Global Outsourcing: Challenges and Opportunities

by Lothar Katz

In current business and economic discussions, the topic of global outsourcing receives a lot of attention. Companies across many industries increasingly look to other countries not only as a source for materials, products, and sub-systems, but also as a supplier of both blue- and white-collar labor. Many of America's larger firms have opened foreign manufacturing or product development facilities, call centers, and more. Others use foreign outsourcing vendors for the same services. Even some start-up companies now leverage the trend by outsourcing operations and processes to specialized foreign subcontractors. While lower cost is the primary benefit, other motivating factors include access to foreign markets, diversity of talent, and the economies of scale that well-run large outsourcing vendors have to offer.

At the same time, many people are concerned about jobs being exported to lower-wage countries. The latest predictions by *Forrester Research* show 830,000 jobs in the U.S. alone going overseas by the end of 2005. By 2015, *Forrester* predicts a total of around 3.4 million U.S. jobs lost, in line with a similar forecast by the *U.S. Bureau of Statistics*. Depending on one's perspective, that's a little or a lot. (For comparison: the *Labor Department* estimates that almost 30 million Americans lose or leave their jobs every year). While some economists warn of the wage pressures and job market effects of global competition, others argue that international outsourcing benefits the economy at home, as the stimulating effect on foreign markets increases U.S. exports and the cost advantages help maintain the country's global competitiveness. In any case, it is a debate that is far from over.

Outsourcing Failures and Their Causes

If you choose to look at global outsourcing as an opportunity, as numerous companies do, you may quickly realize that making it work requires a carefully planned and orchestrated approach. Quite a few firms had to find that poorly-managed efforts to leverage outsourcing as a cost-saving opportunity in their case led to quite the contrary: communication didn't work well, expectations were not met, work quality was substandard, and the need for frequent re-work wiped out any cost advantages. While others report good results and high satisfaction levels, it pays to look at why outsourcing engagements may fail and what can be learned from that.

A recent study by the *Outsourcing Center* (http://www.outsourcing-center.com) presents findings from a survey of more than 300 buyers and providers of outsourcing services. It analyzes the primary reasons why outsourcing initiatives fail. According to this study, the most frequent causes of outsourcing failure were identified as

#1 Buyer's unclear expectations up front (23% of respondents)

#2 Poor communication or poor cultural fit (16%)

#3 Interests became misaligned over time (15%)

These are interesting results. One might argue that #1 is largely the providers' perspective (although 14% of the buyers also highlighted the point), while #3 reflects the buyers' view of what is at its heart the very same issue. The report observes that "the dominant theme recurrent in the tips provided, whether from buyers or providers, is that those who spend more time and effort up front ensure predictable results and less chance of failure in their outsourcing initiatives." Defining and setting clear expectations, targets, and deliverables at the beginning of an outsourcing engagement is critical to its success. Also, one needs to consistently follow up through effective project management, which includes communicating quickly with the foreign vendor if any of the expectations change or become obsolete over time.

Communication and cultural fit, the other identified primary causes of outsourcing failures, are often paid little attention to in the early stages of an outsourcing engagement. That can be a very costly mistake. They even came out on top of the survey when the participants were asked to identify the most frequent causes of relationship failure:

#1 Poor communication or cultural fit (25% of respondents)

#2 Buyer's unclear expectations up front (16%)

#3 Provider's poor performance (13%)

In most foreign countries, relationships hugely impact all stages of a business engagement. It is therefore pivotal to pay close attention to relationship aspects across cultural boundaries[1]. Making the communication work, building mutual trust, and ultimately establishing a win-win relation requires considerably more effort in global outsourcing than it does within the framework of a domestic business engagement.

Outsourcing Destinations

When preparing for a global outsourcing engagement, a number of factors have to be considered in the decision which country to engage in. Among others, the list includes;

- Labor and infrastructure costs
- Worker motivation, experience & skill levels, work quality
- Country culture differences and requirements
- Political/economic situation and outlook
- Legal aspects, safety and security

With outsourcing becoming an ever-more competitive field, there are many countries who offer potential advantages. Here is a brief overview of those who are most attractive at the present time:

Americas

Lately, the global competitiveness of Mexico in manufacturing seems to have declined some as other destinations combine improved workforce skills with significantly lower cost. However, Mexico continues to be attractive to the United States as an outsourcing destination, especially in light of its NAFTA status. In Latin America, Brazil is the current manufacturing heavyweight, combining skilled workforce with a decent infrastructure, albeit in a still-shaky political and economic environment. Nevertheless, the country is also an up-and-comer in the IT industry. Cross-cultural aspects need to be carefully managed in all of these countries.

[1] For learn more about this, see *Ten Steps to Prepare for Global Business Interactions*, on the web at www.leadershipcrossroads.com/arti_tsp.htm).

Europe

Former East bloc countries like Hungary, Czech Republic, and Poland have become attractive manufacturing destinations, combining good infrastructure, skilled workforce, and stable political and economic environment through their integration into the European Union. Current wage and salary levels still give them a strong cost advantage.

In software development and many other high-tech areas, Ireland maintains a favorable position owing to its young and well-educated workforce, but its cost base has become considerably less attractive as its cost of labor now exceeds the EU average. Here, Hungary, Czech Republic and Poland are again strong competitors, each of them with an effective public education system. In all three countries, cross-cultural aspects deserve attention but don't present huge hurdles, while language barriers can be difficult to overcome.

Asia

A fiercely competitive field exists in the manufacturing area in Asia, where many low-wage countries, among them China, Malaysia, Indonesia, Thailand, and the Philippines, compete primarily on cost. Even Korea is now outsourcing significant manufacturing work to other Asian countries. Worker efficiency and quality of work can be spotty, so it pays to select carefully and to establish effective control systems. Cultural differences present additional challenges, requiring preparation and constant guidance.

In technology outsourcing as well as in services (e.g., call centers), India has become the 800-pound gorilla in Asia. Since the country's most highly qualified resources are concentrated in a few centers such as Bangalore, Hyderabad, and Mumbai, and since there is much competition between local and foreign employers to hire the best of them, salaries, while still low to U.S. standards, have gone up quite a bit over the last few years. India's overall infrastructure and political stability are still gating factors, and the challenge to communicate and manage across cultures can be tough.

Outlook

The trend to outsource manufacturing, product development, and some services to foreign countries continues as global trade and global competition intensify further.

Making outsourcing successful requires doing one's homework in a number of areas. Up front, these include comprehensive requirements analysis, definition of metrics, project planning, and preparation for the cross-cultural encounter. Throughout the execution of an outsourcing project, one needs to consistently foster open communication and apply disciplined project management. Done right, global outsourcing can provide significant opportunities for companies to reduce their cost base and increase both their domestic and their world-wide competitiveness.

Lothar Katz is the founder of Leadership Crossroads. He has a wealth of experience in achieving productive cooperation across cultures and driving business success on a global scale.

A seasoned former executive of Texas Instruments, a Fortune 500 company, he regularly interacted with employees, customers, outsourcing partners, and third parties in more than 25 countries around the world. These included many parts of Asia, e.g., China, India, and Japan. Originally from Germany, he has lived and worked both in the United States and in Europe.

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