

Globalization and Outsourcing



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Session 21

The articles suggest a number of questions

- What do recent trends suggest for global strategies (e.g changes in Chinese sourcing)?
- What are strategies for competing in a developed country? When should companies offshore?
- Can a company offshore (and or outsource) completely?
- How important are operations and manufacturing to advanced economies such as the US?
- What are the long-term macro effects – eg specific industries, US economy in general?
- In general, what are the implications for strategy?

First, some background



Some trends

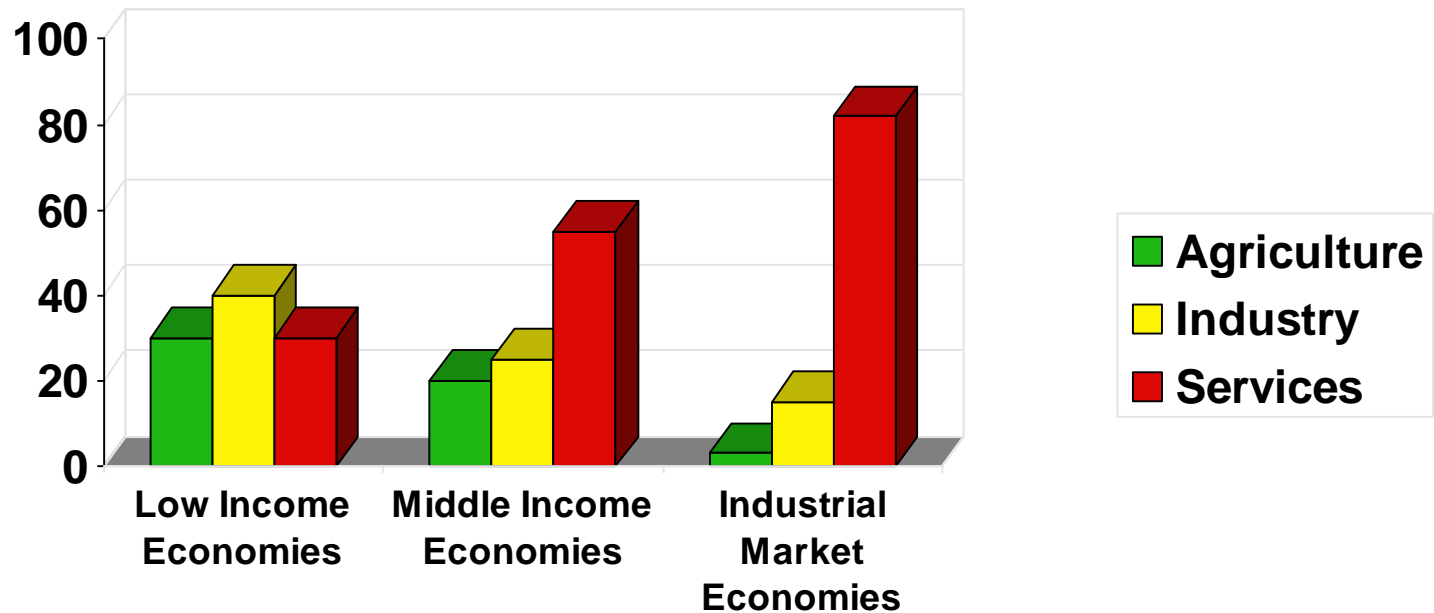
- **Employment in manufacturing has gone down from 50% to 14%**
- **A similar shift took place in agriculture.**
- **Can we (societies such as the U.S.) source goods from China and other locations?**

This concept has been referred as the post-industrial economy.

Some problems with the post-industrial economy

- We did not export or shift *out* of agriculture - - we automated it
- We *linked* agriculture to a large number of jobs (e.g., processing, chemicals, and logistics); the same potential for linkage exists in manufacturing
- Services are by-products of an advanced economy

**Services are the largest share of work and employment
in advanced industrial countries**



**Sources: US Bureau of Labor statistics, 2007 World Development Indicators,
The World Bank**

Other statistics also underscore the importance of manufacturing

- **The US still has nearly 25% of Manufacturing value added (UNIDO)**
- **In general, high income economies have 73% of Manufacturing Value added and 76% of exports (World Bank 2006 data)**



The other big trend: Offshoring



Extent of Offshoring

- **The extent of offshoring is enormous, particularly in the case of China**
 - China exported \$1.2 trillion in 2009, with \$296 billion to U.S. and a surplus of \$273 billion (US-China business council)
 - Labor cost range from 50 cents and up, with comparable differences for skilled designers and developers (China develops 5 times U.S. engineers – *New York Times*)
 - Walmart alone has a significant part of China's exports and GDP

Extent of Offshoring

(cont'd)

- **Economists are split on how the latest trends affect developed countries:**
 - Many cite the economics of comparative advantage
 - Increased job loss arises from improved productivity (comparison with agriculture)
 - Standards rise from importing very-low-cost goods
 - Standards may go down for a number of reasons:
 - Wages are driven down for skilled workers (software) and could extend to a large expanse of the workforce
 - Export prices may decrease due to competition
 - Disruptions caused by shifting



Trends in global sourcing

- Increasing costs in China
- Quality issues “Two-thirds said cheap was the chief attribute of Chinese goods”- *The Economist*, Feb 21, 2009)
- Product problems, suicides etc.
- Questions about labor availability
- Emergence of new consumer markets in China and the other BRICS.

What are the implications of these types of trends



General Patterns of Development

- **Compete on factor costs and industrialize rapidly**
- **Raise the standard of living and transition to higher-value innovative products**
- **Move out of competitive commodities**

These patterns have occurred in Japan, Taiwan, Korea, