

Contents

| | | |
|---|---|-----------|
| 1 | Outsourcing and offshoring: are they worthy resourcing options? | 5 |
| 2 | Extent and structure of offshoring | 6 |
| | 2.1 Dimensions of offshoring | |
| | 2.2 The IT and BPO services sector | |
| | 2.3 Private sector | |
| | 2.4 Public sector | |
| | 2.5 USA experience and issues | |
| 3 | Employment/labour issues | 13 |
| | 3.1 Location and composition of the labour market | |
| | 3.2 Nature of employment relations contract | |
| 4 | The business decision | 18 |
| | 4.1 The distinctiveness of services | |
| | 4.2 International provision of services | |
| | 4.3 The benefits of proximity | |
| | 4.4 The offshoring potential | |
| | 4.5 The costs of offshoring | |
| 5 | Diagnostics: evaluating the benefits and costs of offshoring | 25 |
| | 5.1 Diagnostic tools | |
| 6 | Conclusions | 27 |
| 7 | References | 28 |
| | Annex: Case studies | 34 |
| | Case study 1: Professional services | |
| | Case study 2: NHS | |
| | Case study 3: Multinational electronics and entertainment firm | |
| | Case study 4: IT and Business process outsourcing firm A | |
| | Case study 5: IT and Business process outsourcing firm B | |
| | Case study 6: University | |

Authors: David Hall, Bruce Cronin and Lesley Catchpole from University of Greenwich

Sub-editors: Ruth Holmes and Kelly Drewery

1 Outsourcing and offshoring: are they worthy resourcing options?

For the best part of 20 years, UK organisations have been gripped by an 'outsourcing frenzy'. A desperation to reduce fixed and variable costs, Compulsory Competitive Tendering (CCT) in the Public Sector, Business Process Reengineering (BPR) and other prevailing management fads have all influenced a resourcing strategy which now consumes about 25 per cent of the UK spend on management consultancy. In a more recent development, many UK businesses are now engaging in what is euphemistically called 'offshoring' – the relocation of work (and jobs) to low cost overseas locations. In a process endearingly labelled by academics as the 'de-localisation' of work, the family of outsourcing tools being used by businesses grows ever more imposing.

Yet despite the fact that outsourcing is now an accepted and widespread management practice (though one still vehemently opposed by most Trades Unions), remarkably little is known about its consequences for organisational productivity, performance and capability. For example, organisations which have, for many years, relied on the in-house provision of IT services will require a different set of capabilities to specify, procure and manage outsourced IT services. Many Local Authorities, having outsourced many functions through CCT in the 1980's and 1990's, found the transition from a delivery focus to an enabling focus quite difficult to manage. Some businesses have also found that the skills required to manage the purchasing, quality assurance, service agreement and contractual side of outsourcing more complex than they imagined. And with 'offshoring' the picture just got a whole lot more complicated.

The research reported here took a critical look at outsourcing, focusing specifically on offshoring, asking

whether this strategy genuinely delivers the business benefits it promises. It will provide insights into the way that organisational capability has had to adapt in order to manage product or service delivery in a different way. The report will explore the dimensions of offshoring, employment and labour issues, the factors influencing business decisions and how organisations can evaluate the benefits and costs of offshoring.

2 Extent and structure of offshoring

Our research suggested that the characteristics of offshoring are quite distinct from outsourcing; offshoring does not appear to be a special case of outsourcing. Offshoring is concentrated in distinct industrial sectors, predominantly high-tech manufacturing, computing and financial services. Research and development and business research offshoring are more prominent activities than might be suggested from the business press.

This first section reviews the dimensions and extent of offshoring in different industry sectors and the issues arising for each, covering experience in the UK with some exploration of the USA experience, which has influenced discussion in the UK.

2.1 Dimensions of offshoring

Offshoring and outsourcing are two different dimensions. Firms may decide to offshore work that remains within the core company – this is sometimes known as ‘captive offshoring’. In other cases, work is outsourced to a contractor, and the contractor may carry out the work within the UK or offshore. This gives four categories of options for any kind of work, as shown in the grid below.

Table 1: Typology of offshoring and outsourcing

| | UK | Abroad |
|----------|-------------|---------------------------------|
| Internal | Insourcing | In-house (‘captive’) offshoring |
| External | Outsourcing | Outsourced offshoring |

Some large companies have transferred business processing outsourcing (BPO) work from in-house UK operations to in-house operations offshore in India or elsewhere. GE Capital, part of the USA multinational GE, set up its own in-house BPO division in India in 1993, which employs 12,000. In 1996, BA transferred 600 jobs

from the UK to a newly created Indian subsidiary in India, World Network Services (WNS – but see below for later developments).¹ HSBC is in the process of transferring 4,000 jobs from UK call centres to its Global Service Centres in India, China and Malaysia. Most companies however use outsourced agents, who then carry out all or part of the work offshore. In-house offshoring is likely to be more attractive where the issues of control and confidentiality matter, and also where companies have existing operations in the chosen region, as is the case with HSBC.²

2.2 The IT and BPO services sector

The great majority of work which is being offshored is in information technology (IT), and business process or call centre work. An increasingly high proportion of IT/BPO work is outsourced to specialist companies. The providers of IT/BPO services include companies which originated as IT service companies, international consultancy firms, specialist BPO companies, and IT/BPO divisions of large groups eg Lufthansa, British Airways, United Utilities. They include UK specialists, multinationals, and an emerging group of Indian companies.

The sector has been restructuring in such a way as to combine UK and offshore operations. Most UK or multinational companies providing IT or back office services have set up operations in India or elsewhere to process work. For example, in 1998 the UK IT company Xansa acquired Indian capacity by buying a controlling stake in the Indian IT company IIS Infotech;³ in 2003 Vertex created capacity in India by taking a majority stake in an Indian call centre company, 7C.⁴ Capita did likewise in November 2003, buying 60% of Indian call centre company Mustek.⁵

Offshore capacity is also being developed in countries

other than India, notably China, South Africa, eastern Europe, Malaysia and Philippines. IT/BPO service companies may rely on partnership arrangements, especially for BPO capacity in India. Multinational Cap Gemini Ernst and Young (CGEY), which often acts as partner to Vertex in outsourced IT/BPO contracts in the UK, is opening its own BPO service centres in China and Poland, but in India CGEY relies on BPO partner Vertex for [BPO] service delivery, with its own base dedicated to IT outsourcing.⁶ Lufthansa's IT and booking division, LIDO, which offers IT and BPO services, has offshore capacity through IT partners in New Delhi (with 700 staff), Cape Town, Budapest and Gdansk (for Thomas Cook, LIDO achieved cost reductions in excess of 45% by relocating work from the UK to India).⁷

The Indian IT/BPO companies have not remained as local offshore providers but are becoming competitive multinationals in their own right, winning contracts directly in the UK and opening offices in the UK, to supplement their Indian operations. In 2002, Tata Consultancy Services (TCS) won a £30 million three-year IT services contract with United Utilities, which it is servicing both from Manchester and Kolkata (India).⁸ TCS employs over 1,000 people in the UK, is present in 55 countries worldwide, and expects to be one of the ten largest consulting firms in the world by 2010, when it aims to have global revenues of \$10 billion and a workforce of up to 80,000.⁹ HCL Technologies acquired a 90% stake in the Apollo Contact Centre in Belfast of BT Group, a deal which gave HCL more business from BT, including a \$160 million order for setting up a BPO operation for BT in India,¹⁰ and doubled the numbers employed at the Belfast call centre from 400 to 820 in the first year.¹¹ Another established Indian provider, Infosys, recently beat IBM to win an IT services contract with Australian telecoms company Telstra.¹²

The Indian operators themselves are also going through a process of consolidation: ICICI OneSource, a Mumbai-based BPO company promoted by the Indian banking group ICICI, and Wipro, a leading software services company, both absorbed other call centre companies in the last year.¹³ They are at the same time expanding into China in order to achieve further savings.¹⁴ Some Indian providers have developed through partnerships with multinationals, for example iGate – USA-quoted but 60% owned by its two Indian founders – formed a partnership with GE Capital in 1999 to provide global BPO work through a joint venture in India.¹⁵ (See also the case of HNC's partnership with BT, above).

A final example illustrating the complex globalisation of these companies is WNS, which originated as an Indian offshore subsidiary for BA work in 1996. It subsequently grew by taking on work for third parties, and in 2002 BA sold 70% to a USA private equity company Warburg Pinkus. WNS then acquired an insurance claims management firm in Ipswich, and purchased an Indian-based BPO centre from the USA insurance company GreenSnow Inc.¹⁶ Another example of investment in IT/BPO by USA venture capital is Office Tigers (see below).

UK companies are thus not faced with the simple alternatives of outsourcing to a purely Indian service company, or to a purely UK service company. Most IT/BPO outsourcers can offer a locational mix of capacity in both the UK and India (or elsewhere), which can combine the costs advantages of cheaper labour costs in India (or elsewhere) with the control advantages of a UK presence to interface with the client: 'leveraging the cost effectiveness of our Indian delivery capability whilst providing clients with strong local support [in the UK].'¹⁷

The mix offered on any specific contract is influenced or

specified by the client. Three-quarters of clients for IT services now request an offshore element, but public sector clients usually exclude any offshore component.¹⁸

Table 2: IT, business process and call centre companies (IT/BPO)

| IT/BPO contractor | Ownership | Capacity in UK | Capacity in India |
|---------------------------|---------------|----------------|-------------------|
| Vertex | UK | Yes | Yes |
| Capita | UK | Yes | Yes |
| Xansa | UK | Yes | Yes |
| BT | UK | Yes | Yes |
| CGEY | France/global | Yes | Yes* |
| Lido | Germany | No | Yes* |
| WNS | USA/UK* | Yes | Yes |
| Office Tigers | USA | No | Yes |
| iGate | India/USA | Yes | Yes |
| HCL Technologies | India | Yes | Yes |
| ICICI | India | Yes | Yes |
| Infosys | India | Yes | Yes |
| Tata Consultancy Services | India | Yes | Yes |
| Wipro | India | Yes | Yes |
| Clientlogic | Canada | Yes | Yes* |

