U.S. Offshoring Of Jobs And Businesses To India: A Survey And Analysis

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Abstract

Recently, offshore-outsourcing of U.S. jobs in general and particularly to India has drawn considerable attention from various quarters in the U.S. A combination of factors have propelled this issue to the forefront: ominous headlines; downsizing of corporate labor force; huge trade deficits, increased global competition; poor job growth in a healthy economy; loss of white-collar and professional jobs, etc. The trend of jobs outsourced to India is projected to be sharply upward in the near future. India has clearly benefited from the influx of new jobs. It has also brought some cultural changes in the younger generation in India not well received by the local communities. However, the overall cultural understanding between India and the U.S. has certainly improved. The study finds that the U.S. businesses have many compelling reasons in outsourcing jobs to India: cost savings due to wage differentials; decreasing need for capital investment; availability of educated and skilled workforce, etc. The offshore-outsourcing also has many disadvantages: loss of security; increased dependency; huge startup and communication costs; inadequate protection of intellectual property; poor infrastructure; different legal systems; high levels of bureaucracy and corruption, etc. As the economic theories suggest, the authors find that, given the current competitive global business environment, offshore-outsourcing is an essential part of sound business decisions that U.S. corporations need to make to remain economically viable in the long-run. The short-run problem of displaced workers, although highly important, should be addressed in ways other than imposing trade restrictions, or isolating U.S. from world competition.

INTRODUCTION

The concept of outsourcing or offshoring is not a new one. Since the early 1970s and 1980s, jobs have been exported to Latin America, Korea, Singapore and other low cost nations from high-cost developed countries. In the late 1980s and early 1990s, some of the manufacturing operations were moved to mainland China due to its low labor cost as well as for special incentives provided to foreign investors by the Chinese government. The North American Free Trade Agreement (NAFTA) of the mid 1990s permitted and encouraged U.S. and Canada to shift many of the productive activities, hence, jobs to Mexico. In the late 1990s, India began to receive prominence by providing technical support in addressing the Y2K problem. Now India has emerged as a major recipient of IT related work from developed countries including the U.S.

Before proceeding further with the current issues related to outsourcing or offshoring, it would be useful to define the terms. The concept 'outsourcing' refers to procuring resources from sources external to the firm to produce a product or to provide a service more efficiently and at a lower cost. The concept 'offshoring' essentially means the same as above except that the resources are provided by a firm or a business located in a different country.

Recently, the issue of offshore-outsourcing has caught the attention of the nation due to a variety of television news reports and ominous headlines in newspapers and magazines. The following are some of the headlines which have caused fear of job losses and demand for political action:

"Shortage of U.S. Priests has Churches Paying Indian Clergy to Handle Prayer Requests," Post Standard, Syracuse, NY, 2004.[1]

"The U.S. federal government is accelerating its already aggressive plans to expand its use of outsourcing providers and allow private companies to compete for work that is currently being done by federal employees," Network World Fusion 2004.[2]

"In the airline industry, Delta Air Lines offshore-outsourced some of its worldwide reservation services to India-based Wipro Spectramind. This third-party vendor manages Delta's reservations from its Mumbai call center; a move that Delta expects will save $26 million in 2003 alone." Robinson and Kalakota (2004) [3]

A variety of surveys and studies conducted over the last few years show that there is an increasing trend and emphasis on offshore-outsourcing primarily to secure cost advantages. A survey by Deloitte Research estimates that the top 100 global financial companies with a market cap of more than $10 billion each will offshore an average of $2.1 billion of their operating costs in 2005. Forrester Research projects the U.S. will lose a total of 3.4 million service jobs to outsourcing between 2000 and 2015.[4] AMR Research estimates 20 percent of manufacturers and financial services companies have outsourced some information technology work and predict that their percentage will double in the next two years (Online.wsg.com 3-1-2003). Literature shows that offshore-outsourcing is quite widespread with respect to types of business activities in the U.S. and the recipient countries. The trend in outsourcing is clearly upward.

