Outsourcing, Part 1: Is Resistance Futile?

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"In general, organizations are more hesitant to outsource processes and functions that are mission-critical, highly differentiating and/or highly integrated with other processes and functions," Tom Weakland, of Diamond Management and Technology Consultants, told CRM Buyer. "Another important risk is resource availability, quality and effectiveness."

Some 90 percent of brand owners outsource at least some of their manufacturing, according to AMR Research. In addition, more than half of them expect to increase their use of contract outsourcing over the next two years.

While it's been shown that outsourcing adds significant value -- and jobs -- to the U.S. economy, that's just the tip of the proverbial iceberg.

As economic globalization continues, a wider range of companies are outsourcing, near-shoring or offshoring a growing number of business processes and functions.

This two-part series examines what is driving outsourcing growth, portents for the future, and business processes and functions where the outsourcing shoe just doesn't seem to fit.

Service Sector Job Losses

Higher than average job losses are forecast in 28 U.S. metropolitan areas between 2004 and 2015 due to the loss of service sector jobs overseas, according to a recent study as part of the Brookings Institution's Metropolitan Policy Initiative.

IT jobs will be among the hardest hit, according to the report.

A Reluctance to Outsource

The rationales underlying the outsourcing wave are many and varied. However, while outsourcing continues to grow at a rapid clip, in numerous instances companies have underestimated the risks and challenges and wound up restaffing positions they had attempted to outsource.

Moreover, organizations are reluctant -- or even unwilling -- to outsource certain business functions and processes.

The reasons for this are also many and varied: corporate and customer data security and integrity, strategic and competitive value, functional and process complexity, government regulations and cultural differences, political risk and public perception. All of these factors indicate that there are certain functions and processes that businesses will not outsource.

The Big Picture

In the development of new market economies and the ongoing multinationalization of businesses -- in other words, economic globalization -- the practice of outsourcing has come a long way in a short period of time.

"Outsourcing and offshoring practices have matured in recent years," Ben Rissing, a research scholar at Duke University's Pratt School of Engineering, told CRM Buyer.

"Successful operations that were originally created to take advantage of low-wage, low-skilled workers to produce for international markets are now providing value-added services and targeting domestic consumers. ... While the first wave of outsourcing targeted call centers, basic design work and manufacturing, subsequent waves of outsourcing will likely target high-end R&D operations," he said.

"One factor [driving outsourcing growth] is the clear maturity of the market overall. Suppliers have more experience in transitioning and operating services from remote locations and are cresting the learning curve for most common services. Buyers are also more experienced and see the value from offshoring and outsourcing, although they also recognize the complexities in managing their relationships effectively," said Jim Mikell, associate principal at the Everest Group.

Technological innovation in the form of manufacturing and business process automation and ongoing innovation in information systems and digital telecommunications are among the large-scale driving forces underlying this trend.

Computerized automation in both production and business service functions increases productivity and helps lower and keep down labor and fixed costs.

Other Factors

Cost competitiveness remains the most frequently cited outsourcing driver. However, other issues can figure into the outsourcing calculus: strategic growth and organizational development; proximity to markets, customers, suppliers and resources; and government regulations, including tax regimes and environmental regulations.

Rissing is a member of Duke University team spurred on to conduct ongoing research into the outsourcing phenomenon, based on Duke engineering students' growing concerns that their careers might already have been outsourced before they graduate.

"Today, many of the world's largest companies are global in nature; as such, they have no allegiance to any particular country. Moreover, to maintain a global reach, these companies must design and develop a portion of their products in local markets to cater to local needs," Rissing noted.

"While competitiveness and productivity improvement are relatively consistent objectives for most businesses, increasing globalization is opening up new competitive markets across industries and forcing businesses to concentrate more than ever on their core competencies," Everest Group's Mikell added.

The shortage of skilled labor in developed nations, although disputed to some extent by some, is another factor driving growth in outsourcing.

"Although offshoring has demonstrated some significant productivity gains in addition to the cost savings associated with labor arbitrage, many organizations resisted adopting this approach due to other priorities," said Mikell. "However, maintaining a stable workforce within their operations is becoming a more pressing issue across a wider range of functions, and businesses are realizing that they can only focus on retaining talent for a limited number of areas."

Political Changes and Outsourcing Growth

Political changes -- notably the disintegration of the USSR, China's espousal of capitalism and economic liberalization in India -- have paved the way for the emergence of new market economies. They have also been key factors behind the ongoing growth of outsourcing, specifically regarding national economic competitiveness and its ramifications in the global labor market.

Simply put, these changes have enlarged the global labor pool, adding many newcomers who work for much less money than workers in the developed world.

In addition, it's not surprising that the structural costs of doing business in developing economies -- taxes and regulatory costs associated with employee healthcare, retirement, unemployment insurance, as well as environmental and overall regulatory compliance -- are a lot lower than those in the developed world.

"The U.S. is well-positioned to reap the benefits from growing international competition, but developing countries are quickly catching up in the global talent race," Rissing commented.

"The U.S. must continue to be a pacesetter not only in how it educates engineering and scientific talent, but also in designing ways to deploy this workforce effectively to tap new innovative frontiers. Low-end jobs and those that do not require face-to-face interactions will continue to be threatened by outsourcing."

Still Going Strong

The forces driving outsourcing growth are strong enough to counter all the mishaps and aborted outsourcing projects.

Forty-seven percent of outsourcing "buyers had experienced an abnormal contract termination in the past year, while only 2 percent stated that their outsourcing expectations were exceeded," according to Diamond Management and Technology Consultants' 2006 IT outsourcing study.

Moreover, managers have been questioning "the value of onshore outsourcing and are still struggling with the basics of determining what to outsource, measuring effectiveness and managing a global pool of resources," Tom Weakland, managing partner of Diamond Management and Technology Consultants' Global Sourcing Practice, told CRM Buyer.

"The No. 1 risk with respect to outsourcing is management complexity," he continued. "This only increases as the range of processes/functions being outsourced expands. Buyers continue to underestimate how hard outsourcing is and how much focus and attention is required to be successful."

Resistance Is Everywhere

There are business functions and processes, or aspects of them, that organizations are reluctant or unwilling to outsource.

"Jobs within industries that require face-to-face interactions with clients will not be outsourced in the near future. Doctors and nurses, who generally interact with patients face-to-face, are a great example of this. However, some medical work -- including lab tests and reading X-rays -- may be vulnerable to outsourcing," Duke's Rissing said.

"In general, organizations are more hesitant to outsource processes and functions that are mission-critical, highly differentiating, and/or highly integrated with other processes and functions," Weakland added. "Another important risk is resource availability, quality and effectiveness."

"Many organizations continue to be reluctant to outsource more complex decision-support or analytical activities, such as knowledge processes or research and development," concurred Everest Group's Mikell. "When they focus exclusively on transactional-level activities, however, the leverage for the supplier is minimized, and the total value of the relationship is constrained."

Whereas call centers and customer service have been at the forefront of the outsourcing wave, some aspects of these customer-facing activities have proved resistant to outsourcing. "Although call center outsourcing is a very mature market, the scope of these services is typically contained to internal support calls or very basic, transactional activities," Mikell noted.

"Many companies are rightfully concerned about outsourcing key customer contact activities, particularly those that influence sales decision-making or can have a significant impact on the business relationship," he added. "Additionally, differences in accent and cultural awareness by offshore resources make many buyers very nervous about making their offshoring activities very noticeable and visible to their customers."