* = using partner

Sources: Company websites, press reports

2.3 Private sector

Table 3: Recently reported decisions on offshoring

| Company | Sector | Service | Offshored | In-house? | Source |
|---------------------------------|---------------|----------------------------------|---|-----------|---|
| Lloyds | FS | IT/BPO | 1500 to India | Yes | BBC News 01 Nov 2003 |
| HSBC | FS | IT/BPO | 4,000 jobs to India, China and Malaysia | Yes | Independent 31 Oct 2003 |
| Abbey | FS | IT/BPO | 100 jobs to India | | Independent 31 Oct 2003 |
| Barclays | FS | IT/BPO | 150 jobs to India | | Independent 31 Oct 2003 |
| Royal Bank of Scotland | FS | IT/BPO | No | | Independent 31 Oct 2003 |
| HBOS | FS | IT/BPO | No | | Independent 31 Oct 2003 |
| Alliance and Leicester | FS | IT/BPO | No | | Independent 31 Oct 2003 |
| Standard Chartered | FS | IT/BPO | | | Independent 31 Oct 2003 |
| Prudential | FS | IT/BPO | 850 jobs to Mumbai | | US Banker Sept 2003 |
| Aviva | FS | IT/BPO | 2500 back office and callcentre jobs in India | Yes | Company PR 02/12/2003 |
| BT | Telecoms | IT/BPO | 2200 callcentre jobs to India | | November 04, 2003 |
| JP Morgan | FS | Investment analysis | India | Yes | Investment Dealers Digest 03 November 2003 |
| Morgan Stanley | FS | Investment analysis | India | No | Investment Dealers Digest 03 November 2003 |
| Deutsche Bank | FS | Investment analysis | India | No | Investment Dealers Digest 03 November 2003 |
| Allen & Overy | Law | Research/backoffice | India | No | ALB Asia Legal Bulletin October 2003 |
| United Utilities | Utilities | IT | India | No | Business Line 04 Jan 2002 |
| BA | Air Transport | Callcentre | India | Yes>No | Economic Times of India 12 September 2003 |
| eBookers | Travel agent | Callcentre | India | | Guardian 25/9/2003 |
| Lastminute.com | Travel agent | Callcentre | | | Guardian 25/9/2003 |
| Thomas Cook | Travel agents | Callcentre | India | No | Air Transport Intelligence October 22, 2003 |
| Channel 4 | Media | | | | M2 Presswire 18/9/2003 |
| Silica Benelux | Electronics | Design, R&D | No | | Electronics Weekly September 10, 2003 |
| Arrow Electronics | FS | IT help desk, network monitoring | Yes | Yes | Australian Financial Review 2 Sept 03 |
| National Rail Enquiries Service | Transport | Call centre | | No | PR Newswire, July 9, 2003; THE JOURNAL (Newcastle, UK), July 12, 2003 |

2.3.1 Banking

The banking sector has been involved in well-publicised decisions to offshore IT, business process and, above all, call centre activities. HSBC has announced that it will offshore 4,000 jobs to its global services centres in India, China and Malaysia over the next three years: analysts commented that HSBC had extensive experience and established operations in Asia already.¹⁹ Lloyds TSB is transferring 15,000 jobs to India by the end of 2004.²⁰ Barclays is considering moving 150 call centre jobs; Abbey is transferring 100 jobs.²¹ Other banks are not yet doing so: Royal Bank of Scotland, HBOS, Northern Rock and Alliance and Leicester have all said that they will not make use of offshore facilities. Alliance and Leicester cited the problem of long-distance control, the others implied that their position relates to customer reaction.²²

2.3.2 Other financial and legal services

Investment banks have started placing investment analysis and research work offshore. JP Morgan is setting up its own 'captive' in-house centre in India, Morgan Stanley and Deutsche Bank are using established BPO companies such as Evalueserve or Office Tigers.²³ Offshoring of this type of work is expected to increase. This is against the background of a decline in job opportunities in the sector: vacancies in investment banking and fund management in the UK fell by one-third this year, almost ten times the fall of 3.4% for all graduate vacancies.²⁴

Legal firms have also begun to offshore back office work, such as secretarial and document production work: for example, Allen and Overy is relocating half its document production work to India, through Office Tigers.²⁵

2.3.3 Utilities

Utilities have a large amount of customer billing and

customer service contact work. Under pressures of competition in liberalised markets such as electricity and telecoms, offshoring of this work has developed, either through existing outsourced contractors or directly. Thames Water is transferring some billing and customer services work to an existing IT contractor, Xansa, for processing in the contractor's Indian facility. United Utilities' specialist division Vertex, which carries out customer billing work for other companies as well, has acquired Indian capacity through takeover of an Indian centre. Powergen has offshored credit management work to Delhi.²⁶ The National Rail Enquiry Service (NRES) is also expecting to make use of Indian capacity for its call centre work, through the process of renewing outsourced contracts. Four companies are competing (including the incumbent, BT), and the NRES states that up to 50% of the work could be carried out abroad by any of the companies.²⁷ United Utilities itself has outsourced more of its IT work to Tata Consultancy Services (TCS) under a three-year £30 million contract in March 2002. This contract will be serviced by TCS staff in Manchester and by its offshore delivery centre in Kolkata, India.²⁸ BT is transferring 2,000 call centre jobs from the UK to new sites in Delhi and Bangalore.²⁹ Carphone Warehouse, however, has stated that it will not offshore call centre work.³⁰

2.3.4 Pharmaceutical

Pharmaceutical companies are looking at the possibility of conducting clinical trials in India. There are two perceived advantages: cheaper technical labour, and a wider supply of potential volunteers.

GlaxoSmithKline (GSK) has made a research alliance with Ranbaxy, India's largest drugs company, to collaborate in drug development projects. The aim is to tap India's high-quality but low-cost scientists. With other

companies moving to outsource parts of their research operations and conduct clinical trials in India, it is possible that the success in information technology might be replicated in pharmaceuticals.³¹

IT/BPO companies are seeking to enter this market. Established USA/India-based BPO company iGate has set up a clinical research arm, iGate Clinical Research International (ICRI), by purchasing 90% of the University of Pittsburgh Medical Center's clinical trials subsidiary, and DiagnoSearch, a clinical research outsourcing company based in Mumbai, India.³²

2.3.5 Other

Companies in other sectors have also been involved in offshoring some IT/BPO work, but not universally. Sainsbury's outsourced a £28 million package of its IT work to India-based Infosys in 2000;³³ travel agents including eBookers, Lastminute.com and Thomas Cook have outsourced booking work. Electronics research and development work in Europe is not expected to be offshored: 'Component distributors are quietly confident that the predicted exodus of design firms from Europe to lower cost regions will not happen because local design activity will always need to be close to the market ... the majority of manufacturers still want design to take place as close to their customers as possible, which for markets like mobile, telecoms, industrial and automotive means in Europe ...'.³⁴

2.4 Public sector

The public sector has made relatively little use of offshoring so far. No central government department has offshored any major piece of work. The well-publicised use of Indian contractors as an emergency measure to clear the backlog of work at the Criminal Records Bureau in 2002, which was itself a PFI project

run by Capita, was an exception.³⁵ The government is currently running a review of back office efficiency (Gershon review), which will address the issue implicitly if not explicitly. At the same time it is conducting a review on the relocation of 20,000 civil service jobs out of London to create jobs in the regions (Lyons review). The employment creation objectives of the dispersal policy make it unlikely that the efficiency review will support offshoring, which could negate the effects of the dispersal policy.

Local government shows a similar pattern, with almost no direct decisions to offshore despite much outsourcing of work to partner firms. One factor is the important role of local councils in most labour markets, and the local electoral consequences of visible job loss to overseas locations. This contrasts with the extensive use of outsourcing to partner firms such as Capita, Liberator and BT, where the loss of local jobs is normally less than total, and in some cases may attract extra work: for example Blackburn has outsourced work to Capita, who have located a regional centre there because of the council contract, with new jobs created.³⁶ One exception to this rule has been Westminster Council, which has agreed an outsourcing deal with a partnership led by Vertex, which involves the use of offshore labour in India.

In the NHS, some use has been made of offshoring surgical work to European hospitals as a way of clearing backlogs. However, there is no evidence of use of offshoring of business process functions: according to one report, the NHS decided this year not to include an outsourcing proposal from Indian firm Wipro amongst its IT options.³⁷ Some USA hospitals make use of offshore diagnostic services, but the NHS does not.

In higher education one university, Nottingham, has set

up an overseas branch (in Malaysia), an example of internal offshoring. Other UK universities run courses in developing countries, using UK-based staff, with some use of local teaching staff. Australian universities have set up a number of such offshore units in south and south-east Asia, which are in effect an alternative to foreign graduates attending universities in Australia.³⁸

2.5 USA experience and issues

There is a similar level of concern over the impact of offshoring in the USA. A similar range of work has been outsourced: the Philippines figures more strongly as a destination. Boeing has transferred research and development work to India.³⁹ There are a number of significant USA investments in offshore IT/BPO activities, with GE Capital being very active: a recent new venture is a partnership with Japanese IT company TIS and Chinese company Digital China Holdings to seek offshore work, especially from Japan.⁴⁰

Indian IT/BPO firms working in the USA have used Indian nationals to work there, to which there has been some backlash: the firms are now moving the work back to India, which also achieves cost savings and removes the visibility of the Indian labour. There is concern that the scale of offshoring is leading to the loss of jobs that would otherwise have arisen in the USA during economic recovery, and so offshoring is being pinpointed as one possible cause of 'jobless growth'.⁴¹

3 Employment/labour issues

The development of new technologies in the service industries has resulted in the independence of many tasks from any particular location and made possible the relocation of many service jobs from industrialised to cheaper developing countries. The main locations are said to be those developing countries that provide a suitable infrastructure, high skills labour market and labour cost benefits.

Nonetheless, the issues are not simply about saving costs. The emergence of the global knowledge company is said to have the potential to re-shape the relationship between the employer and employee in the service sector in much the same way as manufacturing was altered in the mid-80s.⁴² Equally offshoring can affect the shape, nature and capability of UK organisations. Relevant issues for consideration include the location, and composition of the labour market – including its type, quality, skills and effectiveness of the employees; and secondly, the changes to the nature of the employment contract – wages and conditions, industrial relations, and creation and loss of jobs.

3.1 Location and composition of the labour market

3.1.1 Location

To date India appears to have profited most from offshoring, popular on account of being able to offer a large English speaking, highly skilled workforce at a reduced cost compared to the UK and US.⁴³

Previously, industrialised countries like the US relied on such countries to provide migrant labour. The method was preferred because companies retained control of their employees; the migrant workers gained from the higher wages and experience; and 'exporting' countries

acquired the remittance their expatriates sent home. On the negative side, companies risked losing their best employees to local competitors willing to offer higher wages and permanent contracts. Outward migration also resulted in a brain drain, depriving developing countries of scarce skills.