As mentioned earlier, offshore-outsourcing is not a new phenomenon. It has been going on for over 30 years. Why then has outsourcing become a hot-button topic today? It seems that a combination of factors have propelled this issue to the forefront: ominous headlines as stated above; downsizing of corporate labor force; huge trade deficits; increased global competition; poor job growth in a healthy economy; presidential election issue in 2004; loss of white-collar and professional jobs, etc.

The above factors have heightened the concern of workers as well as the politicians. As a reaction "reportedly, nearly 200 pieces of legislation intended to limit outsourcing are at various stages in the U.S. Congress and most of the country's state legislature."[5] As the free-trade policies are considered to be the reason for the huge trade deficits and consequent job losses, protectionist sentiments are on the rise.

The economists, scholars and multinational corporations (MNC) view offshore-outsourcing and the concomitant side effects as the result of global economic condition and increased competition. They do not view the long-term outcome for the U.S., with respect to jobs and economic growth, to be detrimental. They would, however, readily agree that the short-term disruption, particularly job losses, to be a real labor and business problem, which must be addressed effectively. They would recommend retraining and relocation of workers with adequate social safety net, but they would not recommend passing protectionist legislations. Are the economists, scholars and MNCs correct in their evaluation of the situation? What are the cost and benefits of offshoring? Are the exports of white-collar jobs to India necessarily a loss to the U.S.? What is the cost-benefit situation in India? Will increased trade and business with India develop better relationships between the two countries? The proposed study intended to study some of the above issues. More specifically the objectives of this study are as follows: To study

- An overview of U.S. and India offshore-outsourcing of jobs and businesses.
- The cultural impact on India and the U.S.
- The reasons and risks of U.S. Offshoring of jobs and businesses.
- The long-run expected outcomes.

[1] Arora and S. Arora (2004).
[2] Ibid.
[3] Robinson and Kalakota (2004)
[4] Arora and Arora (2004)
[5] K. Ketkar and S. Ketkar (2004, pp 70-71.)

AN OVERVIEW OF THE OUTSOURCING SITUATION IN THE U.S. AND INDIA

This section surveys the magnitude and trend of offshore-outsourcing with respect to jobs lost, total dollars invested, kinds of business activities involved, etc.

Various private and governmental agencies have reported statistics on outsourcing, job losses and foreign investments. According to the U.S. Bureau of Labor, the number of jobs lost in 2000 was 0.1 million, which is expected to rise to 0.59 million in 2005 and 3.32 million by 2015. McCarthy of Forrester Research estimates that 3.3-3.4 million white-collar jobs will move overseas by 2015, which amounts to over 220,000 jobs per year out of a total U.S. workforce of 138.3 million. Other computations by Goldman Sachs and Company suggest that McCarthy's calculations are somewhat on the conservative side. Their researchers find that depending on the underlying assumption, up to six million service jobs could be offshored over the next decade (Garner 2004).

According to a survey performed by Deloitte Research, the world's top 100 banks expect to transfer approximately $351 billion of their operations and two million jobs offshore in the next five years in an effort to reduce their costs. The same survey reported that 33 percent of respondents have already sent Information Technology work offshore and that 75 percent plan to have work offshored within the next 24 months.[6]

"In 2001, according to a study by McKinsey and Co., offshoring was a $25.75 billion industry. McKinsey estimates a growth rate of 30 to 40 percent a year over the next five years" (Meisler, 2004).[7]

Assortments of statistics on offshoring of jobs and investment dollars are available. It is difficult to determine their reliability. However, the overall offshore-outsourcing trend forecast for the future is clearly upward, both with respect to the rest of the world as well as India. The following paragraphs provide a few selected statistics with respect to India.

India has emerged as the leader in Business Processing Outsourcing (BPO), employing nearly 110,000 people and earning revenues of $1.5 billion in 2001-2002. General Electric (GE) has a target of 10,000 people for its Indian BPO arm GECIS by 2005.

India has the largest number of call centers in the world. In 2004, there were 158,000 call center seats, and at the rate of 1.8 employees per seat, about 284,400 individuals are working in different shifts (Meisler, 2004).

