CHAPTER IV

GETTING MAXIMUM VALUE BY OUTSOURCING, TRENDS IN BPO AND MARKET ANALYSIS
CHAPTER IV

4 GETTING MAXIMUM VALUE BY OUTSOURCING

Most companies locked outsourcing in the back room—using it to pass off unimportant functions and processes to competent specialists so managers could focus on more critical activities. But that’s all changing. Outsourcing is increasingly making its way into executives’ strategic toolkit. In an earlier research study, Three types of outsourcing relationships: conventional, collaborative, and transformational. Executives use conventional outsourcing to generate cost efficiencies in support processes. They use collaborative outsourcing both to upgrade business processes and to provide flexibility to respond to changing business needs. Business transformation outsourcing holds a higher standard. It’s a comprehensive approach to both create new capabilities and to use them to achieve a clear strategic objective.

Metrics and incentives are an important component of all three types of relationships, but as executives use outsourcing more strategically, these become more critical than ever. In this research study, it was found that each type of outsourcing
relationship calls for different metrics and incentives to some extent. More importantly, executives also use the same metrics and incentives in different ways to shape the outsourcing relationship they need. Based on our in-depth conversations with executives, we conclude:

Conventional outsourcing can't generate incremental savings forever. Despite rigorous measurement and tough penalties for failure, the stream of incremental savings that conventional outsourcing delivers ultimately reaches its limit.

Driving additional value means moving toward a more sophisticated relationship. Many firms have migrated toward more collaborative outsourcing relationships in order to create value beyond simple cost cutting.

It also means relaxing the tight linkage between accountability and control. Tapping new sources of value means sharing ownership for results with an outsource partner. The more transformational the outsourcing agenda is, the more blurred the lines of accountability.

Effective firms use metrics and incentives in a whole new way to manage transformational relationships successfully. Executives who operate at this cutting edge have loosened their
white-knuckle grip on control and use metrics and incentives to foster commitment.

Conventional Outsourcing Metrics and incentives are staples of today's large-scale outsourcing relationships. All of the executives we spoke with have barometers in place for tracking their progress toward the goals of the deal.

Although they pick from a broad menu of metrics, executives with conventional outsourcing relationships generally rely on a short list of approaches. Most contracts spell out service levels—such as computer availability, call-center phone response time, and transactions processed per hour—and cost reduction targets. Vendors are compensated by fixed fees with penalties for missing "guaranteed" service levels and, in some cases, bonuses for beating savings bogies.

Over time, as companies gain outsourcing experience, they learn what works and what doesn't. They revisit their initial sets of metrics and make adjustments that boost performance. Best practices they related to us include making sure objectives are clear at the outset, paring the performance measures down to a small number of critical ones, shifting from input to output
metrics where possible, and making sure these are developed early in the relationship.

Armed with these best practices, executives do achieve cost savings from conventional outsourcing—to a point. Firms report a 20 to 50 percent average cost savings over the course of a long-term contract. However, the results they achieve depend heavily on the efficiency of the operation to start with. And once it has been tuned up to industry standard performance, the ability to generate substantial year-over-year cost improvements drop markedly. What do executives do to keep up the momentum? Some peg their improvement targets to industry benchmarks. Using outside experts to measure, they aim to keep costs and service levels in the top quartile, as compared to similar operations. Annual incremental savings may be flat or small, but at least the firm maintains parity with the most efficient organizations.

Other firms stoke up market incentives. These companies keep multiple vendors in the mix to foster better performance through competition. A Telecommunication executive points out, "We have four or five main providers and hundreds of people
asking for support. If a vendor demonstrates good service at the ground level, it's more likely to get follow-on work."

A smaller group of companies go for scale with multi-firm service centers. There's a limit to how much improvement even the best outsource vendor can achieve with your operations. To drive cost reductions even further, some organizations press their vendors to bring other firms' work into the same facility.

The architect of extensive business process outsourcing at a major resources firm explains, "We had accounting organizations dotted all over the place. When we consolidated to a single location through outsourcing, we achieved a significant cost reduction. To get the benefit of another scale change, we worked with vendor to pull the operations of six of our competitors into the same center."

These approaches to continuous improvement satisfy some of the firms we interviewed, but 74 percent have taken a different tack. They have shifted their outsourcing relationships to a more collaborative footing in order to expand their
opportunities for value creation. One CIO on the cusp of this decision lamented, "Every month there's a metrics meeting with our IT outsource vendor. We rate them; they rate us. But when I walk the halls, everyone's really pretty unhappy with the service. I want to make IT a key strategic focus for the company, but I need all the arms and legs rowing in the same direction to accomplish this. That's just how our outsourcing works today."

Collaborative Outsourcing a conventional outsourcing relationship gets you what you asked for; collaboration gets you what you want. Companies looking for more value from their outsourced business processes—from supply chain management to human resources—strike collaborative relationships. Unlike conventional outsourcing relationships, these can offer significant upside in the form of customer delight or an edge in efficiency. Outsourcing complex processes with substantial upside potential means using metrics and incentives to promote collaboration. In the absence of tight controls on performance, parties in these deals go one step further. They create and document shared principles that guide the way they will jointly deal with each other—what Trevor Nagel, a partner at Shaw
Pittman, calls a "constitution, not a contract." These principles not only set forth the work approach, they capture the key business goals and thought processes behind it, as well as the methodology for achieving it. The goal: to ensure the principles set the correct tone for the relationship as it evolves, regardless of the individuals involved at any time. Explains outsourcing expert Harry Glasspiegel, CEO of Glasspiegel Ventures, LLC and formerly of Shaw Pittman and CNA Insurance, "The original parties can help the relationship succeed over time by giving later participants a gift-context."

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Business Transformation Outsourcing

many organizations have pushed outsourcing beyond a conventional relationship. A few bold leaders have gone even further. They are using outsourcing to transform their businesses. Companies undertaking business transformation outsourcing (BTO) seek radical change that can rock an industry. It requires unflinching commitment to an outcome that may be years away and a partner to share the journey. Although the potential rewards are enormous, unexpected shifts in technology or the competitive landscape could call for mid-course corrections at any moment. Executives forge strong relationships to see them through this white water ride. One CEO told us, "I work side by side with my counterpart at [the partner firm] to ensure that we anticipate and confront change as it happens."

If a conventional relationship gets you what you ask for, and a collaborative one gets you what you want, a transformational relationship gets you what you need. Business transformation requires commitment because of its bet-the-ranch character. In it, both parties forsake the comfort and
security of clear scope of work, defined outputs, and structured roles and responsibilities to pursue dramatic improvements in enterprise performance. They use metrics and incentives to keep their interests tightly aligned and to support deep, continuing commitment on both sides to reach their aspirations. This is a whole new game. It means establishing some new enterprise-level metrics, crafting a gripping new set of incentives, and changing the way lower-level metrics are used.

When the goal is business transformation, the only relevant metric is business value created. Architects of BTO relationships measure:

Enterprise-level outcomes... And they set their sights on dramatic improvements in business value. Companies aim to double revenue, achieve market dominance, or completely reposition the firm. For example, Archer Financial Group, a disguised global financial services firm, doubled both operating margins and stock price through business transformation outsourcing.