For the importing countries problems included the employment of cheaper skilled migrant labour forcing domestic wages down, and the low incentives for firms to train their existing workforce. Therefore, for a whole number of reasons – not least an increased awareness of the capability of Indian programmers and engineers – offshoring became an especially attractive alternative to continued immigration of labour.⁴⁴

Currently, the move to offshoring suggests that more back-office service functions will be outsourced to more cost-effective providers, including finance, accounting, customer service, research – perhaps almost anything not requiring face-to-face contact.⁴⁵ It brings with it many benefits in terms of location, not least educated Indians having the opportunity of working in their own country. Although India is not the only country to benefit, developing countries such as China, Vietnam, South Africa and the Philippines are increasingly getting involved, albeit at the lower end of activities.

Despite obvious labour cost savings the case studies revealed a major downside to offshoring, mostly linked to distance and lack of control. A large professional services firm interviewed, reported that there was there was initial scepticism to offshoring because the resources were so remote.

In the public sector, the Chief Executive of an NHS Trust

also explained that lack of control over staff was an issue in her sector:

'Even when the NHS Direct was first outsourced there were problems ... the demand for ambulances increased by 100% because nurses were anxious not to under-estimate any illness. Luckily we were able to control this, but that would not be possible if the agency was thousands of miles away in India.'⁴⁶

Therefore in terms of location, whereas offshoring can benefit third world countries by keeping skilled employees in the developing countries, the case studies revealed a concern over remoteness and lack of control over staff.

3.1.2 Composition

The type and composition of the offshore labour market is, in reality, quite diverse, although some patterns are discernible. The labour force appears very young – for example the median age in India is 29.3 – and the turnover is high, especially amongst those with 2-3 years' experience with project management skills. In terms of gender the software industry is highly male dominated. In India, for example, the labour force is 86% male.⁴⁷ Many of these jobs tend to be high-wage professional jobs, although this is not always the case. For example some film animators, medical specialists, architects and aerospace engineers are being relocated to far cheaper locations in Asia. In the professional services firm the knowledge management side of the business was driving the work: 'As well as a team providing secondary research support, we also have a team that supports the content management processes for the firm's intranet site.'⁴⁸

In contrast, in the less-skilled professional jobs – such as

data processing in call centres – the workforce is predominantly female. World Employment Report, (2001) estimated that in India (between 1997 and 2001) 250,000 jobs for women were created through the mobile telephony centres.⁴⁹ Nonetheless such work, although often better than other local labour market alternatives, does not necessarily lead to career upgrading for women. In sum, offshoring includes a young, diverse labour force, with a wide variety of high-wage professional jobs being dominated by males, with the lower-skilled jobs being done mainly by women.

3.1.3 Skills

Currently, the offshored labour markets are creating the need for two types of skills. First, foundations skills such as ability to communicate, analyse and solve problems are required – all essential for work environments that rely on rapid innovation and interpersonal exchange. Second, the technical skills related to ICT. Nevertheless, unskilled or de-skilled jobs are still common, resulting in the skill polarisation in the networking economy. Moreover, the polarisation has the capability of reinforcing the gender-based segmentation of the labour market.⁵⁰

Nonetheless, even where the technology is straightforward language skills are required (which gives India an advantage over China), and there is a need for familiarity with the equipment. Language was identified as a potential problem by the Chief Executive of an NHS Trust, who explained that operators would have to have the language sophistication to cope with patients with many different, even special, needs. More especially, if companies choose the wrong supplier with insufficient skills and access to training, the cost of reassignment to another supplier would be high.⁵¹ Therefore, whilst offshoring provides access to a highly skilled workforce,

unskilled work is equally common. Yet, even with less skilled work, language and familiarity with the use of equipment is essential.

3.1.4 Quality, functioning and effectiveness

Effectiveness and productivity of labour is a further issue. UK firms have reported savings of as much as 65% through offshoring certain activities.⁵² Presumably cost accounts for much of this, especially as offshored labour costs are routinely a fifth of those in the UK, with pay levels around £1.25 an hour compared with £5-£10 in the UK.⁵³ Nevertheless, evidence shows that gains in enterprise performance only occurs when new technology is combined with changes in work organisation: semi-autonomous, task-orientated teams with controls over quality and performance, plus greater flexibility in work patterns.⁵⁴

Table 3: Comparative pay rates in India and UK/USA

| Occupation | Salary in India | % of UK/US level |
|---------------------------------------|-----------------------|------------------|
| Call centre operator ⁵⁵ | 60p to £1.25 per hour | 13-20% |
| Software engineer ⁵⁶ | \$5,000 to \$15,000 | 15-17% |
| Experienced IT manager ⁵⁷ | \$36,000 | 15% |
| Accountant ⁵⁸ | \$5,000 | 12% |
| Market research analyst ⁵⁹ | \$12,000 | 13% |
| HSBC average ⁶⁰ | £2,500 | 14% |

There are limitations here. Problems are encountered with flexibility and speed of delivery, due to practical implications of language, time difference, cultural subtleties, and the level of face-to-face interaction so often required to solve complex problems.⁶¹

A quality dimension appears essential to this work. Overall, the Knowledge Manager of the professional services firm reported that the recent project to set up a research team in India had – with careful management

of exposure – gone well.⁶² However, the Chief Executive in the NHS remained concerned about the lack of control over the quality. She reported that in most cases offshoring was perceived as offering: ‘a poorer service ... there would be concern over whether they could fully understand the geography of this country; or even have a thorough understanding of how the NHS works.’⁶³ So, although the lower costs of efficient labour are making offshore outsourcing increasingly attractive, quality and control are equally important.

3.2 Nature of employment relations contract

‘Offshoring’ is also altering the individual employment contract, and collective relations in both the home and host country. The following sections investigate the wages and conditions, the creation and loss of jobs, and the industrial relations.

3.2.1 Wages and conditions

Wages and conditions of working in offshore locations appear to vary widely. In the best, an informal and appealing work culture is discernible, but in the worst, call centres have been called the sweatshops of the digital age. All case study respondents reported that cost linked to wages and conditions was very much the issue, although quality was seen as equally important.⁶⁴ Nevertheless, wage increases, high turnover and demand for skilled staff, plus equal pay for women, were already forcing salaries to rise in India. Consequently, cost is important. India still figures as a low cost location, but no longer offers the best cost savings.⁶⁵

3.2.2 Creation and loss of jobs

Evidence shows that unemployment has declined most in those countries where the use of new technologies is most widespread, such as Denmark, Finland and Ireland. Nevertheless, since ICT enables

routine tasks to be automated it can also become a source of job loss.⁶⁶

In terms of jobs, developing countries have obviously benefited most from offshoring. However, it is possible to overstate the advantage. In reality, in places like Bangalore the software industry, by Indian standards, is not considered a big employer – although numbers have been steadily rising as software firms increase in the region.

In industrialised countries, however, offshoring is said to be the new redundancy, with millions predicted to lose their jobs in much the same way as jobs were lost in the manufacturing industry in the 1980s. In the US, three million jobs have been lost since 2001. Research conducted by Accenture estimates up to 20,000 jobs would migrate from the UK by 2008, whereas Deloitte Touche predict two million jobs could exit from western economies within the same time scale.⁶⁷ Nevertheless, offshoring does not automatically result in the closure of home operations; the professional services firm case study showed that client demand for US and UK research teams, meant they were retained alongside the Indian team.⁶⁸ In sum, although new technologies are set to both create and destroy jobs, service jobs are at risk in industrialised countries.

3.2.3 Industrial relations issues

Offshoring also has major implications for industrial relations. Fragmentation in the organisation of production, on account of the diffusion of new technologies in the economy, will no doubt challenge the collective organisation of workers, especially as unionisation is low in places like India due to the perceived high status of the work.

Some international trade secretariats, such as the Union Network International (UNI) already have strategies in place for the networking economy, with their 'online rights for online workers' campaign, emphasising employee rights and the need for greater collective communication and voice. Other initiatives include the use of the internet, with local disputes going global, and unions engaging in 'cyber-pickets' to shed light on bad industrial relations practices.⁶⁹ Attempts are also being made to protect national labour standards, regulations, and legal frameworks. The ICFTU (International Confederation of Free Trade Unions) is pushing for international codes of conduct to be created; offshoring issues are discussed in international company and trade union forums such as European Works Councils, and British trade unions are keen to ensure that overseas workers' rights are protected under any outsourcing deal.⁷⁰ These international initiatives are independent of the strength of unions at the national level.

Locally in the UK, unions have responded to fears of unemployment, by moving to ensure a number of safeguards. The union Connect obtained an agreement with BT to protect staff whose jobs were outsourced, with promises of no compulsory redundancy and redeployment. However, the Communications Workers Union (CWU) believes the deal is not robust enough.⁷¹ What emerges from the evidence, is that labour relations in the service sector could potentially become increasingly turbulent, but whether labour chooses to address issues associated with offshoring, nationally or as an international movement, is as yet unclear.

Table 4: Summary of labour issues

| | |
|---|---|
| Location | <ul style="list-style-type: none"> • benefits developing countries by keeping skilled employees in those countries • concern over remoteness and lack of control of staff |
| Composition of labour | <ul style="list-style-type: none"> • young labour market with high turnover • wide variety of high-wage professional jobs, dominated by males • women tend to predominate in low-skilled work, danger of reinforcing gender segmentation in labour market |
| Skills | <ul style="list-style-type: none"> • access to a highly skilled workforce • unskilled work equally common, although language and familiarity with the use of equipment essential • choosing the wrong supplier, providing inadequate labour skills and training, is costly |
| Quality, functioning attractive & effectiveness | <ul style="list-style-type: none"> • lower cost of labour makes offshoring • reliability of service, quality and control equally as important |
| Wages & conditions | <ul style="list-style-type: none"> • cost linked to wages and conditions is important, but quality was equally important • India is being replaced by other developing countries as low cost destination |
| Creation & loss of jobs | <ul style="list-style-type: none"> • new technologies set to both create and destroy jobs • industrialised countries likely to be most affected by job losses |
| Industrial Relations | <ul style="list-style-type: none"> • potential to become increasingly turbulent • uncertain as to whether labour will choose to address issues nationally or internationally |

4 The business decision

There are some clear implications of offshoring, as outlined in the last section, that businesses must consider before deciding whether to pursue such a resourcing strategy. The offshoring of service activities is of particular interest from a business perspective because services are not generally as amenable to outsourcing as more tangible products. This is even more the case for offshoring of services. So, the rapid rise of this phenomenon is somewhat unexpected.

Management of offshoring involves a wider range of tasks than domestic outsourcing, with quite different priorities. For firms offshoring services, management of expatriate activities, infrastructure provision, transition and labour relations issues are of major concern. The costs of these management activities are significantly greater for firms offshoring services, particularly monitoring and transition costs. Offshoring firms encounter a much greater range of difficulties than outsourcing or inhousing firms, with government relations, contract negotiation and intellectual property rights most problematic. In this section, we initially explore the distinctiveness of services, and then discuss the benefits and potential of offshoring and conversely the various costs to business.