Around 80 percent of the world's 500 largest companies already outsource at least one function to India (Phillips 2003). Revenue from BPO grew by some 50 percent during 2003 to U.S. $3.6 billion (The Economist 2004), with the global IT research and advisory company, Gartner Inc., forecasting Indian BPO revenues to reach U.S. $13.8 billion by 2007 (Anon, 2003a). Employment growth is also increasing dramatically, the National Association of Software and Service Companies (NASSCOM) estimating that overall employment in the ITES sector will increase from 160,000 in 2003 to 1.1 million in 2008".[8]

A.T. Kearney Inc. (2004) in a recent report reveals that India is the most attractive location in the world for BPO on the basis of people skills and availability, but the retention rate of employees is one of the lowest in the world. The major industry players in India[9] are as follows:

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[6] Kumar, V. (2003) Whitepaper: Offshore Services: Maximizing the Benefit for Financial Institutions. EDS Internal Whitepaper.
[7] Meisler, Andy (Jan. 2004), "Think Globally, Act Rationally" Workforce Management at www.workforce.com.
[8] Williams, Jeremy B. (2004).
[9] Kobayashi-Hillary, Mark (2004).

Name	When Started	No. of Employees	Revenue/Date
Infosys	1981	17,000	753.8m/3-31-03
Wipro	1947	21,000	902m/3-31-03
Tata Consultancy	1968	24,000	1041m/3-31-03
Progeon	2002	850	4.5 m/3-31-03
Wipro Spectramind	2000	6,500	34/9/3-31-03
ICICI One Source	2002	2,200	N.A.
Daksh	1999	3,500	29m/3-31-03

According to the McKinsey Global Institute (MAI) study Foreign Direct Investment in India has led to the creation of a more than $10 billion a year software and outsourcing industry which employs 500,000 people, who perform white-collar jobs for foreign company. Projections suggest that it will employ 2,000,000 people by 2008. The Information Technology and Financial Services appear to continue their lead in outsourcing their processes.[10]

The projected numbers of U.S. jobs to move overseas by 2015, by job-type are as follows:

Job Type	Number of Jobs
Management	288,381
Business	348,028
Computer	472,632
Architecture	184,347
Life Sciences	36,770
Legal	76,642
Art, Design	29,564
Sales	226,564
Office	1,659,310
Total	3,322,138

Source: Forrester Research, Inc. November 2002

Many U.S. and foreign companies have set up businesses in India such as: Toyota, Motorola, Honda, Nokia, Fujitsu, HSBC, General Electric, American Express, International Business Machines (IBM), Electronic Data Services (EDS), Accenture, Daimler Chrysler, General Motors (GM), Ford, Coca-Cola, Citybank, Microsoft, Conesco, Toshiba, McDonald, Pizza Hut, Ernst & Yount, Reebok and dozens of others.

In general MNCs have found India as one of the most desirable countries to do business with due to a variety of factors: low cost; availability of highly qualified workers; facility with English language; worker attitude; governmental support, etc.

The major outsourcing cities in India are Bangalore, Hyderabad, Mumbai, Delhi, Pune, Kolkata, Chennai, etc. However, foreign businesses are beginning to spread throughout India. The U.S. multi-national corporate functions that have been outsourced most in the past vary depending on the core business of the outsourcing company, but most have focused on the following areas:

- Billing/Financial Transaction
- Collections
- Telemarketing
- Technical support
- Customer Surveys

[10] Farrell (2005)

- Customer Service
- Software Programming and Development
- Transaction Processing
- Medical Transcriptions
- Insurance Processing

The above areas are back office functions and relatively low end on the outsourcing value chain. As competition at the lower end increases because of rising wages in India, the focus is shifting to exploiting the skilled talent pool available in India for high end knowledge work. This includes research, work on intellectual property, analysis of financial markets, market research, clinical trials for big pharmaceutical companies, remote medical diagnosis and treatment.