4.1 BPO: A Balancing between Risk and Reward
The concept of BPO started relatively small, with only very basic processes and functions such as inbound customer support and basic transaction processing being outsourced. But, over the past decade, the functions being outsourced have become increasingly more complex and far-reaching, requiring global strategies, a wide range of talented people and innovative technology solutions.

Today's BPO market is a multibillion-dollar industry that continues to undergo rapid transformation on a global scale. Most of the world's leading companies have already — or are currently in the process of — adopting BPO as a strategic business solution, leading to dramatically increased spending across the board on a wide range of related services. As a result, the BPO industry is extremely diverse with multiple sub-sectors, each with its own unique characteristics.

According to Gartner, by 2007 the size of the global BPO market will be $173 billion, of which more than $24 billion will be outsourced to offshore contractors. Currently, the leading
verticals in the BPO market are:

- Telecommunication;
- Technology;
- Financial services;
- Healthcare; and
- Energy.

In these verticals, the most commonly outsourced processes include internal auditing, payroll, human resources, benefits management, contact centers/customer care, payment/claims processing, real estate management and supply chain management. But despite the continued growth and potential of BPO outsourcing, many experts feel that it has certain risks. With this in mind, a review of the risks and rewards of BPO is warranted.

4.1.1 The Risk

*The eternal dilemma* - is risk-taking something we are supposed to grow out of? Isn't it just a remnant of impulsive, youthful behavior we should have left behind as we matured and
grew wiser? The answer to this is straightforward – No pains no gains! An individual who wants to grow and prosper personally and professionally must be able to dare and take on chances. There are always some who may like to adopt the protected and calculated approach and never consider leaving the comfort zone.

It is often noticed that managers and entrepreneurs who consistently perform at a higher level have certain things in common. They are committed to their success, have a passion for their profession, have clear goals and are uniformly more comfortable taking risks than most others. Their ability to take intelligent decisions with the right balance of caution is an important ingredient in their success and a huge determinant in the level of achievement. Success cannot be the sole aim for all actions undertaken. True achievers are those who have the faith and take the leap.

Fear is fantastically powerful. It is the primary obstacle to being a talented risk-taker. It is also a huge limiter of success. The fears of rejection, failure and success are always present in every environment. Learning how to prevail in the face of fear is
the single most important step one can take towards becoming a successful risk-taker and maximizing success. Comfort zone is partially shaped by life-preserving fears and partially by groundless ones. To become more capable risk-takers, we must move away from the instinctive response to fear and toward the counterintuitive response. The constructive, though counterintuitive, response to fear is to acknowledge and accept it. One has to confront fear and not be paralyzed by it.

A couple of years back many organizations were apprehensive about outsourcing some of their service and manufacturing processes to countries like India and China. These companies soon realized that by taking the risk of moving some processes to destinations that were more cost effective and delivered higher quality of work, they were able to focus on core areas and save large sums of money. Even the basics of nature are based on the fact that one grows by taking a step forward. An infant has to overcome the fear of falling to ultimately start walking. The biggest gainers at the stock market are those who take high risks – but a reality check is highly recommended or else the chance taken can be harmful for all involved.
Loss of control:

Outsourcing key processes may result in the loss of direct managerial control of the process. Many managers suppose it is harder to manage the outsourcing service provider as opposed to managing one’s own employees internally. Although processes are customized to meet the specific needs of clients, discrepancies usually occur early in the business relationship between a BPO provider and the client.

Mitigating the risk:

The most effective way to maintain control of an outsourced process is to develop an ongoing communications plan and ensure a strong governance model. In some cases organizations have been known to place an employee onsite with the outsourcer to manage and oversee the process on a daily basis. This is particularly effective early in the relationship.

Security threats:

Although rare, an unfortunate reality is that outsourcing can threaten the security and confidentiality of a company’s most sensitive data and processes. When a company outsources
a highly confidential business process such as payroll, the outsource service provider will be in possession of sensitive information such as salary and social security numbers. It is a delicate process with daunting ramifications, and a company must fully evaluate each potential risk and benefit before deciding which business processes to outsource and/or retain in-house.

Mitigating the risk:

Scrutinize the provider's information technology infrastructure to ensure security, document expectations as they relate to sensitive customer information and protect against any breach with strong contractual provisions. In addition, there are a number of worldwide certifications designed to help protect both physical and data security. One of the most common is BS-7799, although BS-1500 is also quickly gaining momentum as the new worldwide standard.

Hidden cost:

Generally speaking, the potential hidden costs of outsourcing are not pre-calculated. These silent add-ons may
include legal fees and time spent coordinating the contracts between two companies. Hidden fees conspire to reduce the allure of BPO by unexpectedly driving up costs, which is ironic, as cost savings are a major reason why companies outsource in the first place. The hidden and missed costs of outsourcing are hard to predict, which can cause overall costs to be underestimated.

Mitigating the risk: Simple due diligence can go a long way toward minimizing hidden costs in advance. Many companies are providing the master services agreement (MSA) and statement of work (SOW) upfront in the request for proposal (RFP) process to minimize time and costs.

4.1.2 The Rewards

Cost control:

As previously noted, outsourcing is seen by many as a major driver of globalization for many companies. At the same time, for most companies, it offers substantial cost savings. The economic benefits of outsourcing are real and significant. First, outsourcing reduces costs in three areas:
Implementation costs:

Client companies save time and money by leveraging the BPO provider’s IT investments and professional expertise. Implementations are simplified and streamlined because configuration and customization options are typically limited to proven alternatives.

Operational costs:

Companies that internally manage their own processes can spend more than twice as much annually on maintenance and upgrades than those companies that outsource their functions. Such substantial cost savings are largely achieved through the ability of outsourcers to pass economies of scale and efficiencies of centralization on to their customers.

Reduction in technical staff:

Companies that manage their own technology typically have a dedicated technical staff — an expensive “black hole.” In contrast, companies that use outsourced technology platforms are often able to reduce their technical staff by nearly 50 percent.
These cost savings are available because outsourcers have developed excellent cost structures. Providers become experts at implementation, configuration, customization and operation of a given process. They integrate content only once and can then share that expertise with potentially hundreds of clients. They also offer highly flexible “standardized” process customizations, which can then be leveraged by multiple clients and can be implemented in minutes. In contrast, “unique” customizations in companies that do not outsource can often take months.

**Increased efficiency:**

Companies that outsource their business processes are often able to capture new efficiencies while simultaneously improving productivity. Again, they are in a better position to reallocate resources to other projects, helping their employees achieve greater efficiency and results in the process. In most cases, BPO providers bring in high-caliber subject-matter experts to design and manage the processes. These experts offer years of experience that many companies do not have access to or cannot afford on an ongoing basis. The end result is the
development and adoption of well-defined business processes that allow for productivity improvement without compromising quality.

Reallocation of resources:

The more back-office functions that can be offloaded, the more effective the organization. An important facet of business process outsourcing is its ability to free top executives from some of their more mundane day-to-day process management responsibilities. On average, executives spend 80 percent of their time in the management of details and only 20 percent on formulating strategy. But when a business process is outsourced, this ratio can be easily reversed.

At the same time, outsourcing enables employees to assume greater responsibility within an organization. In particular, it often lets managers at all levels spend time saved on activities such as:

• Strategic planning;
• Measurements and analytics;
• Planning and budgeting;
• Work with line-managers to understand business needs
• Developing and evaluating new technologies and processes for even greater efficiency and effectiveness.