4.1 The distinctiveness of services

The distinctive features of services are their:

- Intangibility – services are activities, not objects. Services cannot be measured or evaluated in advance of consumption; branding and association with standardised tangible elements signal expected quality.
- Inseparability – production and consumption occurs simultaneously in time and space. This encourages a customised basis for competitive advantage; the value of a service derives more from its ability to meet the specific needs of the consumer than from cost

advantage. Some services may be partially 'disembodied' via a medium.⁷² More tangible 'hard' services, such as architectural design, are more separable than 'soft' services, such as health care or accommodation.⁷³

- Heterogeneity – services are labour-intensive and shaped by the interaction of producer and consumer and are thus highly variable. This encourages the standardisation of process rather than output.

Thus, services have a contradictory nature, demanding standardisation and economies of scale and scope on the one hand, but also customisation and responsiveness on the other hand, with the emphasis on the latter.⁷⁴

4.2 International provision of services

The distinctive features of services make their provision across borders more difficult than the international provision of goods. On the one hand, the high labour content in services makes provision from low labour cost locations attractive. On the other hand, physical distance inhibits the unique, simultaneous producer–customer interaction. Yet some services are more amenable to international provision than others. More separable, 'hard' services are more satisfactorily provided in a disembodied or mediated manner, and thus can be offered across borders.⁷⁵ General, standardised services, or at least processes, are also easier to provide at a distance than specialised or customised services.⁷⁶ Some services are also inherently cross-border because they relate to international activities,⁷⁷ such as those associated with:

- cross-border transactions (eg legal services, freight forwarding, brokerage)
- electromagnetic transmission (eg television, radio, telephone)
- international assets.⁷⁸

As with the distinction between explicit and tacit knowledge, however, in practice it is difficult to separate different types of service in this way. For example administrative tasks may be considered as standardised but these often involve elements of specialised or customised synthesis and analysis.

There are three ways in which services can be provided across borders:⁷⁹

- person-based – where the provider moves to the consumer or the consumer of the service moves to the provider⁸⁰
- process-based – the process is moved across border (such as franchised food service)
- mediated – information is moved cross-border physically (mail) or by telecommunications (often synchronous such as phone, electronic chat, or video conferencing).

Several degrees of commitment can be distinguished in the international provision of services:⁸¹

- cross-border export of services
- indirect exports (sale of services in association with export of specialised goods)⁸²
- licensing or franchising to a third party
- overseas subsidiary.

Finally, it is not just the characteristics of services but also the characteristics of particular firms that have been found to influence the likelihood of service internationalisation. Significant factors include:

- management enthusiasm for exporting, significant because of the lower capital costs involved in internationalisation of services than of manufacturing⁸³
- customer-following (advertising and banking)⁸⁴
- lenient host-country regulations (banking)⁸⁵
- market size⁸⁶

- technology intensity: such firms tend to pursue global rather than local niche strategies in the face of high R&D costs, short product life-cycles and great uncertainty⁸⁷

- close contact with important business networks in the foreign location, providing relationship-specific, or 'idiosyncratic', information, assets and resources, which are often key to building strategic capabilities.⁸⁸

The current interest in BPO appears to relate to the international standardisation of a range of business processes (standardised through business schools), lower costs and greater capabilities of 'disembodying' media such as broadband internet, and the emergence of business specialised process exporters.

4.3 The benefits of proximity

A useful starting point in discussing the benefits and costs of offshoring is to consider why firms undertake any activities locally and in-house at all. Nike epitomises such a standpoint, outsourcing its entire output to 900 contract manufacturers worldwide.⁸⁹ But even Nike still directly employs 23,000 staff and the case for directly administering core business activities is strong, centring on strategic and collaborative advantages.

4.3.1 The strategic advantages of in-house provision

A major motivation for undertaking business activities in-house is to protect core product and processes innovations. Competitive advantage often draws from such an innovation but this advantage can be quickly lost if competitors are able to imitate it, as Ford discovered when GM copied the mass-production technique. Locating core activities deep in-house, however, can protect these from outside observation.⁹⁰

4.3.2 Collaborative advantage

One of the keys to innovation is collaboration, and the clustering of complementary activities in a locality is a major contributor to collaboration. Proximity provides the opportunity for knowledge spillovers from frequent interaction and the easy detection of developments. It also enables closer monitoring and low cost common access to specialised resources and infrastructure, reducing development costs.⁹¹ Proximate activities can be easily customised to the specific needs of the firm.

4.4 The offshoring potential

The economic attractiveness of BPO arises from the potential to reduce labour costs and the potential general benefits of outsourcing – the possibility of efficiency through specialisation and the reduction of agency costs. But there are some distinct considerations in the case of outsourcing services.

4.4.1 Reduced labour costs

Because services are labour-intensive, staffing accounting for 65% of the cost of running IT departments and data centres,⁹² the relocation of business processes to low labour cost centres is attractive.

A consequence of widespread subsistence agriculture in India and China is a huge reserve of low cost labour, including a large absolute number of skilled workers. The supply of highly skilled, professionally qualified labour in India, in particular, has increased since 2001 as the USA has tightened restrictions on migrant labour.

Relocation of service provision to low wage countries is only possible where the consumption of the service can be disembodied, most likely with 'hard' services or standardised processes. A key factor is the degree to

which provision can be mediated, such as through a physical or electronic communication process.

Further, because services comprise heterogeneous interactions between provider and consumer, the interaction skills of providers are significant to the quality of service provision, not just technical skills and knowledge of standardised processes. The human resource management capacity of the outsourcer is important in this regard.⁹³

4.4.2 Efficiency through specialisation

Any outsourcing has potential to gain benefits of efficiency through specialisation. Specialisation can increase efficiency through economies of scale and learning gained from large volumes.⁹⁴ Lessons from this can be consolidated into proprietary low-cost processes. This can provide a specialist with a lower unit cost advantage over a generalist with lower volumes or without propriety low-cost processes.

The degree to which the lower costs of specialist producers become available to the outsourcing firm depends on the extent of competition among specialists; only temporary cost benefit is likely to accrue to a firm that outsources to a monopoly provider.⁹⁵

The distinctiveness of services, however, reduces the scope for economies of scale and learning compared to those available in the production of goods. Because services are heterogeneous and inseparable, the individual proximate producer–consumer interaction remains fundamental to the value of the service. Because they are intangible it is difficult for a firm to measure service levels. Potential economies of scale are thus limited to the standardisation of process. But this standardisation can limit the customisation of services, a

critical component of their value. Economies of learning and the proprietary process knowledge can be internalised in the provision of service depending on the quality of staff training and development.

4.4.3 Reduced agency costs

A second source of lower costs from outsourcing derives from agency costs involved in organising business activities within a firm. Agency costs arise because it can be difficult to precisely identify the costs of activities carried out within the firm and to eliminate inefficiencies. Outsourcing can be attractive because the cost is clearly identified by the external contract.⁹⁶

This is perhaps the key attraction of outsourcing in the area of services because it provides a solution to the problem of intangibility of service levels. Yet this is not a complete solution as the problem a consumer of services has in measuring the value of service in advance of each unique transaction also applies to a firm outsourcing business services. The firm will need to rely on branding, process standardisation, proximate interactions and post-facto indicators of expected quality, less suitable for critical business processes.

4.4.4 Differential benefits

Summarising the discussion of the potential benefits of different configurations of service provision, the specific benefit varies with the location and degree of control involved.

Table 5: Differential benefits

| | Local | Offshore | Local integrated offshore |
|----------------------|---------------------------------------|---------------------------------------|--|
| In-house outsourcing | Agency cost reduction | Agency cost reduction | Agency cost reduction |
| | Protection of proprietary information | Protection of proprietary information | Protection of proprietary information |
| | Collaboration | Labour cost reduction | Labour cost reduction |
| | Customised offering | Customised offering | Customised offering |
| External outsourcing | Agency cost reduction | Agency cost reduction | Agency cost reduction |
| | Specialisation efficiency | Specialisation efficiency | Specialisation efficiency |
| | | | Labour cost reduction Customised offering |

4.5 The costs of offshoring

The potential cost savings of offshoring need to be balanced against the potential costs of offshoring itself. These are variations of the general costs of outsourcing and include search costs, transition costs, co-ordination costs, exchange costs and capability losses.

4.5.1 Search costs

Search costs comprise the time and effort to discover the range of prices in the market and to identify the lowest for the particular product or service offering sought. These costs are highest when price alone is insufficient to judge utility, as when product offerings are not standardised, when quality and product offerings are uncertain (new products and long-term supply contracts), and when information asymmetries exist.⁹⁷ Services are particularly susceptible to these issues.

By their nature, services are not standardised, only processes may be. So the cost of determining value for money when outsourcing services will be higher than when outsourcing goods production. Further, by their heterogeneous nature, service levels in any transaction

are uncertain. So the search for low cost services will focus mainly on secondary information – the evaluation of processes and branding associated with this and post-facto evaluation. Both these dimensions are made more costly when the search is international in scope. A rule of thumb for search costs in IT is between 1-10% of contract value.⁹⁸

Secondly, service transactions typically involve information asymmetries. The consumer does not know the full value of the service until after the fact and the firm outsourcing is likely to have better knowledge of the utility of the service to their business than the vendor. This situation encourages opportunistic behaviour by both parties, increasing the risks and thus costs of the transaction.⁹⁹

4.5.2 Transition costs

A decision to outsource business activities involves costs in terminating the internal business process, establishing the new process and integrating this with the rest of the business's operations. Again, because of the distinctive nature of services, this is likely to have a greater impact on a business outsourcing services than on one outsourcing production. Because the quality of service is unique to each transaction service provision is sensitive to individual performance by service providers. Training and integration of the new providers is likely to be significant to service levels in the short term; these costs are likely to be greater when encompassing different national business environments and different national cultures. Redundancy, reorganisation, and retraining may have detrimental impacts on the remaining capabilities of the firm. A rule of thumb in IT is that the costs of familiarising outsourcers with existing operations can cost 2-3% of contract costs, while redundancies and associated costs can add another 3-5%. Additionally,

initial productivity shortfalls of 20% in the first two years of contracts have been experienced in IT.¹⁰⁰

4.5.3 Co-ordination costs

Beyond the initial costs of transition there are ongoing costs involved in ensuring the outsourced activities are well integrated with the rest of the firm's activities. One Indian specialist offshorer, Wipro Technologies, cites the cost of a sufficient telecommunications link for effective communication between a UK firm and an Indian operation at £70,000 per year.¹⁰¹ Ongoing costs in specifying operational requirements of projects for IT outsourcers can account for 1-10% of contract price.¹⁰²

There is a continual risk that production as a whole may be interrupted by a failure on the part of the contractor to carry out what is required. This has greatest effect when a business process involves a precise order¹⁰³ and is more costly when the outsourced activity is physically or cultural distant. The risk of disruption can be reduced by hedging or insuring against interruptions in supply but this too is a cost.