INDIA'S FUTURE PROSPECTS AS AN OFFSHORING CAPITAL

India has emerged as a predominant player as an offshore provider for business processes. The country's offshoring sector is dominated by the IT services sector. A McKinsey study estimates that in 2004-2005 the business process outsourcing industry will generate approximately $17.3 billion in revenue and employ 695,000 people. This is expected to rise to 1.5 million people by 2007-2008 (Farrell, 2005). The country's value proposition for customers, such as cost savings, productivity gains and quality improvements, have given India an edge in the global IT business processing domain. The primary advantages India offers are abundant skilled manpower, improving telecom and other infrastructures, fast turnaround time, proactive and industry friendly government policies.

While the immediate prospects appear to be bright, there are potential problems on the horizon which demand immediate attention from the industry and the government. Salaries of IT professionals in the popular locations such as Bangalore, Hyderabad, Mumbai, and other large metropolitan centers are reported to be rising at the rate of 15-20% per year. The high turnover among engineers suggests that the demand for high skilled professionals in IT is beginning to exceed supply, and this provides an opening for other low wage countries to challenge India's dominance. As mentioned above the India's value proposition is not derived strictly from low wages, but over the years it has developed a core competitive advantage through the development of a large number of world class IT service providers that can save foreign companies from setting up their own offshore centers. It also has an abundant supply of talent in areas outside of IT, such as R&D, finance and accounting, call centers and back-office administration. It has also developed as a major player in the generic drug industry, along with enhanced capabilities to conduct basic research in the biotechnology industry.

While India does have a vast pool of young university graduates estimated at 14 million with 2.5 million being added every year, only a small percentage of them have the ability to work for MNCs. There are various reasons for this ranging from the vast difference in quality among Indian universities, poor English language skills, and also a lack of managerial talent with international experience. Annual wages for project managers in the IT sector are estimated to be growing at an average of 23% per year compared to a 13% increase in the wages of programmers (Nasscom Strategic Review 2005). To remain at the top of the IT sector, India must rise standards and improve the quality of its universities with emphasis on a more uniform curriculum.

Another major roadblock to ensuring India's attractiveness as an offshore location is the poor infrastructure of roads and communications networks. Unless the government spends considerably more money on developing the infrastructure in a short period of time, it is unlikely that India will remain an attractive alternative for offshoring.

CULTURAL IMPACT

The traditional India has been culturally diverse, but different from western culture. India's first significant experience with western culture came from the British rule of India for approximately two hundred years, which ended in 1947. In recent years, it is increasingly the U.S. culture which is influencing India particularly the younger generation. India, today, seems to have a big range of cultures from traditional to highly modern and western. However, in general the family and corporate culture in India still remains quite different from western values and cultures. Hence, mutual understanding of each other's cultures remains an important consideration in doing successful outsourcing of jobs and businesses to India. The following paragraphs present an overview of cultural awareness, understanding or change due to U.S. outsourcing of jobs and businesses to India.[11] The effects on three groups of people are considered: 1) Indian employees of U.S. businesses; 2) managers/owners of U.S. businesses and their U.S. employees in India; and 3) workers, businesses, people and politicians in the U.S.

The spate U.S. outsourcing of jobs and businesses together with Hollywood movies, TV broadcasting, etc. are having a great impact on India's culture, particularly on the younger generation in big cities. The U.S. Call Centers, which have mushroomed in many large cities in India, generally employ young men and women in their low twenties, who are wiling to accept the challenges of very different and difficult requirements of their work. They take training in speaking with an American accent, study the basic geography of the land, watch U.S. movies and TV serials such as "Friends" to be familiar with U.S. customs and culture etc. To avoid customer backlash, they even learn to pretend that they are located in the U.S. To match with the day time business hours in the U.S., call center workers work during night time in India. Below is a short list of some of the resulting effects and changes:

- Girls working during the night-time are not considered respectable in India. Parents strongly object to their daughters' night-time working hours. The U.S. employers, being aware of the problem, are hosting "family nights" to show the parents where their daughters are working, what the work involves and their working environment.
- High wages and opportunities are creating young affluent generation with independence and western values.
- The young men and women, working outside the influence of their parents, are finding romance, love and marriage without parental consent. In India parents expect to have a major say in who and where their sons and daughters marry. Often parents expect to live with their children in their old age. The social security system, as in the U.S., does not exist in India. The support of children is the "social security" for parents in their twilight years.
- The attitude of 'spend not save' together with cell phones, credit cards, eating out, partying, etc. are contributing toward a western style consumer class.
- Training and experience with American accent, product, places, attitude and expectations of U.S. customers, etc. have increased familiarity with U.S. culture.
- The parents are deeply concerned about the change in moral values of their children and also feel that they are losing control over their children. Although, they see the need for their children having a well paying job, they are not sure their children are staying on the right path. Many are afraid that their children may be influenced by the worst of western culture.

