply because they do not know what to expect if they enter the China market. They hear a lot, they are curious, they take a discovery trip, but they are still unclear and worried. For many companies, choosing India is less risky because it is already widely accepted as an outsourcing center.

Managers choosing India may now find this is no longer the safe choice, based on past data, and are making poor recommendations to their firms, in the face of rising costs, high turnover, and a diminishing tech talent pool. Over the course of this book, we explain why China is the clear choice for the future as the leading source of offshore outsourced technology talent.

OUTSOURCING AS A BUSINESS FORCE

Outsourcing as a force of business transformation continues to dominate headlines and boardroom discussions. Utilizing modern infrastructure and sources of talent worldwide, more and more corporations look to focus their resources on their core strengths and businesses, and let outside, professional firms handle other business processes, while reaping cost benefits at the same time.

This trend can only continue. The twenty-first century is a time of globalization, and ongoing technological advances improve every day. The progress made in the past 100 years is staggering: modern air connections ferry passengers from Beijing to New York in just over 13 hours; documents zip back and forth across the world in seconds; whole libraries of information can be searched in moments.

Despite the current trend of presenting outsourcing as a relatively recent phenomenon, it is actually one of the most common business practices. Does your neighbor's son mow your lawn? That is outsourcing. The teenager from around the corner who babysits your children on Saturday nights? That is also outsourcing. Do you hire an accountant to prepare your tax return? That is outsourcing too.

Outsourcing is not like the mercantilism practiced by European countries in the eighteenth century; in fact, it is the opposite of that. Mercantilism used large, government-supervised companies to gather resources from around the world, like cotton, sugar, and gold, and then return them to the home nation or a third country to manufacture finished products. At the time, developed nations needed resources, not labor or manufacturing facilities. The height of technology at the time was industrial manufacturing, not information technology, and those facilities only generally existed in Europe.

Today, the business landscape is entirely different; however, corporations in developed countries are still looking to other parts of the world for resources. While some of that demand is still for physical commodities, there is an increasing need for human resources. Nations that are in the process of modernizing, and some smaller countries that have developed superb educational systems, are in position to play a significant role in globalization, and draw foreign investment, both financial and otherwise, to themselves.

Since the end of World War II, global businesses, especially those engaged in textiles and consumer electronics, have used the cost advantages of manufacturing and assembling particularly in Asian countries, to produce high-quality products at increasingly affordable prices. Early electronics efforts from Japan were dismissed for their poor quality; now, not a single brand of television is made in the United States, and even Japan's TV makers do much of their building in Korea and China, or have allowed manufacturers in those countries to move into the space. "Made in Taiwan" became a household phrase in the United States, first for shoddy products, but later for reliable goods at reasonable prices.

Globalization itself is nothing new, with trade between the continents dating back centuries. However, in the later years of the twentieth century, the process of globalization increased as agreements between countries dropped a large number of traditional protectionist tariffs, and allowed companies from one area to more easily and inexpensively do business in another.

For example, the formation of the European Union (EU), in 1958, along with the 2002 adoption of a single currency—the euro—by many of its member states, paved the way for increased trade and movement of labor. The EU now includes 27 countries, 13 of which use the euro, which recently has strongly outpaced the U.S. dollar.

The 1990s also saw the signing of the North American Free Trade Agreement (NAFTA) between Canada, Mexico, and the United States, similarly reducing or removing trade barriers between these neighbor nations. However, NAFTA does not provide for the freedom of movement or employment that the European agreements do.

NAFTA, did, however, begin to permit a greater degree of outsourcing, especially by U.S. companies that moved manufacturing operations over the border into Mexico, to take advantage of the lower cost of labor there. It was NAFTA more than other agreements that began to cause anti-globalization sentiment, leading in some cases to violent protests by a small, fringe minority. However, most businesses and individuals realize and embrace the concept that trade can only become more global, as communications and transportation make markets worldwide more accessible.

As these global trends began to take hold, a backlash began to grow, culminating in the 1999 antiglobalization protests, and ultimately riots, at the World Trade Organization meeting in Seattle. Antiglobalization forces believe that the increased interlocking of trade between nations is driven by corporate greed, keeping workers in developing countries impoverished by forcing wages down, causing workers in developed nations to lose their jobs, and wreaking environmental havoc by moving industry to countries with lower pollution controls and standards. While there are grains of truth in some of these statements, the movement has largely diminished in the face of the increasing benefits of growing international trade for all involved.

MADE IN CHINA

"Made in China" supplanted the "Made in Taiwan" label during the 1980s. Walk into any major North American or European department store, and it is filled with clothing, shoes, and all kinds of consumer electronics. Since the early 1980s, with China's new policy of openness and reform still in its formative stages, foreign firms began using the existing infrastructure of large, state-owned manufacturers, especially in southern China in established special economic zones. China, of course, had another major advantage: a massive labor pool and tremendous cost advantages.

From the early 1980s of producing clothes, toys, and basic electronics, China is now moving on to value-added services. Where previously one could only expect hardware from the China market, both government and private industry are actively supporting world-class software development facilities.

Because "outsourcing" now encompasses a wide variety of services, for the purposes of this book we will define and expand our terms. At my company, I.T. UNITED, our daily course of business requires us to communicate not only in English and Chinese, but also in French, German, and occasionally Japanese and other languages. As such, we found it critically important to define clearly the various terms that we and our customers use so that we can communicate effectively, either internally or externally, no matter what language is being used. We certainly don't want our meaning—and our business—to get lost in translation!

Business Process Outsourcing (BPO). The transfer of internal business processes, such as customer relationship management, finance and accounting, human resources, and procurement, to an external service provider that improves these processes and administers these functions to an agreed service standard and, typically, at a reduced cost.