4.5.4 Exchange costs

While contract specification aims to compensate for transition costs, minimise co-ordination costs and protect against loss of proprietary information, it is costly to prepare and enforce detailed contracts to cover every eventuality. In complex situations there are too many alternatives for people to evaluate rationally;¹⁰⁴ it is difficult to specify contracts that will sufficiently cover even likely contingencies. This is most clear in the case of labour, where a detailed specification of the tasks required of the labourer is normally much more costly than a simple agreement to submit to the authority of the employer. Again, the intangibility and heterogeneity of services makes contract specification particularly

difficult and thus costly. International contract specification is more complex and costly because of the multiple legal and regulatory regimes embraced.

Exchange costs are greater the more the potential gain from transgression.¹⁰⁵ Enforcing the terms of exchange is particularly difficult in international transactions where the time between product despatch and delivery is long and the process is often ambiguous and thus the opportunities to renege on the agreed terms is great.¹⁰⁶ In IT, ongoing contract management can account for 6-10% of total offshore contract price.¹⁰⁷

4.5.5 Capability losses

The final set of costs arises from the impact of outsourcing on the strategic capabilities of the principal firm. These include the risk of loss of proprietary information, dependence on specific assets, reduced infrastructural capacity and reduced options.

Firstly, the involvement of outside parties in the activities of a firm increases the risk that proprietary information to which they have access may be lost to competitors.¹⁰⁸ This is a risk of loss to the firm's strategic capability. Typically firms minimise this risk by retaining the core processes related to their competitive advantage (core competencies) in-house, outsourcing only more distant processes. However, the provision of some seemingly secondary business services, such as data processing, IT or some research and design processes, may be inseparable from their use in these core processes. The risk of loss of capability can be reduced through more detailed contract specification but this represents increased exchange costs.

A second threat to a firm's strategic capability comes from the potential damage to reputation and brand from

adverse political impacts and the potential for regulatory restrictions. Firms such as HSBC, Lloyds TSB, BT and British Airways have been subject to intense media scrutiny and trade union criticism over plans to offshore significant operations. In the US several state legislatures have debated introducing tendering restrictions on offshoring firms.

Thirdly, a firm's strategic capability may also be reduced when outsourcing involves the use of specialised assets specific to that transaction; there are costs or asset devaluation if these assets are used for other purposes.¹⁰⁹ An example of a specific asset is a mould developed to press a door panel for a particular model of car; the mould cannot be used for any other purpose and would be of little value if the car assembler no longer wished to purchase these panels from the owner of the mould. Offshoring services would be likely to involve specific training and communication media.

Asset specificity creates a risk of loss of strategic capability. The purchaser of the output of a specific asset can demand a lower price, knowing that the supplier has limited ability to utilise the asset for other purposes, an activity known as 'holdup'.¹¹⁰ However, alternatively, the supplier may gain a bargaining advantage over the purchaser as the supplier may have no other source of supply ('reverse holdup'). This may happen once a competitive bid for supply has been won, the contracted supplier makes the dedicated investment, and the others abandon this particular market.¹¹¹ Such systematic advantage by a specialised supplier is reasonably likely.¹¹²

Because of the risk of opportunist behaviour in this manner, either way, asset specificity increases exchange costs. The opportunity for holdup complicates contract

negotiations, making more detailed contract specification, contract renegotiation and delays more likely. It generates distrust, leading to negotiation of additional safeguards in contracts and limiting information sharing among parties, which can impede supply efficiencies. It encourages parties to hedge against disruptions to supply by investing in duplicate standby facilities or by seeking alternative suppliers.¹¹³

A fourth potential loss of strategic capability arises from the reduction in organisational infrastructure accompanying outsourcing. Once a business activity is outsourced, the technical expertise, infrastructure and knowledge to carry out that activity in house is typically eliminated or significantly reduced; the capital assets involved are often sold off at prices less than replacement cost to reduce enduring agency costs. The capacity of the firm to change its decision and insource the activity at a later time, say in the face of poor performance by a series of outsourcers, is limited because it will be costly to recreate necessary infrastructure. New capital assets would need to be purchased or leased, where depreciated assets are likely to have been used before, and synergetic combinations with other processes are no longer likely to be available. The institutional knowledge and specific skills associated with the process are likely to be costly to rebuild. There are also likely to be some associated 'influence costs', inefficiencies arising from competition for internal capital funding within the firm.¹¹⁴

Finally, strategic capability may be reduced when a firm's options (or choices) are reduced. A firm with the option of outsourcing a business process or retaining it in-house has a degree of flexibility in responding to future events, and thus a degree of protection or insurance against detrimental events that may occur. If in-house

operating costs escalate above market prices, the firm can avoid the increase by outsourcing. If in-house prices remain similar to market prices, the firm still benefits from cost stability. However, once the option of outsourcing is exercised, the contingency is no longer hedged; the firm has fewer choices. It no longer, for example, has the means to offset a rise in operating costs.¹¹⁵

4.5.6 Differential costs

Many of these costs arise from the act of outsourcing alone. Search costs, transition costs and specific asset risk are likely to be of particular note for services because of the difficulty of ensuring quality of provision. Co-ordination costs are likely to be greatest for business processes that are more critical to other operations of the firm. But in general the costs are likely to be an inverse function of the degree of control the principal firm retains. While the option loss is universal, the costs are likely to be generally trivial for in-house outsourcing (insourcing), notable for in-house offshoring, more significant for local external outsourcing and greatest for external offshoring.

Table 6: Differential costs

| | Local | Offshore | Local integrated offshore |
|-------------|--|---|---|
| Insourcing | Option loss | Search costs Transition costs Co-ordination costs Exchange costs Proprietary information risk Reputation risk Specific asset risk Infrastructure loss Option loss | Search costs Transition costs Co-ordination costs Exchange costs Proprietary information risk Reputation risk Specific asset risk Infrastructure loss Option loss |
| Outsourcing | Search costs Transition costs Co-ordination costs Exchange costs Proprietary information risk Reputation risk | Search costs Transition costs Co-ordination costs Exchange costs Proprietary information risk Reputation risk | Search costs Transition costs Co-ordination costs Exchange costs Proprietary information risk Reputation risk |

5 Diagnostics: evaluating the benefits and costs of offshoring

The principle of comparing benefits and costs in outsourcing decisions is well established, with expected present value calculations commonly used to compare anticipated costs over time. This is a widely practised technique of capital budgeting in the private sector, while UK government guidelines explicitly require comparison of cost streams of in-house and external providers.¹¹⁶ Offshoring would seem to simply add some additional potential costs and benefits to established outsourcing criteria. In this final section, we will look at some methods that organisations can use to assess the benefits of offshoring.

While labour costs between the UK and India, for example, may vary by as much as 80%, estimates of cost savings from offshoring focusing on final contract prices and some co-ordination costs suggest maximum savings of 30-60%.¹¹⁷ Typical Indian IT subcontractor billing rates, for example, are \$15 per person hour rather than the \$1.50-\$3 wage rate.¹¹⁸ Yet even firms experienced in outsourcing, such as the US IT firm United Technologies, are achieving savings of only 20% through offshoring. While it may be possible to contract call handling in India at £1.30, this needs to be compared to other options such as web self-service at 30p.¹¹⁹

The decision criteria used in these cost-benefit techniques do not normally take full account of the costs discussed above, however, especially changes to strategic capability and particularly to the loss of options. This is most notable in the public sector requirement to outsource when the expected present value of in-house provision exceeds the expected present value of outsourcing by any amount. A more accurate cut-off point would be where this is in excess of the value of the option lost. Many private sector managers do account for this implicitly by using a high

hurdle rate rather than that indicated simply by systematic risk.¹²⁰

5.1 Diagnostic tools

The expected value framework discussed above suggests the following tool is useful for systematic decision-making on offshoring:

Table 7: Diagnostic tools

| Benefit | Value | x Probability | = Expected value |
|--|-------|---------------|------------------|
| Difference in labour costs | | | |
| Cost reduction from economies of scale | | | |
| Reduction in agency costs | | | |
| Total benefit (EV _B) | | | |

| Cost | Value | x Probability | = Expected value |
|-------------------------------|-------|---------------|------------------|
| Search costs (1-10%)* | | | |
| Transition costs (8-35%)* | | | |
| Co-ordination costs (1-10%) | | | |
| Exchange costs (6-10%) | | | |
| Proprietary information risk | | | |
| Reputation risk | | | |
| Specific asset risk | | | |
| Infrastructure loss | | | |
| Total cost (EV _C) | | | |

**Short-term costs*

If the expected present value of the total benefit ($\text{EV}_B / (1 + r)^t$) exceeds the expected present value of the total costs ($\text{EV}_C / (1 + r)^t$) then the offshoring is beneficial. Note, however, that to take account of the option loss, r needs to be set at a rate above the level of systemic risk. For example, with interest rates at 5% and systemic risk at 1%, r might be set at 7% or 8%.

5.1.2 Offshore capability analysis

The existing commitment to offshore service provision

by the principal firm affects the level of search, transition, and co-ordination costs. The greater the commitment, the lower these costs and the more likely the firm is to offshore in-house rather than externally.

Table 8: Offshore capability analysis

| Existing offshore service commitment | Optimal offshoring |
|---|----------------------|
| None | External |
| Cross border export | External |
| Indirect exports | External or in-house |
| Licensing or franchising to a third party | External or in-house |
| Overseas subsidiary | In-house |

5.1.3 Outsourcer capability analysis

Evaluation of likely co-ordination and exchange costs can be aided by an assessment of the outsourcer's capabilities, drawn from software outsourcing.¹²¹ The higher the capabilities, the lower these costs

- Level 1: Initial

Ad hoc, ill-defined processes. Outcomes depend on individual efforts.

- Level 2: Repeatable

Basic project management processes are established to track cost, schedule, and functionality. Processes are repeated for similar projects.

- Level 3: Defined

Processes are documented, standardised, and integrated into standards for the organisation. All projects use an approved, tailored version of the process.

- Level 4: Managed

Detailed measures of process and quality are collected and controlled as a result.

- Level 5: Optimising

Continuous process improvement through quantitative feedback from the process and from piloting innovative ideas.