**Incremental Value**

Business process outsourcing is particularly beneficial in that it directly influences shareholder value. BPO is all about optimizing business performance to create and maximize value where it did not previously exist. There has been a tremendous upsurge in BPO and related outsourcing industries in developing countries like India because of their ability to reduce costs while increasing quality of service. This has helped outsourcing companies and BPO service providers alike create enormous ROI for their shareholders and investors.

The above points give us an idea of the advantages associated with BPO. In addition, it helps expand global business relations while increasing foreign exchange for countries involved in the process. But there have been certain points that highlight the disadvantages associated with BPO as well.
Outsourcing is a trend that will continue to grow as global barriers to business fall. Increasingly complex solutions, integration initiatives, budget and staff constraints and the demand for diverse talent are among the many factors that will fuel the trend. Companies should consider outsourcing as part of the regular planning and budgeting process. When used under the right conditions, outsourcing can have near-term value to organizations and the clients they serve. CIS

4.2 MARKET ANALYSIS

The Business Process Outsourcing (BPO) market is growing.

Victorious providers have best practices, methodologies and industry principles that allow deals to get done rapidly. The entire BPO field has learned from earlier period deals, so we now see larger deals with better foundations. As a result, BPO is continuing to be used in new functional areas, new industries and across the world.
BPO has come a long way in the past five years.

Five years ago, BPO meant payroll processing and profit administration - not exciting enough to talk about at a conference. Mainly the large consulting firms were talking about it, said Scholl of Gartner Dataquest. Since then the mega-deals have become very significant in determining the new form of Business Process Outsourcing or BPO. The field has become much more segmented, complicated, and sophisticated. It will fundamentally change how businesses work.

The main drivers of Business Process Outsourcing (BPO) have changed.

Cost savings and variable cost structures are more vital. Information security, the ability to carry out, and business continuity have also become more important. But approach and transformation are less significant, as are innovative financial and tax structures.

Technology administration - including IT
outsourcing - is moving into the hands of process-based management organizations.

A survey conducted by Forrester Research on 50 CIOs, on an average, they outsourced 28 percent of their IT budget and they are looking to outsource 34 percent. One company has outsourced 76 percent of its IT. This is just the tip of the iceberg. The IT organizations pattern is being restructured. IT organizations used to build everything. Now, an increasing sum of their work is below ground. The emerging business model is collaborative and operates at a process level. Firms specialize in their core competencies and collaborate with other specialists for the balance of the work. The technology to operate these outsourced processes - which used to be supplied by internal IT - is now provided by the process outsourcer.

The market drivers are more realistic than in the earlier period.

Gartner Dataquest conducts a BPO survey for every fall. In fall 2001, the top two drivers of Business Process Outsourcing (BPO) were focus on core business and reduce costs, both of
which are more practical than the previous year's top driver: gain competitive advantage.

**BPO workers will come from many sources.**

People from industry may have process experience on a large scale, but they often do not have multi-client skills which they need, because they must serve different clients in different ways every day. Some people come from consulting, but they often lack operating experience. And IT people lack domain (process) expertise. As a result, BPO providers must mix-and-match skills from these different sources.

**Business Process Outsourcing (BPO) expansion is going to be infinite.**

Providers will find ways to get to this higher-margin work. In fact, the Business Process Outsourcing (BPO) marketplace is similar to the ITO marketplace in 1992-93. That's when CEOs and CFOs asked their CIOs, "Why aren't we doing this?" In the not-too-distant future, there will be a BPO deal or series of deals
that galvanizes the BPO market. When that happens, this market will grow faster than the ITO market did.

4.3 Current International Trends

The driver of this next stage in automation is not technology per se, but changes in competition and how businesses operate and execute their strategies. The Internet may be the agent of change, but the engine of change is a need to cut costs and improve core business processes in increasingly competitive global markets.

4.3.1 Trends in outsourcing

Over the past 25 years, the types of service activities being outsourced have changed considerably. As one traces the history of back office operations, one can see the convergence of several trends affecting which activities get outsourced:

• Minimizing input production costs

Long before current digital technologies were in use, United States corporations were shipping hard-copy documents and tapes abroad and receiving the data back in electronic form.
The initial contribution of digital technologies was to provide the infrastructure for internal data support services (i.e. information processing) to be 'shipped’ faster and less expensively from one production location to another.

- **De-linking the front end**

As global tele-communications costs began to drop and the quality of the global Telecommunication infrastructure improved, companies started to move their toll-free reception numbers offshore. Locations like Jamaica invested in teleports to attract reservations and general reception contracts to augment basic data-processing contracts.

- **Accessing specialized skills**

By the late 1980s, organizations had begun contracting out (or outsourcing) specialized functions that were not part of their core business. Moving that outsourced activity abroad was an easy next step, justified by the ability to remain focused on core business. The availability of more cost-efficient Telecommunication supported corporate decisions to search
globally for the technical skills they needed and so optimize their use of talent.

- **Customer service outsourcing**

  The growth of the Internet and online connectivity made possible the provision of technical support and problem resolution for customers from remote locations. Call centre activity began to accelerate.

- **Business process outsourcing**

  As corporations started to focus primarily or exclusively on their core business, entire support processes began to be outsourced (i.e. business process outsourcing). Some of the earliest examples were payroll processing and credit card processing.

- **Administrative support to global networks.**

  With consolidation on the increase, global networks needed to rationalize their support services. For example, airlines, hotel chains, tour operators, travel agencies and car rental agencies are all striving to create a global brand through
partnerships that provide a seamless service, supported by pooled purchasing and marketing functions.

As a result of these trends, only managerial responsibilities, core processes and the operational review process are routinely kept within an organization. The 1999 Outsourcing Trends Report estimates that soon 50% of an executive’s budget will cover outsourced activities, and the ability to leverage outsourcing relationships will be an important element of managerial success. The report also documents the overall shift from a preoccupation with cost savings to strategy as the primary reason for outsourcing support activities.

There have also been changes in the structuring of outsourced activities. When back office operations were initially created as captives (or subsidiaries) of parent companies, they were treated as cost centers but have since evolved to profit centre.
4.3.2 Country- and region-specific activities

While the movement to back office operations originally involved going offshore in order to lower labour costs, most countries now have at least one firm providing back office operations. As demand growth shifts to higher value-added customer service functions, developing countries are facing increasing competition from developed countries, which are able to offset higher wage structures with specialized skills and significantly lower Telecommunication costs.

Following is a brief overview of country- and region-specific activities:

United States

Because of the size of the United States’ economy and its concentration of multinationals, a number of smaller American communities are now actively soliciting back office business in order to create jobs. In some instances, the back office work is then subcontracted to overseas partners (e.g. in India). This is also discussed later part of thesis in detail.
European Union

After the United States, the European Union (EU) has the most active market for back office operations — primarily call centres, which are growing at the rate of 40% a year. The number of European agent positions was rise by over 38% in 2002. Ranked third globally as an inbound service agency and fifteenth as an outbound service provider, Atesia SPA leads Italy’s call centre activity. Germany is one of the leaders in creating web-enabled call centres; it had 38% of European call centres in 1998 as against the United Kingdom’s 22%.

