



Why domestic outsourcing is leading America's reemergence in global manufacturing

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Abstract With cost advantages from manufacturing in Asia and Mexico steadily deteriorating, U.S. firms are reassessing the option of domestic outsourcing to remain globally competitive. The challenge in evaluating international versus domestic outsourcing strategic options lies in that first-movers are extremely and intentionally vague about how they reach their decisions. The purpose of this article is to reveal these reasons by providing statistical and firm-based evidence on five major factors that are influencing the decision regarding where U.S. companies should manufacture to optimize their gross profits. The factors include (1) increasingly competitive U.S. labor costs; (2) increasing productivity of the U.S. workforce; (3) increasingly competitive domestic production costs; (4) incentives from federal, state, and local governments; and (5) improved synchronization of production with other business functions.

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1. Incentives for domestic outsourcing

With cost advantages from manufacturing in Asia and Mexico steadily deteriorating, U.S. firms are reassessing the option of domestic outsourcing to remain globally competitive. Domestic outsourcing is a fast-emerging strategy among U.S. firms. It involves a company relocating primary and support activities to America that were previously performed outside the country in pursuit of competitive advantage. Alternatively called 'insourcing' or 'reshoring,' *domestic outsourcing* occurs when an

activity is returned to the United States and is performed by the company internally, when it is shifted to a domestic partner through a strategic alliance, or when it is contracted out to a domestic supplier. However, the firm's intention is always the same: to establish a long-term basis for improving company operation by performing a key business activity in the U.S.

Outsourcing manufacturing activities gained popularity among American firms 4 decades ago as they expanded the search for a labor cost advantage. Currently, outsourcing retains the core objective of increasing a firm's competitiveness but has become global in scope, encompasses virtually all business activities, and is undertaken for a package of justifications—with labor savings representing the

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main but not exclusive benefit considered. Outsourcing has evolved beyond manufacturing to include research and development; engineering and software development; logistics; customer service; information technology (IT); human resources; and accounting, tax, and other professional services.

Expected benefits to the company include the ability to exploit economies of scale and scope offered by vendors, to mitigate technological risk and uncertainty, and to improve a firm's focus on its retained core competencies. Yet, the main benefit sought by outsourcing is cost reduction, with 49% of U.S. firms that outsource internationally indicating cost reduction as the primary reason for their initial decision to move operations from the United States (McCormick, 2011).

In 2012, an initial wave of American businesses captured media attention by announcing their intent to reverse previous international outsourcing decisions and bring those production activities back to the United States. In 2013 the momentum grew, with U.S. corporations across a range of industries and firm sizes declaring plans to produce domestically. The news is largely welcomed. It is predicted that such domestic outsourcing will spur employment, economic vitality, and national pride.

To understand the rebound in manufacturing performance in the U.S., we look to corporations that have newly committed to domestic outsourcing. The challenge in assessing their corporate strategic choice of international versus domestic outsourcing is that these first-movers are extremely and intentionally vague about how they reached their decisions. The platitudes that characterize their announced decisions are intended to create causal ambiguity to prevent competitors from benchmarking many of the factors that influenced their decisions. The purpose of this article is to reveal these reasons by providing insights into five major factors that are influencing the decision about where U.S. companies should manufacture to optimize their gross profits.

2. Conditions turning against international outsourcing

The prominent international providers of manufacturing outside of the United States are experiencing severe reversals of fortune. For example, even in the late 2000s, some U.S. firms chose anew to outsource work to India because manufacturers there could hire employees at wage rates that were far below those demanded in the U.S. However, concerns about rising labor costs and problems with the quality of work in India have eroded the

advantages of operating there. The cost savings of outsourcing work to India have gone from 40%–50% to a current low of 10% (King, 2008).

Similarly, other U.S. firms have outsourced work to Mexico because of its low wage rates, which were often below those required in India. While Mexico maintains some labor cost advantage in manufacturing, there are factors that do not make it a viable source for all outsourced work. The low availability of skilled labor, a cost-ineffective supplier network, and an inferior infrastructure prevent much of the manufacturing done in India from relocating to Mexico.

Propelled by the devaluation of its currency, a reduction of tariffs from its entrance into the World Trade Organization, generous tax incentives, cheap industrial land, and low labor rates, China became the first-choice option for the international outsourcing of manufacturing at the turn of the 21st century. Faced with super-low-cost competition from China, firms that manufactured in the U.S. had to accept relegation to niche specialty markets or move their production to low-wage nations. China became the preferred site for these U.S. companies, especially if they competed in clothing, electronics, or computer manufacturing. However, China's economic progress as a newly industrialized nation brought internal changes that are counterbalancing its low wage rates and degrading its competitive advantage as a provider of manufactured goods. Immature infrastructure, environmental pollution, overcrowding, government regulations, bureaucratic delays, and the perpetual challenges of subcontractor values, cross-cultural decision-making, and long-distance communication increasingly negate the labor cost savings that Chinese manufacturers can offer.

As recently as the U.S. recession in 2007–2009, the ability to perform portions of a business at significantly cheaper costs resulted in U.S. firms outsourcing internationally to Mexico, India, China, and other low labor cost nations. However, major changes are underway. U.S. companies that made the decision to outsource internationally are being induced by economic evolution and competitive innovation to reassess and reconsider the comparative costs and benefits of domestic outsourcing.

Each time a nation's low wage rates led it to become the new hot spot for international manufacturing, the resulting economic invigoration helped propel the country's growth and development. Foreign direct investment and increased trade from the United States and other developed nations stimulate the economic advancement of host countries to such an extent that their domestic costs rise, eroding their advantages as low-cost

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