6 Conclusions

In this research, we have taken a critical look at offshoring as a specific example of a resourcing strategy. There were several key findings from this work around initial business decisions as well the subsequent implications for the organisation as well as to the macro economic issues. Firstly, in terms of decision-making, client preference is a central factor in determining whether work is offshored or not. While offshorers share with outsourcing firms an emphasis on pricing, innovation and investment, offshoring is more likely to emerge from established product and process offerings. Offshorers are not prone to incorporate stakeholder views in their business goals. Staff cost is a major motivator for offshoring but control, quality and efficiency are also significant considerations. Offshorers have typically experienced a recent small decline in costs outside the costs of offshoring itself. Clearly offshoring is a more costly endeavour than domestic outsourcing but is accompanied by significant increases in quality, efficiency and control of business services.

The public sector seems solidly resistant to offshoring, even by firms to whom it has outsourced work, for clear reasons of public policy on employment reinforced by public expectations.

In terms of subsequent implications for the private sector, concerns centred on the issues of control and how customers react to being in contact with offshore call centre staff. Firms should assess the potential for offshoring based on evaluations of net expected costs and benefits. They should take account of a range of factors, including risks capacity and their offshoring competence.

7 References

1. www.wnsgs.com/web/evolution.asp
2. Even for companies setting up inhouse options, there are intermediate support agencies, such as venture capital firm Ariadne Capital which offers advice on "creating offshore subsidiaries":
www.ariadnecapital.com/journal/v3e1/portfolio_news_ou_tsource.htm
3. F.I. GROUP [former name of Xansa] completes acquisition of IIS Infotech 24 February 1998
www.xansa.com/pressreleases/7853?parent=858&link=858
4. United Utilities Interim report 2002-2003 Chief Executive's Review
www.unitedutilities.com/pdf/annual_report_02/Interim_report.pdf
5. Evening Standard (London) 11 November 2003 Capita calls on Bombay for help
6. ICN Direct Newswire July 2003
195.112.22.43/icndirect/issues/icndirect0703.asp#3
7. Air Transport Intelligence 22 October 2003 Lufthansa Systems predicts strong growth in outsourcing unit
8. Global News Wire - Asia Africa Intelligence Wire Business Line 4 January 2002 TCS Gets Rs 200-Cr Order From United Utilities
9. Financial Times Investor (Stories) 20 October 2003 PRESSURE GROWS ON INDIA'S TCS FOR SHARE SALE
10. Infoworld 2 July 2003
www.infoworld.com/article/03/07/02/HNindiabpo_1.html; The Hindu 8 April 2003 HCL Tech Bags BT's BPO Contract
11. Belfast News Letter (Northern Ireland) 9 April 2002, Tuesday Sigh Of Relief As Call Centres Escape Axe; 23 January 2003 Take Off For Apollo Jobs: Contact Centre Doubles Posts In A Year
12. Computerwire 10 September 2003
13. Infoworld 2 July 2003
www.infoworld.com/article/03/07/02/HNindiabpo_1.html
14. Financial Times Investor (Stories) 20 October 2003 Pressure Grows On India's TCS For Share Sale
15. PR Newswire 30 August 1999 Mastech Corporation Announces Major Strategic Investment and Expansion Of Business Relationship with General Electric Company
16. Economic Times 12 September 2003:
www.wnsgs.com/web/pdf/wns%20ETonline.pdf
17. Xansa: The bottom line Report and Accounts 2003
www.xansa.com/investors/reportandaccounts/200300/randa2003_complete.pdf
18. Computing 9 October 2003; Computer Business Review Online 4 November 2003
www.cbronline.com/currentnews/a1c30c1da12fe39180256dd4001e4655
19. Sunday Times 5 October 2003: This is the 8.15 to Bombay
20. BBC News 1 November 2003
21. Sunday Times 5 October 2003: This is the 8.15 to Bombay; Computer Weekly 14 October 2003
22. Independent 31 October 2003 Outsourcing – the benefits don't always add up
23. Investment Dealers Digest 3 November 2003
24. European Banker 30 September 2003
25. Legal Week 16 October 2003; Sunday Times 5 October 2003
26. PR Newswire 19 August 2003
27. Financial Times 13 November 2003 : Switching rail enquiries to India 'may be improvement'
28. Global News Wire - Asia Africa Intelligence Wire Business Line 4 January 2002 TCS Gets Rs 200-Cr Order From United Utilities
29. Financial Times 10 March 2003 The revolution revs up: call centres; www.rediff.com. 4 November 2003 BPO alarms as jobs move to India
30. Birmingham Post 5 November 2003
31. Financial Times 23 October 2003, GSK unveils Indian research tie-up as sales rise
32. PR Newswire 27 May 2003? FirstCall/ iGate

Corporation (Nasdaq: IGTE) today announced its entry into the rapidly growing market for offshore clinical research outsourcing.

33. Economic Times of India 2 May 2000

34. Electronics Weekly 10 September 2003

35. The Guardian (London) 4 June 2002 Indian firm used in bid to clear vetting backlog . In November 2003

Capita bought a 60% stake in a subsidiary of Mastek, the firm it had used in the emergency in June 2002 (Evening Standard 11 November 2003: Capita calls on Bombay for help).

36. Guardian, 1 October 2003: An equal partnership?: David Brindle takes a unique inside look inside Capita, the UK company 'touching 33m lives'

37. M2 PRESSWIRE 9 October 2003 Wireless Healthcare www.wirelesshealthcare.co.uk.

38. Consortium of Higher Education Researchers CHER 15th Annual Conference 5–7 September 2002 Vienna, Austria, Australia As A Major Higher Education Exporter Grant Harman Email: mailto:ggharman@metz.une.edu.au.

39. Cwire 23 September 2003

40. ComputerWire 29 September 2003

41. Newsweek 10 November 2003 Profits without people

42. Sedley M & White W (eds.), (2003), UK PLC on the World Stage in 2010: Book 2: Globalisation and the Knowledge Society – the new drivers for business and the workforce, Management Consultancies Association

43. Interview: Knowledge Manager, professional services firm, 5 November 2003

44. World Employment Report: Life at Work in the Information Economy, ILO Publications, 2001.

(www.ilo.org/public/english/support/publ/wer/overview.htm. - 14 October 2003)

45. Bryan, M, Outsourcing Needn't be all One-way, Australian Financial Review, 5 August, 2003

46. Interview: Chief Executive, primary care group, 14 November 2003

47. World Employment Report op. cit., 2001

48. Interview: Knowledge Manager, op. cit. 5 November 2003

49. World Employment Report, op. cit., 2001

50. World Employment Report, op. cit., 2001

51. Shillingford, J, 'On the Road to Bangalore', The Guardian: Guardian Life, 25 September 2003

52. M2PressWire, 'NASSCOM announces the Launch of its UK Chapter', 18 September 2003

53. Shennan F & Bain, S, 'Identity Fraud Fears Grow as Secret Data Floods Abroad: Plans to make it easier to transfer vital information', The Herald, 4 October 2003

54. World Employment Report, op. cit., 2001

55. Shennan, F and Bain, S, 'Identity Fraud Fears Grow as Secret Data Floods Abroad: Plans to Make it Easier to Transfer Vital Information', The Herald (Glasgow), 4 October 2003, p. 23; Snow, J, 'Gone to India', Estates Gazette, 15 March 2003, p. 2

56. Anon, 'On the road to Bangalore', The Guardian, 25 September 2003, p. 18

57. Thottam, J, 'Where The Good Jobs Are Going ; Forget Sweatshops. U.S. Companies are Now Shifting High-wage Work Overseas, Especially to India', Time, 4 August 2003, p. 36

58. Thottam, J, 'Where The Good Jobs Are Going ; Forget Sweatshops. U.S. Companies are Now Shifting High-wage Work Overseas, Especially to India', Time, 4 August 2003, p. 36

59. Luce, E, Merchant, K and Roberts, D, 'Service Industries Go Global - How High-Wage Professional Jobs are Migrating to Low-Cost Countries ...', Financial Times, 20 August 2003, 15-

60. Finch, J, 'In India, it's service with a compulsory smile', The Guardian, 17 November 2003

61. Electronics Weekly, 'Analysis – Don't be Sunk Offshore', 17 September 2003; Interviews, November 2003

62. Interview: Knowledge Manager, op. cit. 5 November 2003
63. Interview: Chief Executive, op. cit., 14 November 2003
64. Interviews: November, 2003
65. Shillingford, J, op. cit , 2003
66. World Employment Report op. cit. 2003
67. Rushe, D & Robertson, D, 'This is the 8.15 to Bombay. It is carrying Indian Commuters, on the Way to do your Job'; Sunday Times, 5 October 2003
68. Interview: Knowledge Manager, op. cit. 5 November 2003
69. World Employment Report, op. cit. 2003
70. ICFTU, 'The International Trade Union Movement and the New Codes of Conduct'; 2003
(www.icftu.org/displaydocument.asp?index=991215157&Language=EN. – 14 October 2003)
71. Greek, D, 'BT Agrees Deal to Protect Staff if their Jobs are Outsourced'; VNU Business Publications Limited, 18 September 2003
72. Bhagwati, J. N, 'Splintering and Disembodiment of Services and Developing Nations', *The World Economy*, 7, 1984, 133-43.
73. Erramilli, M.K, 'Entry mode choice in service industries'; *International Marketing Review*, 7(5), 1990, 50-62.
74. Campbell, A. J and Verbeke, A, 'The globalization of service multinationals'; *Long Range Planning*, 27(2), 1994, 95-.
75. Örava, for example, argues that expertise in 'treatment process management' is more amenable to internationalisation than acute or 'basic-level' medical care. See Örava , M, 'Globalising Medical Services: Operational modes in the Internationalisation of Medical Service Firms'; *International Journal of Medical Marketing*, 2(3), 2002, 232-240
76. Valikangas, L and Lehtinen, U, 'Strategic Types of Services and International Marketing'; *International Journal of Service Industry Management*, 5(2), 1994, 72-84.
77. Javalgi, R. G, Griffith, D. A and White, D. S, 'An Empirical Examination of Factors Influencing the Internationalization of Service Firms'; *Journal of Services Marketing*, 17(2), 2003, 185-201.
78. Clark, T and Rajaratnam, D, 'International Services: Perspectives at Century's End'; *Journal of Services Marketing*, 13(3), 1999, 298-310; Clark, T, Rajaratnam, D and Smith, T, 'Toward a Theory of International Services: Marketing Insights in a World of Nations'; *Journal of International Marketing*, 4(0), 1996
79. Örava, 'Globalising Medical Services'; O'Farrell, P.N & Wood, P.A, 'Internationalization by Business Service Firms: Towards a New Regionally Based Conceptual Framework'; *Environment and Planning A*, 30(1), 1998, 109-28.
80. Aharoni, Y, (1993), 'Globalization of Professional Business Services'; in. Y. Aharoni (ed.) *Coalitions and Competition: The Globalization of Professional Business Services*, London: Routledge,
81. O'Farrell, P.N & Wood, P.A, 'Internationalization by Business Service Firms'
82. Ochel, W, 'The International Competitiveness of Business Service Firms: The Case of Germany' *The Service Industries Journal*, 22(2), 2002, 1-16.
A common practice among Taiwanese electronics companies is to send technicians a company trained in China to assist in operations in other countries. As one manager explained: 'We employ 26,000 people in China. There are bound to be some talents. We train them, and send them to Thailand, to Mexico for production support, or even to the US and Japan for sales support. A Chinese engineer's pay is no more than one-eighth of a Taiwanese engineer. We save a lot of money that way.'" Cited by Chen, T-J, 'Network Resources for Internationalization: The Case of Taiwan's Electronics Firms'; *Journal of Management Studies*, 40, 2003, 1107-30. Managerial skills are less commonly moved from

developing countries, however, because of their scarcity.