Call centre activity is growing in Belgium, Denmark, Northern Ireland, Norway and Scotland. However, Ireland, the Netherlands and Sweden are the main contenders, along with France and the United Kingdom, for call centre business. Ireland has leveraged its success as an international financial service centre to expand into call centres, touting its young, multilingual, well-educated workforce and its lower Telecommunication cost. The Netherlands has claimed the broadest base of linguistic talent and has created 50 fully wired business parks around the country with state-of-the-art Telecommunication support. Sweden has not only developed a
strong technical infrastructure but also a human infrastructure — the ‘call centre community’ — of associated resources, including university courses on call centre management.

**Australia and New Zealand**

Australia has been positioning itself as the call centre capital for the Asia-Pacific region. As of 1997, Australia had an estimated 70% of the call centre market in Asia and the Pacific (according to Telstra, the country’s Telecommunication company). By the end of 1998, Australia had created 4,000 jobs and generated US$ 1.3 billion in revenues through help-desk call centres; it had close to 100% growth in 1999. Australia’s position, however, is now being challenged by New Zealand, where labour costs are 20% lower.

It has a mature BPO industry with 4000 call centers employing 225,000 people with US$ 5.7 billion revenue. It has the advantage of large English speaking population with a favorable time zone.
Canada

Canada’s growth in back office operations was initially stimulated to create jobs in the country’s lower-growth areas, and one province has begun marketing its central location successfully.

Since only five per cent of total BPO business (by year 2005) from United States would be offshore amounting to US $7.5 billion, Canada and Eastern European States could put severe pressure on India on price front, besides being sought after for their near-shore capabilities by the US.

The Caribbean

Both Barbados and Jamaica have developed flourishing back office industries, primarily based on attracting corporate captives. The Dominican Republic is a more recent, successful entrant. Smaller eastern Caribbean economies are collaborating to promote their back office capabilities.

Asia

The two major suppliers of information processing services in Asia are India and the Philippines. Among the other areas with
some back office activity, supported by teleports, are Hong Kong Special Administrative Region (China), the Republic of Korea, Malaysia, Pakistan, Singapore and Taiwan Province (China). China is offering lower-cost data entry and has just approved AT&T as the supplier of its first international call centre. Back office operations in Viet Nam, a low-cost market with a well-educated workforce, are just beginning.

**Philippines**

In the Philippines, the manpower costs are 60 to 80 percent lower as compared to UK and US. The average salary cost is around $700-800 per month in the BPO sector. The country has a shortage of manpower mainly due to the small population as compared to India. The manpower base for BPO is only 300,000. Right now the country is getting business from nearly 70 companies employing more than 12,000 people with revenues of US$ 250 million.

The main advantages of Philippines are as follows:

a) Large scale technical training program: The government has initiated a number of policies by which the skills can be provided to a larger population.
b) Improved telecom and office infrastructure: Philippines scores over India in this respect.

c) Third largest English-speaking nation in the world: This is a very important advantage.

d) Well developed IT skill set: It is considered 2nd only to India due to performance in software.

e) Costs of technology workers: This (which represents the biggest recurring costs for, say, a B2B site) is only around 16% to 25% in the Philippines to that of comparable workers from the United States.

f) Former American colony: As a former American colony, American culture and language is widely emulated here. These cultural and communications skills could prove to be so appealing to American firms that they would outweigh slightly higher labor costs in the Philippines.

g) The main disadvantages of Philippines are as follows:

h) Low graduate turnout: Philippines has a low graduate turnout (only 400,000 per annum). This compares very unfavorably with India.
i) Not having a record of high quality: India has consistently delivered very high quality in Software and has built a very high reputation in it.

j) Political instability: The country has frequent elections which makes it difficult for companies to outsource as there is lack of uniformity of policies with changes in the Government.

k) No disaster recovery facilities or multi-location facilities: After the WTC bombing, terrorism has become a very important issue for the US companies in particular and they want that the BPO providers should have multi-location facilities which can be used in case of any terrorist attack.

l) Issue of scaling up: Philippines faces the important issues of scaling up. Issues like scaling up have stunted the growth of BPO activities being outsourced to Philippines. The largest call Centre in Philippines of AOL has only 800 people. The size of the Philippines BPO industry is only $100 million, whereas India’s BPO industry is presently at $1.5 billion (2001-02).
China

In the outsourcing field, China is the biggest challenge in the future and the largest threat to India. With the largest population and fastest economic growth, China has at least two strengths in the global outsourcing market: manufacturing and IT.

The main advantages of China are as follows:

1. Lower Manpower costs: The Chinese workers cost about 15 percent less than equally qualified Indians.

2. Japan Advantage: China is likely to grow through the Japanese outsourcing route. The advantages that China has are Japan’s proximity to China, similarity of the languages. India currently offers almost no BPO services in Japan.

3. Extremely low cost real estate and power: These costs are lower than in India. This can be a very attractive to the US companies, which are looking for cost cutting due to the downturn.

4. Proactive Government.: The Government is very friendly to this sector and has taken the following steps.
4.1 English teaching and other skill sets: Over $5.4 billion was invested in nine universities in China to promote English language and other skill sets.

4.2 Increasing telecom density and PC penetration: China scores over India in these aspects and intends to further increase the gap.

5 Leveraging on the manufacturing image: Western manufacturing companies have found that outsourcing their manufacturing function to China for their companies' global operation can be profitable and also of good quality.

The main disadvantages of China are as follows:

1 Lack of a good Quality record in Software: India has a better image as a quality supplier mostly due to its track record of better quality software than China.

2 Low English speaking population: This is the biggest drawback of China. It has a very small proportion of the population speaking fluent English.

3 Less mature: The Indian business processes are much more mature. China has only recently entered into BPO. As such,
despite lower billing rates, total project costs in China would turn out to be higher because of the higher overheads incurred.

**Latin America**

Back office operations in Latin America are still primarily captive operations of United States corporations. Exceptions include companies like EDM International, which processes more than 300 million documents a year in Mexico.

The major challenge to the growth of back office operations in Latin America has been the development and deregulation of Telecommunication infrastructures. However, countries like Argentina, Brazil, Ecuador, Mexico and Peru now have teleports that could be leveraged. Brazil’s New Work Station Telemarketing is one of the top ten call centres globally. Costa Rica’s private free trade zone, Metro, is actively promoting call centre investment, and Uruguay is offering data processing services to foreign companies. With regard to business process outsourcing, centres of excellence are established in Colombia and Venezuela in support of international oil and gas companies.
Economy in transition

Telecommunication infrastructure remains a challenge in many economies in transition. Individual call centres or software outsourcing operations have been reported in Albania, Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, the Russian Federation, Slovakia and Ukraine.

Africa and the Middle East

Again, Telecommunication infrastructure is a challenge through much of these regions. Outsourcing activities are focused in export free zones, as in Mauritius and the United Arab Emirates. Gateway Ventures Ltd has been piloting data processing in Zimbabwe. Call centres are beginning to develop in South Africa.

4.4 THE GLOBALIZATION EFFECT

To remain competitive and to spur top-line growth, large companies are increasingly looking to enter foreign markets - catalyzed still further by a lessening of direct
Government regulation in many growing economies. To effectively serve local markets, businesses face increasing pressure to work with ever-increasing numbers of homegrown producers, suppliers, Government agencies and supply chain partners.