India's recent connection to western entertainment has also contributed to cultural awareness and change. The number of television stations has increased from two, state-run, channels in the 1990's to over eighty channels now available via cable networks. As entertainments such as "Friends" and MTV have become available, the principles and values which these shows expound such as freedom of spirit and self gratification have become concepts to aspire to by many of the young middle-class consumers. Products such as mobile phones, Reebok tennis shoes, Pepsi Cola and restaurants such as McDonald's and Pizza Hut are quickly increasing in popularity. McDonald's has 48 stores in India which each service about three thousand consumers a day, with sales estimated to gain at a rate of 40 percent annually.[12]

The attitude of young, middle-class Indians toward money has also undergone a change. They are no longer concerned with saving, the way their parents were. According to one study, Indians spent 55 percent more money eating out in 2002, than the prior year. They are also more willing to take on debt. In 2001 and 2002 the number of new credit cards issued has risen 25 percent and the number of new mortgages 35 percent. It is not uncommon for

[11] Besides the U.S., other European and Asian countries are also doing business in India, hence there are multiple sources of cultural change in India.
[12] (Schuman, 2003)

individuals to have over 50 percent of their annual salary in credit card debt. These young workers have seen their salaries double in as little as a year and have no doubt of their annual income continuing to grow dramatically.[13]

In general businesses in India are used to personal and management culture quite different from that of the western world. However, foreign businesses, including those from the U.S. recognize that to succeed in India, they must understand Indian culture and communication style. The following is a short list of items related to India's cultural aspects, which foreign businesses are becoming increasingly aware of[14]:

- "India values revolve around a strong family orientation as well as loyalty to a 'group' which often has to do with their profession. Examples are the diamond trade community or textile merchants. The honour (sic) of both family and group is strongly defended and arranged marriages are quite common within the trade."[15]
- Women exist in a complex duality where they are increasingly well represented in political parties as well as in professional jobs, yet the family needs are their first priority.
- "Most Indian people, including managers, seek a sense of inner peace even if they do not declare themselves to be overtly religious."[16]
- Indian subordinates often require more guidance than a western manager would like or expect. According to G.D. Sharma "Dependency proneness is a tendency of the subordinates to seek support, advice and help from superiors even in situations which do not warrant such dependence." The subordinate may be quite capable of doing the job in his own way, but to remain in complete harmony with his superior, he or she may prefer to do it the way boss wants it done.
- The interpretation of body language in India, such as shaking of head, may be quite different, possibly the opposite, in meaning to what a western person may think.
- Western business people have learned that although English is spoken widely in India, but how the language is used could be quite different causing confusion with respect to its real meaning. Westerners are beginning to pay more attention to Indian English.
- Hierarchy is important in Indian family as well as in business. Normally, subordinates do not correct superiors even if they are wrong. At the same time, the superiors dealing with subordinates in a rough manner is not uncommon. However, this behavior does not mean that in work or in family the elders or the superiors are unconcerned about the welfare of the subordinates or the youngers. On the contrary there may be a higher level of emotional ties between the subordinates and the superiors than normally seen in the western world.
- "Indians love business negotiations, but they are offended by arrogance and conceit especially if conducted in the condescending manner of an ex-colonial. If you conduct a gentle bargaining process with patience and avoiding the constant Asian fear of losing face then you will succeed, but always be wary of any promise that is too good to be true." (Kobayashi-Hillary)
- In a business setting, jokes are not common in India.
- Besides knowing culture and communication in India, foreign businesses are increasingly interested in knowing about the government, politics, the society and the geography of the land.
- Western business people are beginning to understand that in India the negotiation concept is viewed as a win-lose situation as against the western concept of win-win situation. However, they find that Indians are flexible. They will accept "losses" if that means future gains. Indians focus on developing relationships, rather that just completing a deal quickly and efficiently.[17]

Successful outsourcing of jobs and businesses to India is affecting U.S. corporate culture, and also causing some concern for the union workers and the politicians[18].

