Business Horizons (2005) **48**, 311—315

Available online at www.sciencedirect.com

SCIENCE DIRECT®

ELSEVIER

INDIANA UNIVERSITY

KELLEY
School of Business

www.elsevier.com/locate/bushor

Outsourcing: Pros and cons☆

Murray Weidenbaum

Weidenbaum Center on the Economy, Government, and Public Policy, Washington University, St. Louis, One Brookings Drive, Campus Box 1027, St. Louis, MO 63130-4899, USA

KEYWORDS
Outsourcing;
United States;
Markets

Abstract Overseas outsourcing of jobs is far more complicated than is generally understood. Pressures to outsource range from better-serving overseas markets to increasing the competitiveness of American business. Outsourcing—domestic and international—responds to management's desire to focus the firm's in-house activities on its core competence. A negative side to outsourcing results from companies doing so simply because "everybody is doing it." They may be surprised by accompanying factors such as unexpected costs and complications, as well. Governmental policymakers need to realize that foreign companies outsource more business services to the United States than American firms send overseas.

1. The complexities of outsourcing

Overseas outsourcing of jobs has quickly become a controversial national issue. Some see outsourcing as a way of maintaining or increasing a company's competitiveness. Many others view outsourcing in a far more negative light, focusing on jobs lost.

Clearly, outsourcing is not a subject that can be effectively dealt with on a bumper sticker or via 30-second sound bites. Let us start with a little background before we ponder on any firm conclusions. Outsourcing involves far more complicated advantages and disadvantages than debaters on either side of the argument are willing to admit.

2. Why do companies outsource?

Many service companies started creating jobs overseas to gain access to foreign markets. They had to audit, consult, and repair where customers were located, rather than telling those same overseas customers that they had to come here. Moreover, many foreign markets have been growing quickly, while some domestic areas have become relatively saturated, or at least mature.

The age of economic isolationism has long since passed. Approximately 60% of the revenue of American information technology (IT) companies originates overseas. That is not unique; in various industries, ranging from banking to consumer products to job placement services, leading firms report that their overseas revenues exceed their domestic sales.

Simultaneously, some domestic businesses hired specialized workers overseas to respond to U.S.

☆ This manuscript was accepted under the editorship of Dennis W. Organ.
E-mail address: moseley@wustl.edu.

0007-6813/$ - see front matter © 2004 Kelley School of Business, Indiana University. All rights reserved.
doi:10.1016/j.bushor.2004.11.001

limits on immigration. When American employers could not get those workers to come here, the need to send the work to them became real. While doing so, the companies learned how to use modern technology to shift the location of work economically. They thus became accustomed to taking advantage of lower costs, both domestic and foreign.

Telecommuting from employees' homes also helped pave the way for some enterprises to extend the process to new suppliers, at home and abroad. Moreover, the shift of some telemarketing and customer service jobs overseas followed an earlier pattern within the United States, when such work was outsourced from urban to rural areas where labor costs were lower (Drezner, 2004).

Most fundamentally, many companies are focusing their efforts on their core competence. It is the rare enterprise that produces an entire product by itself, or even half of the end value. Most businesses subcontract out most of their activities to other companies, mainly domestic. Viewed from that perspective, overseas sourcing is a minor part of the trend to decentralize business operations. Nevertheless, many American corporations came to appreciate how frequently the higher productivity of U.S. workers offset the wage differentials and other costs of operating overseas. Thus, they quickly encountered practical limits to offshore outsourcing. To put the matter bluntly, no company can outsource the management, responsibility, or accountability of its activities.

On the other hand, outsourcing can help a company operate in an increasingly competitive global marketplace. Many U.S. companies learned the benefits of drawing on workers stationed in other countries. Outsourcing can enable a business to provide constant coverage, especially for consumers who need round-the-clock support (Siems & Rather, 2003). It is frequently impractical for a firm to adopt a unilateral policy against outsourcing work, especially when its foreign and domestic competitors are doing so. There is also a growing division of labor. For example, system designers in the United States working closely with retailers may conceive an inventory management software that helps use electronic product tags more effectively, but once the system has been mapped out, the actual software code could be written by programmers in India.

All sorts of adjustments are being made. In 2003, Delta Airlines outsourced 1000 jobs to India, but the US$25 million in savings allowed the company to add 1200 reservation and sales positions within the United States (Drezner, 2004). Large software companies, Microsoft and Oracle, have simultaneously increased outsourcing and their domestic payrolls.

It is important to gain some perspective by seeing the relative importance of domestically and internationally produced services. Much of the current controversy focuses on IT. In 2003, approximately US$120 billion was spent on IT in the United States. While approximately 1.4% was moved offshore, the 98.6% of the work that stayed here was not deemed newsworthy.

In total, about 400,000 U.S. positions in IT have gone overseas. Meanwhile, total U.S. employment rose from 129 million in 1993 to 138 million in 2003, mainly in the service sector. It turns out that, on balance, the international movement of services is quite positive to the American economy.

This is so because American corporations are not the only companies that engage in offshoring. In 2003, for example, the United States imported (i.e., offshored) US$86.7 billion in private business services, which included a lot of relatively low-skilled call center and data entry work done in lower-cost developing countries. However, in the same year, we exported (i.e., companies in other nations offshored to us) US$133.5 billion of private business services. That "insourcing" generated a substantial array of relatively high-skilled jobs in engineering, management consulting, banking, and legal services. On average, "insourced" jobs pay 16% above the national average. A net balance of US$46.8 billion flowed to the United States: a 63% increase over 1994, a decade earlier. Such good news rarely surfaces in the often emotional debate over the issue of offshoring.

3. The limits to and dangers of outsourcing

A word of warning, however, is necessary in the face of current business enthusiasm for overseas workers. Companies who outsource just because "everybody is doing it" may be surprised by unexpected costs and complications. About one-half of the outsourcing arrangements entered into end up being terminated, for a variety of reasons. Some new overseas vendors encounter financial difficulties, or are acquired by other firms with different procedures and priorities (Lutchen, 2004).

Businesses that arbitrarily set a fixed percentage of work to be outsourced will likely regret it. Newcomers to overseas contracting may find themselves dealing with unreliable suppliers who put their work aside when they gain a more important client, or their overseas vendor may