For low-cost producer to exist in the global economy, outsourcing must exist. Look no further than the steel industry. In the 1960s, the United States had the dominant steel companies. As steel became cheaper to produce in Korea and Taiwan, the U.S. jobs went from 600,000 (1960) down to 230,000 (1999). However, even with the reduced workforce, the U.S. steel companies make roughly the same amount of steel. What we saw here is the power of technology to improve productivity.

4.4.1 The Internet Infrastructure: A Vital Enabler

The Internet is making the world smaller and smaller. India and China are a click away and worldwide communication is easy. The global sourcing model is further proof of the fundamental change from the industrial economy to the information economy.
The Internet also enables very sophisticated remote monitoring. For instance, call center applications can remotely monitor call center reps in India and watch the performance of the agents. This level of real-time performance monitoring is new and only happening because of CRM technology. Technology is enabling outsourcing to be successful. With that success, the quality and value add are only getting better.

The BPO trend will require a major infrastructure buildout that includes broadband connectivity, databases, hosting, security tools, application integration tools, Web-enabled ERP applications, application integration modules, supply chain management, content management, dynamic pricing suites, payment and settlement, and the list goes on. All the pundits who are predicting the demise of the IT industry might be surprised by the growth in infrastructure spending.

4.4.2 Core versus Non-Core Processes

What are your core processes? What do you consider to be your non-core processes? Are you doing a significant amount of non-core processes in-house? If above criteria
meets, then organizations are a good candidate for an outsourcing strategy.

Manufacturing and service outsourcing have changed over the years. It is a macro-economic trend to which every company needs to react. If competitor can make a product and provide associated services for less, then organization need to follow, or risk being put of out of business. Follow the old adage: Don't fight the market.

Although initially low-skilled jobs such as manufacturing, call center, and computer coding were shifted abroad, as more companies expand their offerings into outsourcing, new functions like human resources and knowledge skills like technology are being outsourced. As the worldwide migration continues and the movement overseas matures, more high-skilled jobs such as accounting and engineering will likely be sent abroad.

4.4.3 Offshoring Outsourcing

Most companies are now adjusted to manufacturing being done offshore. What took place in manufacturing is now occurring in back-room processing and services. Ten years
ago, if anyone had boldly predicted that by 2003, we would begin to see back-room service centers and call centers housed in India or the Philippines or in China, they would have been laughed at. How could high-touch customer service agents who interact directly with customers work halfway around the world? The cost would be prohibitive given that monitoring the agents would be impossible and every call would be international.

Since the 1970s, many Western companies began manufacturing products in offshore locations such as Japan, Korea, Thailand, and Taiwan. Despite the relatively high cost of transporting the goods by sea and air, it was cheaper to make them in the Far East (and in Mexico after the NAFTA treaty) than to keep manufacturing in the United States or Europe.

With the advent of reliable, cheap global communications, the Internet and the abundance of skilled labor forces in many developing countries, offshore service centers have become both feasible and real. Many banks and others in the financial industry have already moved IT
operations abroad, and some have started business process offshoring efforts in which whole processing tasks are exported.

The main driver of outsourcing has always been cost saving. Although it is not the sole reason businesses look to outsource today, reducing expenses is still a major consideration. Since cost is such a priority, it makes sense that one of the biggest trends in outsourcing is offshoring. Countries such as India have a large, highly educated, English-speaking resource pool from which to pull. By outsourcing functions such as call centers or accounting, operational expenses can be reduced by at least 50%.

Offshoring is a critical strategic issue. We have found that productivity gains resulting from outsourcing advancements disproportionately fall into the hands of very large companies that can afford to capitalize the expenses required to set up and maintain complex offshoring relationships.

4.4.4 Vendors Becoming Public Companies
The market for global outsourcing services is somewhat unsettled. Based on size and resources, the "Tier 1" providers are IBM, CSC, EDS and according to some, ACS. Behind them are the "Tier 2" providers: Perot Systems, CGI, Accenture, Unisys, Lockheed Martin and Siemens. In addition, hardware manufacturers like Hewlett-Packard and Dell are trying to move into the more lucrative IT services business. Also, some new offshore players like Tata Consulting Services ("TCS") are trying to expand into the US market.
What used to be the consulting arms of the "Big Five" have all morphed in some way and, with the exception of Braxton, are all now publicly held companies:

<table>
<thead>
<tr>
<th>Yesterday</th>
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<td>Andersen Consulting (created as part of Arthur Andersen, then &quot;separated&quot; into an arm of Andersen Worldwide)</td>
<td>Accenture</td>
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<td>PricewaterhouseCoopers</td>
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The public nature of these companies has two important consequences. First, public companies are subject to the vagaries of the market. Hardware and software companies are already driven by quarterly and annual results, and these
now-public service providers will be subject to the same forces. Securities industry analysts are beginning to have concerns about continued growth in the IT services and outsourcing industry because of reduced backlogs, longer lead times to conclude transactions and a general downturn in the industry. This could be due to the general issues with the economy, maturation in the industry or some customer dissatisfaction with the outsourcing model, performance, price or something else entirely, but, regardless of the cause, it affects the stability of public outsourcing vendors. Second, these companies use their stock as compensation, and as the value of their stock decreases, their ability to attract and retain talent decreases, as well. This are fairly well understood.

4.4.5 Offshore Outsourcing

The hot area in the US for Information Technology Organization is offshore outsourcing, either on its own or as part of a larger transaction. Offshore outsourcing is attractive due to its cost (currently a factor of 5-10 times less expensive than using domestic providers) and the quality of the services provided (most Indian vendors have been
certified by the Software Enterprise Institute as achieving “Level 5” of the Capability Maturity Model).

Currently, the main location for offshore ITOs is India, but the demand for technology workers in India is beginning to outstrip the supply, which is driving up the cost of services in India. While services in India are still substantially less expensive than those available in the US or Europe, services provided in China, Eastern Europe, Malaysia, the Philippines and Russia are becoming more attractive. The major players in offshore outsourcing are divided between the larger firms listed in the previous section, each of whom either has its own offshore operations or a close tie to an offshore provider, and the native, “pure-play” offshore companies such as Tata Consulting Services (“TCS”), HCL Technologies, Infosys, Wipro and Cognizant.

4.4.6 Challenges for offshore providers are:

The ability to scale their operations while maintaining quality; the fundamental premise of outsourcing is that an outsourcing provider whose core business is providing technology services can provide those services to multiple
customers at a lower cost. As more companies move IT operations offshore, the Indian vendors may not be able to maintain the level of quality for which they have become known.

Business continuity: The distance between the US and India, combined with the level of infrastructure in India, also raises some questions regarding disaster recovery and business continuity. On one hand, having facilities on the other side of the globe provides for some redundancy, but, the very real issue is that your outsourced operations in India are being performed in a country with nuclear weapons that is on relatively unfriendly terms with its next door neighbor, who also has nuclear weapons. For offshore ITOs that go through one of the larger global providers that has operations or a close alliance with an offshore provider, this can be mitigated by the global provider.