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[13] (Ibid)
[14] Mark Kobayashi-Hillary, Springer, 2004.
[15] Richard Lewis Communication is a long standing established leader in the area of cultural training. Work cited by Kobayashi-Hillary.
[16] G.D. Sharma, an Emeritus Fellow of the All India Council for Technical Education. Work was cited by Kobayashi-Hillary.
[17] Richard Lewis Communication work cited by Kobayashi-Hillary
[18] U.S. outsourcing to other countries are also having similar effects. It is difficult to separate the impact of any one country.

One of the most significant impacts outsourcing has had on the United States culture is the rapid and continued decline of organized labor. Although outsourcing cannot be entirely blamed for the decline of union membership, it is one factor which along with labors inability to win significant wage gains via collective bargaining, has contributed to the significant decline in union membership and new organizing activity. The threat of offshoring in and of itself is often enough to cause weakness in any union's collective bargaining power. Often two different locals of a same union will engage in offering competitive concessions in an attempt to keep their plant open, knowing the other locals may have to close.[19]

Another change in the United States working culture is being recognized by its younger workers. Individuals no longer can expect to stay with the same company for years, eventually retiring from it with comfortable benefits. Outsourcing has created a much more competitive labor market where individuals are expected to re-train themselves, often at their own expense, in order to be considered desirable to companies. Companies are also reducing their pension benefits encouraging their employees to participate in personal savings programs such as 401Ks.

Outsourcing has also spurred a small number of companies who offer alternatives to low-cost offshoring. For example, one company, Rural Outsourcing, has set up operations in rural Arkansas where the cost of living is very low. Although admittedly, operations in Arkansas are not cheaper than India, this solution can reduce costs while eliminating some of the more difficult issues related to offshoring such as time-zone differences, cross-cultural issues and transnational legal issues. Of course if this type of competition succeeds, other companies will surely respond pushing these low-cost U.S. firms to improve their offerings, improve their quality, and expand their services, which is the benefit of increased competition (Hayes, 2004).

REASONS FOR OUTSOURCING

While the term outsourcing raises the specter of mass layoffs in American industries there are compelling reasons for outsourcing.

The direct cost savings from outsourcing business processes is one of the primary reasons for pursuing such opportunities. These savings typically arise from the wage differentials for comparable skills between the developed and the emerging economies. According to most estimates the wage differential between Indian Information Technology professionals while decreasing is still sufficiently high to the tune of 40-50% to justify outsourcing IT processes. Global corporations are now turning to India not just for the low end transaction processing tasks, but also for knowledge processing outsourcing (KPO). For example large scale clinical trials are being done at a 40-50% cost advantage in India compared to the costs for similar trials in America. In addition to the direct cost savings, outsourcing provides other cost advantages by decreasing the need for capital investments in the outsourced processes and relying on the supplier to shoulder much of the capital requirements needed to perform the activity. The reduction in total cost was cited as the primary reason for outsourcing by respondents of a survey conducted in 2004 at the World Outsourcing Summit (Corbett, 2004).

The outsourcing of non mission critical activities allows the firms to focus only on those activities that provide a unique competitive advantage and to invest the savings from outsourced processes for reinvestment in enhancing their core competencies. Since outsourcing frees up management time and reduces complexity, it enables top managers to focus on issues which are really important, via; growing shareholder value, building market share, protecting the bottom line, exploring and entering new markets.

Outsourcing permits companies to access technology and personnel skills that are beyond their financial capabilities to acquire and maintain. The focus on core competencies means that a firm cannot hire or invest in all the talent they need, but cannot survive without such talent. The outsourced providers are more specialized in particular functions and have a much deeper talent pool. The Indian IT industry for example has specialized in optimizing large scale back office functions, and has a large talent pool which specializes in those functions.