83. White, D.S, Griffith, D.A and Ryans, J.K Jr, 'Profiling Exporting and Non-exporting Service Firms: Critical Differences to Decision-makers', *Thunderbird International Business Review*, 41(2), 1999, 195-213.
84. Aliber, R, 'International Banking: A Survey', *Journal of Money, Credit and Banking*, November, 1984, 661-678; Cho, K, 'Determinants of International Banks', *Management International Review*, 26(1), 1986, 10-23; Giddy, I.H, 'The Theory and Industrial Organisation of International Banking' in *Research in International Business and Finance*, Gray, H.P, ed, JAI Press, Greenwich, CT, 3, 1986, 195-243; Gray, J.M and Gray, H.P, 'The Multinational Bank: A Financial MNC', *Journal of Banking and Finance*, 5(1), 1981, 3-63; Terpstra, V and Yu, C.M, 'Determinants of Foreign Investment of US Advertising Agencies', *Journal of International Business Studies*, 19(1), 1988, 33-46; Nigh, D, Cho, K.R and Krishnan, S, 'The Role of Localisation Related Factors in US Banking Involvement Abroad', *Journal of International Business Studies*, 17(3), 1986, 59-72; Williams, B, 'Positive Theories of Multinational Banking: Eclectic Theory Versus Internalisation Theory', *Journal of Economics Survey*, 11(1), 1997, 71-100.
- Customer strategy also impacts on the type of service consumed. Italian international SMEs, competing primarily on price were found to make more use of standardised services whereas firms competing on quality (or differentiation) made more use of customised services. See De Chiara, A and Minguzzi, A, 'Success Factors in SMEs' Internationalization Processes: An Italian Investigation', *Journal of Small Business Management*, 40(2), 2002, 144-153.
85. Miller, S and Parkhe, A, 'Patterns in the Expansion of US Banks' Foreign Operations', *Journal of International Business Studies*, 29(2), 1998, 359-90.
86. Dunning, J.H, 'Multinational Enterprise and the

Growth of Service: Some Conceptual and Theoretical Issues', *The Services Industrial Journal*, 9, 1989, 5-37

87. Qian, G and Li, L, 'Profitability of Small- And Medium-Sized Enterprises in High-Tech Industries: The Case of the Biotechnology Industry', *Strategic Management Journal*, 24(9), 2003, 881-886.
88. Chen, 'Network Resources for Internationalization'; Zander, I, 'Where to the Multinational? The Evolution of Technological Capabilities in the Multinational Network', *International Business Review*, 8, 1999, 261-91.
89. Nike draws revenues of \$10.697 billion, directly employing 23,000 staff compared to an outsourced workforce of 660,000.
www.nike.com/nikebiz/nikebiz.jhtml?page=25&cat=overview. Nike Inc., Annual Report Pursuant To Section 13 Or 15(D) Of The Securities Exchange Act Of 1934 For the fiscal year ended May 31, 2003
www.nike.com/nikebiz/invest/reports/ar_03/10-K_FINAL.PDF, 3, 8.
90. Saloner, G, Shepard, A and Podolny, J, (2002), *Strategic Management*, New York, John Wiley & Sons
91. Marshall, A, (1890), *Principles of Economics*, Basingstoke, MacMillan; Richardson, H, (1978), *Regional and Urban Economics*, Hindsdale, Dryden Press; Krugman, P, (1991), *Geography and Trade*, Leuven, Leuven University Press.
92. Simons, M, 'Bank of Ireland deal -- a worrying benchmark?', *Computer Weekly*, 23 September 2003, p. 16.
93. Weak human resource management capabilities among outsourcers has had a detrimental impact on service provision in NHS contracts. See Grinshaw, D, Vincent, S, and Wilmott, H, 'Going Privately: Partnership and Outsourcing in UK Public Services', *Public Administration*, 80(3), 2002, 475-502.
94. According to Adam Smith, the limit of specialisation is market demand. Firms will only develop specialist

expertise and capacity when market demand for the specialism is sufficient to cover the cost of the investment. Thus, specialisation tends to deepen over time with market growth and as the cost of specialisation lowers, as with developments in information technology.

95. Besanko, D, Dranove, D, & Shanley, M, (2000), *Economics of Strategy*, 2nd Edn. New York, John Wiley & Sons.
96. Besanko, Dranove & Shanley, *Economics of Strategy*.
97. Douma, S and Schreuder, H, (1998), *Economic Approaches to Organizations*, London, Prentice Hall.
98. Overby, S., 'The Hidden Costs of Offshore Outsourcing', *CIO Magazine*, 1 September 2003. Costs include documenting requirements, sending out RFPs and evaluating the responses, and negotiating a contract, and initial travel and hospitality. The process can take 6 months with due diligence.
99. Arrow, K, (1969), 'The Organization of Economic Activity' in K. Arrow, (ed.) *General Equilibrium: Collected Papers*, Vol. 2, London, Basil Blackwell; Williamson, O, (1975), *Markets and Hierarchies: Analysis and Antitrust Implications*, New York, Free Press; Williamson, O, (1985), *The Economic Institutions of Capitalism*, New York, Free Press.
100. Overby, 'The Hidden Costs of Offshore Outsourcing'.
101. Anon, 'On the road to Bangalore - As a Growing Number of Companies Choose to Save Money by Moving Parts of ...' *Guardian*, 25 September 2003, p. 18.
102. Overby, 'The Hidden Costs of Offshore Outsourcing'.
103. Milgrom, P and Roberts, J, (1992), *Economics, Organization and Management*, Englewood Cliffs, NJ, Prentice-Hall.
104. Simon, H. A. (1961), *Administrative Behavior*, New York, Macmillan. For Coase (1937), the complexity of contracts, in fact, was the ultimate obstacle to market transactions. Even where contracts are specified, the task

of monitoring may become overwhelming, a phenomena identified with NHS outsourcing. See Grinshaw, Vincent & Wilmott, 'Going Privately'.

105. Coase, R, 'The Nature of the Firm', *Econometrica*, 4, 1937, 386-405.
106. Hill, C, (2003), *International Business: Competing in the Global Marketplace*, Boston, McGraw-Hill.
107. Overby, 'The Hidden Costs of Offshore Outsourcing'.
108. Besanko, Dranove & Shanley, (2000). A related risk is the loss of legal right to intellectual property that may be developed by the outsourcer in the course of the contract, property that would have accrued to the principal if it had been undertaken in house. See Grinshaw, Vincent & Wilmott, 'Going Privately'.
109. Williamson, *Economic Institutions of Capitalism*.
110. Goldberg, V, 'Regulation and Administered Contracts', *Bell Journal of Economics*, 7, 1976, 426-44.
111. An example of reverse holdup was the ten-year exclusive contract for Fisher Body to supply car bodies to General Motors, which, aided by insufficient contract specification, allowed Fisher to produce with outdated techniques and pass the costs of this inefficiency on to General Motors. See Klein, B, 'Vertical Integration as Organizational Ownership: The Fisher Body-General Motors Relationship Revisited', *Journal of Law, Economics and Organization*, 4, 1988, 199-213.
112. Dore, R, (1996), 'Goodwill and Market Capitalism', in *Firms, Organisations and Contracts: A Reader in Industrial Organisation*, P Buckley and J Mitchie, eds., Oxford, Oxford University Press.
113. Intel, for example, maintained duplicate component suppliers during the high demand for its microprocessors in the 1980s. Womack, J, Jones, D and Ross, D, (1991), *The Machine that Changed the World: The Story of Lean Production*, Cambridge, MA, MIT Press; Besanko, Dranove & Shanley, 2000.
114. Johnstone, D, 'Public Sector Outsourcing as an

Exchange Option', *ABACUS*, 38(2), 2002, 153-176. Lost capacity in the public sector would include a reduction in public service ethic that has accompanied repeated restructuring and redundancies. See Corby, S and White, G (eds.), (1999), *Employee Relations in the Public Services: Themes and Issues*. London, Routledge. On influence costs, see Milgrom, P and Roberts, J., (1990), 'Bargaining Costs, Influence Costs, and the Organization of Economic Activity', in *Perspectives on Positive Political Economy*, J. Alt and K. Shepsle, eds., Cambridge, Cambridge University Press.

115. Johnstone, D, 'Public Sector Outsourcing as an Exchange Option', *ABACUS*, 38(2), 2002, 153-176. This situation arises because of the costs involved in outsourcing and insourcing. See also Aggerwal, R, 'A Brief Overview of Capital Budgeting Under Uncertainty', in R. Aggerwal (ed.), (1993), *Capital Budgeting Under Uncertainty*, Prentice-Hall.

116. Busby, J. S and Pitts, C. G, (1997), 'Real Options in Practice: An Exploratory Survey of How Finance Officers Deal with Flexibility in Capital Appraisal', *Management Accounting Research*, 8(2); Efficiency Unit, Office of Public Service and Science, *Guide to Market Testing*, London, 1993; both cited by Johnstone 'Public Sector Outsourcing as an Exchange Option'.

117. Gallagher, G, 'Making Offshore Outsourcing Work: What in the World Can Go Wrong?', *Insurance & Technology*, 26(11), 2001, p.26; PR Newswire, July 9, 2003; *Sunday Times*, 5 October, 2003; Jyoti Thottam, J, with Gregory, S 'Where The Good Jobs Are Going: Forget Sweatshops. U.S. Companies Are Now Shifting High-wage Work Overseas, Especially to India', *Time*, 4 August, 2003, p. 36.

Total costs of making a documentary film in India, however, are claimed to be 25% of that in Europe. See Luce, E, Merchant, K and Roberts, D, 'Service industries go global - how high-wage professional jobs are migrating to low-

cost countries', *Financial Times*, 20 August 2003, p. 15.