Customer concerns related to confidentiality and non-disclosure You’re shipping your company’s crown jewels halfway around the world where they are subject to all kinds of possible threats. What if something gets disclosed? What if an
employee takes a copy of your data to a competitor? How will you be able to protect yourself? What remedies will you have against the outsourcing vendor? These are probably the questions that concern potential offshore outsourcing customers the most. In case of India, the local outsourcing vendors understand the concerns of US companies and are generally willing to agree to contractual terms that are satisfactory to the customer – including robust audit and inspection rights (Note, however, that one must actually exercise those rights by performing the audits and inspections).

The Indian companies understand the economic value of providing outsourcing services, and they recognize the risk to their economy if foreign firms do not feel safe with regard to confidential information. This is also an issue that can be addressed by contracting with one of the larger global providers. However, this may become more of a real issue as outsourcing moves to countries like China where there has been a history of intellectual property concerns.
4.4.7 BPO deals will get smaller

For the last five years, the outsourcing industry has been driven by large contract, many of which had an IT component.

As the BPO market matures, customers are recognizing they may want to outsource only the "transactional portions of the process." They are recognizing that in some instances, their own staff needs to handle the work that adds value to a BPO process, at least initially. This draw near to mitigates some of the apparent risk of an outsource bond, but still allows the company to achieve price benefits.

4.4.8 Multi-Sourcing to gain acceptance in near future specialists to thrive next year

It was predicated by many outsourcing gurus that in near future every deal will be going to be a mega-deal but now it seems that customer want best-of-breed suppliers, so instead of having mega deals, they are now focusing on specialist for each area and outsourcing their work smartly. Organizations aren't willing to take the risk to outsource everything to one entity. Each task is too important to give to
someone who will just do an okay work and not perform well enough as other competitors can.

However, the some of the executive believes multi-tower deals can eventually flower after suppliers have had the time to build up the required expertise to do it all. Success begets success. When more and more companies combine processes, there will be some successes. That will create the momentum for the multi-tower market

4.4.9 Security and privacy will become a bigger issue

Within a span of over a decade, developing countries become one of the most favored market the world for business process outsourcing (BPO) operations e.g. China, India, Philippines e.t.c. However, over the past few years, information and data security has become one the main challenges faced by the BPO industries.

Information security and data privacy challenges that BPOs face include lack of severe data protection laws, use of portable devices such as laptops by employees to store confidential business information, rising data security costs due to increased employee background checks, training
employees in maintaining data security, ensuring compliance with security policies implemented in the company, and systemic plugging of any loopholes through employee activity monitoring procedures.

To summarize this, the problem with security in BPO is that technology is not the problem. It's the people. One can encrypt everything and still have a problem if someone becomes lax. BPOs need to implement data security measures, which can be classified into measures taken at the recruitment level and measures taken at the operational level.

Suppliers can't become too confident. They have to have set guidelines and then make sure everyone is clear about how to adhere to them.

4.4.10 Offerings have to be global

The outsourcings offerings will grow as organization creates more confined centers in the budding market and as further multifaceted services are performed in these centers. The development of full process delivery model competency among captive turned third party and third party BPO providers will support these inclinations. The client
organization are looking on sourcing to the most qualified vendors in the most cost effective market

4.4.11 Offshoring will gather speed

The shift of services jobs to offshore will accelerate faster. The gains of current year will accelerate next year. Some buyers are buying into offshoring as a business plan because they recognize labor arbitrage is necessary to get to the right economics.

4.4.12 Buyers will look to other locations besides India

Customers experience was good with India, which leads to creation of business case for offshoring. Initially off shoring customers felt India was the only place to go. Now the competition is increasing and buyers are looking at the cost and ready to go any where else apart from India and some examples are China, Singapore’s, Philippines. Among with these countries some other countries are doing well such as Chile, the Dominican Republic, Jordan. For an example Chile has stable government, environment and growing economy.

Also the big Indian giants are setting up their company outside India to capture any possible market. TCS and
Satyam have setup their shops in China, trying to capture on the trained labor pool as well as on infrastructure which is superior than India.

4.4.13 Outsourcing supplier with industry vertical proficiency will find themselves in command

It's also wise to understand that outsourcing suppliers "with unique industry experience will be the next wave." They will have unique offerings that address the particular needs of that industry in addition to the requisite process expertise. To make that evaluation, the buyers should look beyond the bid and assess the vendor maturity, reliability, industry experience (e.g. generalists vs expertise) and much more.

While supplier may claim to offer advantages in infrastructure scale, factor cost, experience and state-of-the-art technology

4.4.14 Outsourcing supplier will no longer be able to compete on cost only

Outsourcing supplier to remain in the market next year they have to prove that they are not only cost effective but also provide a complete solution and have ability to deliver
business transformation i.e. they must sell meaningful business value

4.5 Outsourcing: Perception vs Truth

4.5.1 The Truth Is Offshore

Few decades back when first software code was written that time no one could have expected that the year of 2000 would quiver the information technology world to its foundation by Y2K issue and need of time was to upgrade all the systems to make it Y2K compliant.

At the same time, the developing country India, one of the largest English-Speaking pools having a highly knowledgeable and educated young population, was trying to establish a foothold in the IT and BPO sector.

The world market fell flat on its face in 2001. And time start for the company to cut their cost by any means and easiest option available in front of these organizations was to cut down the jobs and outsource their work to developing courtiers to reduce their cost and survive the competition and challenges in the market and was need of the hour too.
Asian countries such as India, China and Taiwan offer a formidable combination of low wages and regular supply of skilled resources geared up to tap the huge market for offshoring.

With labor alone accounting for nearly seventy-five percent of the expenditure of their development, finding staff, nurturing them and keeping them permanently on the payroll appeared to be a legal responsibility. Most CIOs in the US and Europe had been forced to change their policies and adopt strategies to curb in-house spending.

After realizing cost savings and growth in revenue, there is a rush to outsource work. American and European organization moved to outsource their domestic work either to low-cost countries, primarily India, or to open development centers to accomplish additional control over costs. It has been found that Eighty percent of services are already being carried out remotely.

The global outsourcing of Business Process Outsourcing services has increase almost four times over the last five years. Out of
which Indian organization have managed to get a big piece of share of outsourced business.

The Indian BPO organization stretches themselves to agree to challenges and gain a large share of the growing outsourcing business by expanding operations beyond the metros to counter the crumbling infrastructure and scarcity of professionals in the big cities.

It is expected that the Indian software biggies will make more acquisitions in India and abroad to move up the value chain, and that they will acquire domain expertise. Companies will offer end-to-end solutions from business consultancy to help-desk. They will even offer near-shore support by providing support from nearby countries (e.g. Canada for US clients).

4.5.2 The Sky Is Falling

Outsourcing occurs when a firm subcontracts a business function to an outside supplier. This practice has been common within the U.S. economy for some time. The reduction of communication costs and the standardization of software packages have now made it possible to outsource business functions such as
customer service, telemarketing, and document management. Other affected professions include medical transcription, tax preparation and financial services.

The numbers that are bandied about on offshore outsourcing sound ominous. The McKinsey Global Institute estimates that the volume of offshore outsourcing will increase by 30 to 40 percent a year for the next five years. Forrester Research estimates that 3.3 million white-collar jobs will move overseas by 2015. According to projections, the hardest hit sectors will be financial services and information technology (IT). The Gartner research firm has estimated that by the end of this year, 1 out of every 10 IT jobs will be outsourced overseas. Deloitte Research predicts the outsourcing of 2 million financial-sector jobs by 2009.