[19] Fosum (1999, p. 292)

Contrary to popular perceptions, offshoring can reduce costs and simultaneously result in measurable improvements in quality. The BPO Satisfaction Barometer developed to assess executive satisfaction with their outsourced processes found a 95% and 91 % satisfaction level in USA and Canada respectively. For example the lower labor costs of operating a call center in India, the offshore providers are able to spend more time in interaction and resolution of the issues to the customer's satisfaction. While most American call center operators are high school graduates and the jobs are perceived to be low paid and dead end, most call center employees in India have college degrees and have a higher level of enthusiasm for the job. The wages are relatively high, and do not carry the stigma attached to such jobs in developed countries. The difference in education levels and a culture which is service oriented delivers higher levels of customer satisfaction and lower costs.

Until recently most companies that initiated offshoring considered innovation as a core competency which would reside in-house. Innovation can be measured as the number of new ideas or successful products an organization has conceived and developed over a period of time. While innovation is considered to be crucial for an organization's future success, there is a growing concern that R&D productivity is not keeping pace with its costs. There is a rethinking of the R&D operations, and blurring of the line between mission critical research and commodity technology. Most western companies appear to be embracing a new paradigm of innovation, one that includes global networks of offshore providers. Offshoring has the potential to bring together the core competencies of two or more separate organizations which can interact in unique ways. The relationship, if managed well, can be a source of constant innovation and redesign of processes at an exponential rate. The search for developing a global network of partners for help with innovation is fast spreading to every corner of the economy. Boeing is working with India's HCL to co-develop software for the 7E7 Deamliner jet. Still most companies realize that if they want to achieve a sustainable competitive advantage, they will not get it from outside sourcing. While they are downsizing their R&D facilities at home, they are boosting hiring at their own labs in India, China and Eastern Europe. Intel and Microsoft are investing billions of dollars in establishing R&D centers in India. The strategy is to leverage the best minds and technologies across the globe to exponentially increase the speed of innovation.

RISKS OF OUTSOURCING

While there are substantial advantages to offshoring, it also carries risks both perceived and real. There is considerable resentment and backlash against companies that are at the forefront of offshoring business processes. This resentment stems primarily from the loss of white collared jobs to overseas providers with the IT sector being the primary focus of these job losses. While the loss of jobs to overseas providers has been going on for a long time in the manufacturing sector, the loss of white collared service jobs has caused considerable resentment. The information and communication technology revolutions have speeded up the pace of commoditization of services. This has resulted in the export of the back office processes and the resulting job losses. While it is true that there have been considerable job losses in some sectors, they are minimal compared to the job losses due to the dotcom debacle. It is estimated that only 2.8% of the total IT jobs lost were because of offshoring. The total U.S. employment has risen from 129 million in 1993 to 138 million in 2003 with most of the increase in the service sector. This suggests that America was a net beneficiary of the international movement of services. A McKinsey study estimates that for every dollar spent in offshoring by American companies 65 cents come right back in the form of demand for American products and services from the offshore providers. This coupled with direct cost savings results in an increase in jobs for higher skilled jobs in various sectors of the economy.

The loss of security is a more real risk of offshoring processes. Since offshoring involves the transfer of process ownership to an external service provider, security concerns need to be addressed. The American consumers attach a high value to the privacy of their financial and medical records. Any loss of confidential information will have an adverse impact on the outsourcing organization. The companies initiating offshoring must ensure that confidentiality and security concerns are resolved before entering into an outsourcing contract.

The offshoring of noncore activities leads to an increased dependence on the BPO vendor for satisfactory performance of the outsourced activities. The transfer of direct control of customer contact activities to an offshore provider runs the risk of reducing the visibility and underestimating the importance of those activities and the customers serviced by those activities.

While there is an enthusiasm for offshoring by American companies to exploit the wage differentials, it is critical to understand that wages are only a small part of the total costs. Startup costs and communication costs are incurred along with other costly complications that may arise. Local highways and transportation networks may be inadequate; disruptions in electricity supplies may be frequent. The lack of respect and poor protection of intellectual property rights increases the risk that core technologies may be stolen by vendors. The risks of dealing with arcane legal systems, a high level of bureaucratic requirements and corruption in the public sector are other obstacles an outsourcing firm must consider as part of the total cost.