118. Mishra, P, 'Exercise Caution in Offshore Outsourcing', *Asia Computer Weekly*, 22 September 2003.

119. Anon, 'On the road to Bangalore', *The Guardian*, 25 September 2003, p. 18.

120. Johnstone, 'Public Sector Outsourcing as an Exchange Option'; Busby and Pitts, 'Real Options in Practice'.

121. Gallagher, G, 'Making Offshore Outsourcing Work'.

Annex: Case studies

Case Study (1): Professional services

A professional services firm offshoring their research activities to India.

Background:

- Provides secondary research support for the staff of their parent company.
- Work of the team driven by the knowledge management side of the business – providing description of KM.
- Decision to set up a research team in India was not difficult, already had facilities in India for clients and HR facilities, therefore infrastructure – desks and computers – available.

Outcomes:

- The research team in India is an additional resource rather than a replacement for existing research groups. The team in India comprises 9 people, with scope to expand. Existing teams in UK, US and elsewhere vary in size with over 20 globally.
- Reason for keeping the US and UK team: The research team is seen as an additional resource rather than a replacement for existing research groups. There will always be a need for locally-based research staff. Still a new concept and India doesn't have the same captured audience, needs to go out and push, but still very busy.
- Indian research team project gone very well, functioning within two months and having to turn work away. The biggest concern is that people would not want to use an offshore source, concerned it could not deliver, but managed the exposure, and things were fine.

Key reasons for offshoring?

- Provide research support of an equal (or higher) quality to that already offered by existing research teams for less money.

- New Zealand was considered as a location but India chosen because of existing office infrastructure, time zone (reasonable time differences between US, Europe and Asia/Pacific), English speaking population and skills and cost.

What are the key reasons against it?

- Huge resistance, the research resources would have been remote, concerned that the Indians wouldn't operate the same as US employees.
- Some anti outsourcing legislation being introduced, especially in the public sector.

What scope do you see for future expansion?

Difficult to say – investment bank are putting 40 of their research analysts there, and will be expanding to 100. There is increased competition from other firms, even Indian firms are getting involved. The professional services firm already has existing offshore offices in India that deal with IT software development, and provide HR and IT support, so firm in a good position.

Case Study (2): NHS

A social primary care trust in the NHS: It has a budget of £240 million and employs 2,800 staff. Public sector NHS organisation, providing a range of health care, as well as commissioning. Work is chiefly servicing acute hospitals. 3*-rated organisation.

Background:

- No offshoring currently taking place in the trust.
- Could not contemplate offshoring under the current policy framework. Although as a 3*-rated organisation have earned autonomy, this means the trust has the opportunity to use a 'spin-out' company. Example of this can be found in Birmingham, when a company dealing with intellectual property rights was created. Offshoring might be a possibility when foundation trusts are set up

because they will have more independence.

- Currently it would be frowned upon politically, the nearest the NHS has to such projects is NHS Direct which outsources work.

Key reasons for offshoring?

- Obvious one is money, but it would also have to include a quality dimension. Under best value, duty bound to explore all possibilities.
- Jobs that could be done are the payroll, some scope for digital radiography, research too is a possibility
- If No.11 (Downing St) was to encourage offshoring, it would have to come from the centre, because main brief is to develop local links, with local organisations, communities and bodies.

Key reasons for opposing offshoring?

- Public reaction. In most cases offshoring is perceived as offering a poorer service. There would be concern over whether call centre operators could understand the geography of the UK, or have a thorough understanding of how the NHS works.
- The fact that it is not face-to-face contact would be an issue.
- NHS is viewed as a national, even a local organisation so many of the patients would be unhappy that the service is being operated from abroad. Even the NHS Direct was criticised locally because it operated from another part of the country. 17 complaints received under the National Patient Survey, unhappy that NHS Direct operated from another part of the country.
- Issues regarding training, skills, catering for patients with special needs, language a further problem. Trust would be too concerned about the backlash from people.
- Staffing issues – people are concerned that NHS already take nurses from the developing countries. If

activities expanded to using nurses in call centres abroad to service NHS, might be further criticism.

- Lack of control over staff would be another issue. Problems in the first weeks of setting up NHS Direct. The demand for ambulances increased 100% because of the advice they received from nurses on-line – anxious not to make mistakes or misdiagnose. Nevertheless, able to control this and make changes, not possible if your agency is thousands of miles away in India.
- All manner of legal issues, litigation involving government and so forth.

Scope for future expansion

- At the moment really doing the opposite of offshoring, importing capacity to run health service, bringing doctors and nurses from developing countries. Although patients being offshored, already sending patients to other countries, for example France, even Cape Town – people might combine treatment with holidays.

Case study (3): Multinational electronics and entertainment firm

The company, with 900 staff in Europe, sells £1.6 billion of electronic games products in the region annually.

Background:

- Each region of the company makes its own decisions on customer service provision, subject to headquarters overview of cost and minimum service levels. Customer service is provided by a UK-based call centre. The outsourcer has operations in India but these are not used in this case. A US affiliate of the company is trialling use of an Indian call centre for another product and this experience is being monitored closely.

Potential benefits of offshoring:

- Cost was the only criteria when selecting an

outsourcer when the firm first launched its major product because they were uncertain of potential demand and likely growth. The cost of customer service remains significant.

'I can understand why banks do it (offshore to India). They have a lot of back room operations. Our activity is very immediate. We provide advice and help. We deal with the issues there and then with little back office. Call duration is short. You would need a huge volume.'

Potential disadvantages of offshoring:

- The firm questions whether Indian outsourcers have sufficient skills to match the quality, reliability, state of the art technology, and latest business practices they currently gain from UK outsourcers. While cost remains an issue, two years after launch these issues became of greater concern to the company. 'There are many examples of putting quality ahead of cost. We are lucky – companies like to be associated with us so we have benefited in terms of cost.'
- Locality is of paramount importance to local service managers. Staff visit the call centre a couple of times a week and provide hands-on training to call centre staff. This assists communication, updates, and local knowledge. 'We had a problem in the Benelux countries where customers didn't like calls being answered by a Dutch call centre. Doing this in India would involve lost of operational problems and travel costs. There would have to be a minimum break even number of transactions to justify it. We simply are not at that level.'
- Strategically, customer service is a vital activity for the firm. 'It used to be seen as a necessary evil. Now it is an essential part of marketing the product. It is not taken into consideration when people are looking for a product, but if it is not there you have problems. If customer service is poor, everyone hears about it.'

Case study (4): IT and Business process outsourcing firm A

The company is an established UK-owned provider of IT and business process outsourced work for UK companies. Its clients cover all sectors including local authorities, utilities, retail and telecoms. It employs staff in a number of locations in the UK

Background

- In the last year the company has acquired capacity in India through buying a controlling stake in an established callcentre operation. It had previously developed capacity to work from India through partnership arrangements with Indian BPO firms.
- The principal driver for developing capacity in India is client demand for cost reductions. This is reinforced by two other factors: labour supply issues in the UK, with changing demographics making it harder to employ people at competitive rates; and the flexibility gained by being able to offer a 24-hour operation.

Outcomes

- The workforce in India is of high quality, consisting entirely of graduates who see the work as a good career move giving experience of working in an international context. The savings are passed on to clients who are themselves under competitive pressure to reduce costs.
- Client attitudes to offshoring vary. Public authorities, both local authorities and central government, are not interested in work being offshored. Private sector clients have different attitudes. In some sectors such as financial services the whole sector is moving towards offshoring of BPO work, with IT services having led the way. Some others are concerned about possible customer reaction against being dealt with by someone with an Indian accent, or about the potential fragility of communications links.

- There have been no redundancies or site closures in the UK as a consequence of sourcing some work to India. This is due to a combination of factors: high turnover amongst UK callcentre staff, together with continuing rapid growth in demand for outsourced business process work. The company recognises UK trade unions on sites which were unionised when the company took over operations, but has reached no formal agreements with any of these unions concerning offshoring.

Case study (5): IT and business process outsourcing firm B

The company is an Indian-owned IT, consulting and business services company, which was established in the 1970s. It has clients based in over 50 countries, including multinational companies and government organisations. Its core workforce is in India, and it also has offices in many other client countries. It expects continued growth from worldwide clients, and by 2010 expects to employ 80,000 people.

Background

- It has been providing services to UK companies for over 25 years, most of which is IT consulting and software. Clients come from a range of sectors, the principal ones being banking and finance followed by telecoms. The UK represents about one-sixth of the company's global business.
- The company uses its large workforce in India to carry out most of its work, but has client liaison offices in the UK, as well as employing or seconding Indian staff to work on contracts here. In the last two years it has started recruiting graduates in the UK, who are given company training in India and then deployed back to the UK to work on contracts in this country.

Key reasons for offshoring?

- In response to multinational clients' requests for support to be available globally in languages other than English, its new strategy is to create hubs in various parts of the world to provide local language capability. It has opened development centres in central Europe, staffed by employees from a number of east European countries, in Latin America and in China, staffed by local workers fluent in non-English languages.
- It has also opened a centre in the UK employing staff to deliver a large contract for a public authority, in response to the authority's expressed preference for the work to be done by employees in the UK rather than offshore.
- With this exception, the company has not found that its clients want work done in the UK rather than India. There is no language reason for doing so; and there are no problems of control or specification – projects as large as 300 person-years have been satisfactorily delivered from India.

Case study (6): University

The university has been expanding its offshore provision over the last five years to tap markets that would be otherwise inaccessible. Many students overseas who seek a UK degree find living costs during study in the UK prohibitive but others may be unable to dedicate prolonged periods abroad because of work commitments. The university has around 20 operations in ten countries outside the UK, mostly variations of a similar business model. These operations contribute approximately 1% of total income from teaching. They also provide a revenue stream where physical capacity to host additional students may be limited.

The basic business model is a quasi-franchise with a higher or further education institution overseas. The

franchisee recruits students locally and registers these as UK university students, paying a fee. Students are taught by staff of the franchisee but supported by the UK university with the same course materials as internal students, although there is often room for local customisation. Students have access to online resources of the university. Coursework and exams are validated by the UK university and the students ultimately earn a standard UK qualification. As the programmes offered overseas are already offered in the UK there is only a small marginal cost in terms of administration and supervision.

The key to the success of these operations is the quality control process. The university is very cautious in its selection of franchisees after bad experiences with partners with insufficient resources in staff, classroom or library facilities. There is increasing direct control by the UK university over coursework and exam setting and marking; where some autonomy was allowed in the past, the university concluded that the standards set by franchisees were inadequate on occasion. Quality control is supported by visits to franchises one or two times per year, including some guest teaching by UK university staff, all at cost to the franchisee.

The concern to identify potential partners with sufficient institutional resources to support high quality service provision appears to be the major barrier to further offshore expansion. But the university sees this as only a matter of time as the potential market is very large.

OUTSOURCING AND OFFSHORING