At first glance, current macro-economic indicators seem to support the suspicion that outsourcing is destroying jobs in the United States. The past two years have witnessed moderate growth and astonishing productivity gains, but overall job growth has been anemic. The total number of manufacturing jobs has declined for 43 consecutive months. Surely, many observers
insist, this must be because the jobs created by the U.S. recovery are going to other countries. Morgan Stanley analyst Stephen Roach, for example, has pointed out that "this is the first business cycle since the advent of the Internet -- the enabler of a new real-time connectivity to low-cost offshore labor pools." He adds, "I don't think it's a coincidence that this jobless recovery has occurred in such an environment." Those who agree draw on anecdotal evidence to support this assertion. CNN's Lou Dobbs routinely harangues U.S. companies engaged in offshore outsourcing in his "Exporting America" series.

Many IT executives have themselves contributed to this perception. When IBM announced plans to outsource 3,000 jobs overseas this year, one of its executives said, "[Globalization] means shifting a lot of jobs, opening a lot of locations in places we had never dreamt of before, going where there's low-cost labor, low-cost competition, shifting jobs offshore." Nandan Nilekani, the chief executive of the India-based Infosys Technologies, said at this year's World Economic Forum, "Everything you can send down a wire is up for grabs". In January testimony before Congress, Hewlett-Packard Chief Carly
Fiorina warned that "there is no job that is America's God-given right anymore."

That last statement chills the blood of most Americans. Few support the cause of free trade for its own sake, out of pure principle. The logic underlying an open economy is that if the economy sheds jobs in uncompetitive sectors, employment in competitive sectors will grow. Hi-tech industries are no longer competitive.

### 4.5.3 The Upside Of Outsourcing

To date, the media's coverage of outsourcing has focused on its perceived costs. This leaves out more than half of the story. The benefits of offshore outsourcing should not be dismissed.

The standard case for free trade holds that countries are best off when they focus on sectors in which they have a comparative advantage -- that is, sectors that have the lowest opportunity costs of production. Allowing countries to specialize accordingly increases productivity across all countries. This specialization
translates into cheaper goods, and a greater variety of them, for all consumers.

The current trend of outsourcing business processes overseas is comparative advantage at work. The main driver of productivity gains over the past decade has been the spread of information technology across the economy. The commodification of simple business services allows those benefits to spread further, making growth even greater.

The data affirm this benefit. Catherine Mann of the Institute for International Economics conservatively estimates that the globalization of IT production has boosted U.S. GDP by $230 billion over the past seven years; the globalization of IT services should lead to a similar increase. As the price of IT services declines, sectors that have yet to exploit them to their fullest -- such as construction and health care -- will begin to do so, thus lowering their cost of production and improving the quality of their output (For example, cheaper IT could one day save lives by reducing the number of "adverse drug events." Mann estimates that adding bar codes to prescription drugs and instituting an electronic medical record system could reduce the
annual number of such events by more than 80,000 in the United States alone.

McKinsey Global Institute has estimated that for every dollar spent on outsourcing to India, the United States reaps between $1.12 and $1.14 in benefits. Thanks to outsourcing, U.S. firms save money and become more profitable, benefiting shareholders and increasing returns on investment. Foreign facilities boost demand for U.S. products, such as computers and Telecommunication equipment, necessary for their outsourced function. And U.S. labor can be reallocated to more competitive, better-paying jobs; for example, although 70,000 computer programmers lost their jobs between 1999 and 2003, more than 115,000 computer software engineers found higher-paying jobs during that same period. Outsourcing thus enhances the competitiveness of the U.S. service sector (which accounts for 30 percent of the total value of U.S. exports). Contrary to the belief that the United States is importing massive amounts of services from low-wage countries, in 2005 it ran a $164.8 billion surplus in services.
Outsourcing also has considerable non-economic benefits. It is clearly in the interest of the United States to reward other countries for reducing their barriers to trade and investment. Some of the countries where U.S. firms have set up outsourcing operations -- including India, Poland and the Philippines -- are vital allies in the war on terrorism. Just as the North American Free Trade Agreement (NAFTA) helped Mexico deepen its democratic transition and strengthen its rule of law, the United States gains considerably from the political reorientation spurred by economic growth and interdependence.

Finally, the benefits of "insourcing" should not be overlooked. Just as U.S. firms outsource positions to developing countries, firms in other countries outsource positions to the United States. According to the Bureau of Labor Statistics, the number of outsourced jobs increased from 6.5 million in 1983 to 10 million in 2000. The number of in sourced jobs increased even more in the same period from 2.5 million to 6.5 million.

4.5.4 Political Economy

When it comes to trade policy, there are two iron laws of politics. The first is that the benefits of trade diffuse across the
economy, but the costs of trade are concentrated. Thus, those made worse off by open borders will form the more motivated interest group. The second is that public hostility toward trade increases during economic downturns. When forced to choose between statistical evidence showing that trade is good for the economy and anecdotal evidence of job losses due to import competition, Americans go with the anecdotes.

Offshore outsourcing adds two additional political pressures. The first stems from the fact that technological innovation has converted what were thought to be nontradeable sectors into tradeable ones. Manufacturing workers have long been subject to the rigors of global competition. White-collar service-sector workers are being introduced to these pressures for the first time -- and they are not happy about it.

The second pressure is that the Internet has greatly facilitated political organization, making it much easier for those who blame outsourcing for their troubles to rally together. In recent years, countless organizations -- with names such as Rescue American Jobs, Save U.S. Jobs, and the Coalition for National Sovereignty and Economic Patriotism -- have sprouted up. Such groups have
disproportionately focused on white-collar tech workers, even though the manufacturing sector has been much harder hit by the recent economic slowdown.

It should come as no surprise, then, that politicians are scrambling to get ahead of the curve. During the Democratic primary in South Carolina -- a state hit hard by the loss of textile jobs -- billboards asked voters, "Lost your job to free trade or offshore outsourcing yet?" Last Labor Day, President Bush pledged to appoint a manufacturing czar to get to the bottom of the outflow of manufacturing positions. In his stump speech, John Kerry bashes "Benedict Arnold CEOs [who] send American jobs overseas."

Where presidential candidates lead, legislators are sure to follow. Senator Charles Schumer (D-N.Y.) claimed in a January "New York Times" op-ed authored with Paul Craig Roberts that because of increased capital mobility, the law of comparative advantage is now null and void. Senator Tom Daschle (D-S.D.) has observed, "George Bush says the economy is creating jobs. But let me tell you, China is one long commute. And let me tell you, I'm tired of watching jobs shift overseas." Senator
Christopher Dodd (D-Conn.) and Representative Nancy Johnson (R-Conn.) are sponsoring the USA Jobs Protection Act to prevent U.S. companies from hiring foreign workers for positions when American workers are available. In February, Senate Democrats announced their intentions to introduce the Jobs for America Act, requiring companies to give public notice three months in advance of any plan to outsource 15 or more jobs. In March, the Senate overwhelmingly approved a measure banning firms from federal contracts if they outsource any of the work overseas. In the past two years, more than 20 state legislatures have introduced bills designed to make various forms of offshore outsourcing illegal.