A major part of outsourced work today, call centers, falls under this heading. Some top outsourcing destinations provide little or no IT or software-related outsourcing services, and yet rank high in global outsource rankings. For example, the Philippines ranks among the top five in some surveys, and yet does very little IT work. However, it is a major destination for call center agents.

Outsourced call centers simply create benefits for the client company by utilizing lower-cost labor to handle customer service inquiries. Although many companies now utilize complex automated telephone menus to reduce the number of operators employed, some calls (and some customers) are simply unable or unwilling to conduct transactions or resolve questions electronically. Because of the high cost of maintaining such call centers in North American and Western European markets, these services, especially for English-language customers, are increasingly being outsourced to English-speaking talent pools overseas, namely India and the Philippines. Similarly, Cantonese-speaking areas in southern China perform this function for many businesses based in Hong Kong.

Information technology outsourcing (ITO). The contractual vehicle through which enterprises use external sources to provide life cycle service and support operations for their IT infrastructure.

Insourcing. A decision by an organization to retain functions internally rather than outsource. The term is also used in cases where services are being brought back in-house after a period of outsourcing them.

Multisourcing. A strategy that treats a given function, such as IT, as a portfolio of activities, some of which should be outsourced and others of which should be performed by internal staff.

Nearshore Outsourcing. The transfer of business or IT processes to companies in a nearby country, often sharing a border with your own country. Nearshoring is a popular model for companies that do not want to deal with the cultural, language, or time zone differences involved in offshoring.

Offshore. An outsourcing term describing the provision of services from a country that is geographically remote from the client enterprises. For example, China is located far from the United States and is therefore an offshore destination for U.S. enterprises.

Offshore Outsourcing. The transfer of business or IT processes to organizations in other countries.

Onshore Outsourcing. The process of engaging another company within your own country for business process outsourcing (BPO) or IT outsourcing (ITO) services.

Outsourcing. The concept of taking internal company functions and paying an outside firm to handle them. The process of transferring the operation of business processes to an external service provider, which then becomes accountable for those services.

Value-Added Outsourcing. An aspect of strategic sourcing or outsourcing, in which some functional area is turned over to a service provider. The presumption is that the service provider can add value to the activity that would not be cost-effective if provided by internal staff.

SETTING THE STAGE

Twenty years ago, much of what we discuss in this book was in its nascent stages. Ownership of personal computers in the United States had only begun a few years earlier. The only computer likely to be found in the average home was a game console made by Atari or perhaps Intellivision.

Enterprise IT was limited to big companies buying big computers, and a small group of technicians or engineers trained to use and maintain them. Command-line interfaces, not graphic user interfaces such as Windows, were the rule of the day. In fact, it was not even called IT. No one had ever used the Internet and we had never met anyone who worked for something called a dot-com.

Although offshoring existed well before the IT wave began to swell, it was used for the manufacturing of goods, as noted previously. The idea that high-level, value-added services such as software development could be completed outside of known talent centers such as Silicon Valley was never considered. Even if there were potential cost savings, established pockets of talent were few and far between, and project management across multiple time zones, not to mention the cumbersome process of sending data back and forth by essentially analog means, limited the appeal of this option.

It is a different world now. IT is so much a part of even small companies now that we do not know how we would live or perform our jobs without personal computers, Internet access, and Google searches. Basic IT tools have transformed the workplace; in fact, consumer hardware and software are so powerful that we now conduct business in many cases without offices or physical premises of any kind. Could we have imagined telecommuting or eBay stores two decades ago? At that time "working from home" was almost synonymous with "unemployed."

As such, worldwide end-user (both consumer and corporate) spending on IT has reached a level that was unimaginable 20 years ago. Computers, Internet access, and access equipment such as routers or wireless setups, servers—these appear on new business buyer lists even before desks, chairs, and paper clips.

In 2005, worldwide IT end-user spending hit US$625 billion,[2] and is increasing at a 28.4 percent compound annual growth rate (CAGR). Who would not want a piece of that market?

With IT adoption and the demand for IT services growing in a similar fashion, the outsourcing of some technology functions has also increased, and continues to climb at an even higher rate than general IT spending. In 2006, BPO expanded at an 8 percent CAGR, to $182 billion by 2009.[3]

Clearly, outsourcing in its various forms is more than a trend. It is now a permanent paradigm shift in the global business landscape. Ten years ago we began referring to "e-commerce," to indicate purchasing or transactions that had taken place online. Now, this type of buying by consumers and businesses is so common that we rarely specify how it was conducted.

The same will be true of outsourcing. Although we now state that a particular function is being sent outside the company, country, or continent for completion, a decade from now utilizing service companies to handle non-core processes, regardless of their location, will be absolutely essential and fully integrated into corporate management.

We believe that China, as it continues to increase in importance to global business and trade, will similarly become an integral part of this move toward integrated outsourcing. With India's ability to supply sufficient tech talent to meet global needs faltering, China will emerge as the number-one source of outsourcing IT talent. Therefore, any discussion of the future of global IT, and especially IT outsourcing, must not only include China, but must focus on it.

We will now examine the global outsourcing landscape, including the factors that determine a country's success and potential as an outsourcing destination. Inevitably, the factors that point to that success lead to the one country that will ultimately dominate the industry: China.

ENDNOTES

1. Sibbet, David. "75 years of management ideas and practice: 1922-1997," *Harvard Business Review*, A special supplement, September–October, 1997.
2. www.eba.com.hk/english/viewnews.asp?newsid=1006
3. www.zdnetasia.com/toolkits/0,39047352,39393141-39094243p,00.htm