GUIDANCE FROM ECONOMIC THEORIES

It is often not obvious as to what are the right things to do when we have a huge trade deficit and when we are losing jobs due to offshoring of production and services to other countries. The above situation may create a variety of domestic problems. Domestic corporate investments may drop, workers may get laid off, businesses may go bankrupt, and production facilities may close. On the positive side, due to lower cost of production and higher profits, domestic corporation may be globally more competitive. Further, the rate of inflation may remain low due to increased imports and lower cost of production. The question is, which of the above scenarios is more likely to be correct? Do economic theories help us to understand the situation that we face, and guide us in determining the appropriate steps we should take?

A few of the economic concepts and theories presented below may help us understand the situation as well as take appropriate actions beneficial to the U.S. in the long-run.

David Ricardo's "Law of Comparative Advantage says that a nation should specialize in producing and exporting those commodities which it can produce at relatively lower cost, and that it should import those goods for which it is a relatively high-cost producer" (Samuelson, p. 759). Other economic models such as the Hecksher-Ohlin model also support the comparative advantage idea based on "factor endowments," i.e., a country is better off by maximizing the use of resources which are abundantly available domestically.

Economists generally support the concept of free trade and free market as they are beneficial to all nations in the long-run. It has been amply demonstrated over the years that the countries which practiced protectionism and had command economies (government control of market activity) such as the communist countries, did not prosper as well as the market oriented economies of Western Europe and the USA.

The world has been clearly persuaded by the above ideas. The General Agreement on Tariffs and Trade (GATT), signed in 1947, is generally committed to keep tariffs and non-trade barriers low. The World Trade Organization (WTO), a permanent organization was established in 1994 to oversee the rules established under the GATT and to administer formal trade dispute settlement procedures. More and more nations are joining WTO including the past command economies such as mainland China.

The economic theories have also established that free market with open competition is the most efficient way of doing business, producing products, and providing services.

The technological developments, particularly information technology (IT), Web-based Internet, etc. have brought the world closer together. Hence, our business, production, consumption, competition etc are now increasingly world-wide. According to economic theories, greater competition would lead to higher efficiency, lower cost and greater world-wide economic growth. The offshoring of businesses, jobs, investments, etc. are the result of free market and increased world competition.

An obvious question is, if free-trade, free market and world-wide competition etc. are good for the economies, then why are there so much of labor, business and political opposition to their resulting outcomes such as offshore-outsourcing?

It should be noted that neither the opposition nor the negative impacts of offshore-outsourcing are evenly distributed within the above groups or the different regions of the country. In general, the sectors less competitive, or more vulnerable, due to the nature of the product or business,[20] are likely to be impacted more with respect to job loss and lower revenues.

The employment situation is further affected by general downsizing of corporations as well as increases in productivity. It is a real tragedy for workers who have lost their jobs and for businesses that are facing losses or even bankruptcy. It is not meaningful to them that free trade and world competition are eventually beneficial to the economy as a whole unless adequate alternatives are available to them. It is, therefore, imperative for the affected workers that society has a financial safety net together with retraining and relocation facilities in place. The above provisions for workers must be coupled with appropriate incentives and long-term restructuring of businesses and the economy to realize the benefits of increased efficiency and productivity, and reduced costs of products and services. The U.S. with abundant resources, excellent higher education system, superior technology together with cooperative government and a great economic system should have less to fear and more to benefit from free trade, free market and free world-wide competition. However, the higher wages in the U.S. must be supported by higher productivity. If not, then the wage gap will drive our businesses and jobs offshore in an effort to lower the cost of production, and remain competitive in the world market. If we are unable to remain competitive, our business profits as well as our economic growth will decline and the consequent job losses would be much greater than what we have seen due to offshore-outsourcing.

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[20] A product or service could be more vulnerable if face to face contact is not necessary between the sellers and the buyers.

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