4.5.5 Splendid isolation

There are clear examples of jobs being sent across U.S. borders because of U.S. trade policy -- but not for the reasons that critics of outsourcing believe. Consider the example of candy-cane manufacturers: despite the fact that 90 percent of the world's candy canes are consumed in the United States, manufacturers have sent much of their production south of the border in the past five years. The attraction of moving abroad, however, has little to do with low wages and much to do with
protectionism. U.S. quotas on sugar imports have, in recent years, caused the domestic price of sugar to become 350 percent higher than world market prices. As candy makers have relocated production to countries where sugar is cheaper, between 7,500 and 10,000 workers in the Midwest have lost their jobs -- victims not of outsourcing but of the kind of protectionism called for by outsourcing's critics.

A similar story can be told of the steel tariffs that the Bush administration foolishly imposed from March 2002 until December 2003 (when a ruling by the World Trade Organization prompted their cancellation). The tariffs were allegedly meant to protect steelworkers. But in the United States, steel users employ roughly 40 times more people than do steel producers. Thus, according to estimates by the Institute for International Economics, between 45,000 and 75,000 jobs were lost because higher steel prices made U.S. steel-using industries less competitive.

These examples illustrate the problem with relying on anecdotes when debating the effects of offshore outsourcing. Anecdotes are incomplete narratives that fail to capture opportunity costs. In
the cases of steel and sugar, the opportunity cost of using protectionism to save jobs was the much larger number of jobs lost in sectors rendered less productive by higher input prices. Trade protectionism amounts to an inefficient subsidy for uncompetitive sectors of the economy, which leads to higher prices for consumers and a lower rate of return for investors. It preserves jobs in less competitive sectors while destroying current and future jobs in sectors that have a comparative advantage. Thus, if barriers are erected to prevent offshore outsourcing, the overall effect will not be to create jobs but to destroy them.

So if protectionism is not the answer, what is the correct response? The best piece of advice is also the most difficult for elected officials to follow: do no harm. Politicians never get credit for inaction, even when inaction is the best policy. President George H.W. Bush, for example, was pilloried for refusing to follow Japan’s lead by protecting domestic markets -- even though his refusal helped pave the way for the 1990s boom by letting market forces allocate resources to industries at the technological frontier. Restraint is anathema to the political class, but it is still the most important response to the furor over
offshore outsourcing. As Robert McTeer, president of the Federal Reserve Bank of Dallas, said when asked about policy responses to outsourcing, "If we are lucky, we can get through the year without doing something really, really stupid."

The problem of offshore outsourcing is less one of economics than of psychology -- people feel that their jobs are threatened. The best way to help those actually affected, and to calm the nerves of those who fear that they will be, is to expand the criteria under which the Trade Adjustment Assistance (TAA) program applies to displaced workers. Currently, workers cannot apply for TAA unless overall sales or production in their sector declines. In the case of offshore outsourcing, however, productivity increases allow for increased production and sales -- making TAA out of reach for those affected by it. It makes sense to rework TAA rules to take into account workers displaced by offshore outsourcing even when their former industries or firms maintain robust levels of production.

Another option would be to help firms purchase targeted insurance policies to offset the transition costs to workers directly affected by offshore outsourcing. Because the perception
of possible unemployment is considerably greater than the actual likelihood of losing a job, insurance programs would impose a very small cost on firms while relieving a great deal of employee anxiety. McKinsey Global Institute estimates that such a scheme could be created for as little as four or five cents per dollar saved from offshore outsourcing. IBM recently announced the creation of a two-year, $25 million retraining fund for its employees who fear job losses from outsourcing. Having the private sector handle the problem without extensive Government intervention would be an added bonus.

Americans are now aware that the voice on the other end of the phone might not be American. As technology life cycles shorten, technical support conversations lengthen, and people spend hours resolving software glitches with the 'Invisible Man' who could be troubleshooting from the opposite side of the planet. A service is rendered, an invisible transaction is made, and the forces of international trade thrive though no physical good is exchanging hands.
Such is the nature of service exports, which have acquired a starring role in the global economy during the last decade. Last year, all forms of outsourcing totaled $150 billion, growing at an annual rate of twenty percent. (Bielski, 2003) The United States enjoys an increasing and sizable surplus in cross-border services. In recent years, India capitalized on the globalization of information-technology services to become a strong provider. The country’s workers perform satisfactory service at beyond-satisfactory rates, causing a natural flow of jobs out of the United States and into the booming tech sectors of India’s larger cities. Some view this phenomenon as India’s gradual integration with the world economy, and as mutually beneficial to the United States and its consumers. Others see a tragedy: Americans lose jobs to underpaid workers overseas, causing a depressed job market at home on the stage of an election year. In either case, outsourcing between the United States and India challenges both countries’ existing policies and economic structures, and will continue to shape their roles in the world economy.

To understand the timing and significance of the trend in outsourcing, we must examine India’s path to liberalization. Only fifty years ago, India used a development strategy based
on economic self-reliance and regulations that insulated its economy from the rest of the world. Foreign investment was as bizarre an idea as computer software, but the two would one day go hand-in-hand in India. Political leaders believed that India’s underdevelopment was a result of Great Britain’s free-trade policy. To serve national priorities, they implemented a centrally planned economy based on public ownership of production and quantitative restriction of the private sector.

These factors correlate well with the law of comparative advantage, in which all players theoretically benefit. President Bush’s economic advisor, Gregory Mankiw, explained this concept to Congress, saying that “if a thing or a service could be produced more cheaply abroad, then Americans were better off importing it than producing it at home” (Economist, February 2004). American businesses could reduce labor costs, which would contribute to lower overall operational costs. A side effect of such a policy is that more businesses stay profitable and that services are available at reduced prices for consumers. Adam Smith might have gone on to say that free trade in services not only creates consumer surplus, but also expands markets. This “stimulates productivity growth, because it makes possible
enormous economies of scale in manufacturing, services, and marketing, and enhances competition.” (Madrick, 2004) This competition ensures that America remains on the front economic edge, bettering her industries and enhancing education so it does not fall behind.

Dobbs-like language has also led economists to discuss the relationship between outsourcing and the U.S. job market. Many economists claim that outsourcing creates more jobs than it destroys in the long run and point to three themes. First, the majority of the job losses this decade were cyclical in nature. Analysts look to the unnatural 4.2 percent unemployment rate at the beginning of Bush’s term and estimate that two-thirds of the jobs lost were unsustainable in the first place (Economist, January 2004). Bush’s tax cuts also gave companies incentive to place their money into capital investments instead of people, but those cuts will expire at the end of this year. The labor market will rebound after the positive effects of a growing economy are realized.

Second, outsourcing is not a wholly new phenomenon on the American scene. It India also needs to have a solid presence
in multinational negotiations. The adoption by the World Trade Organization of the General Agreement on Trade in Services (TRIPS) is an opportunity to establish this presence. Middle-income countries look to India's and Brazil's leadership in these settings. Also, India's boom in information-technology software came mostly from borrowed foreign knowledge. It would be in India's interest to push against TRIPS and the protection of intellectual property rights. The borrowing mechanism of TRIPS, in many cases, functions by granting Indians movement to the United States on special, non-immigrant visas. Almost 55,000 of these visas were issued in 1999, and there is pressure to restrict this number. India would like to see a liberal agreement on the movement of natural persons to continue this scale of temporary migration.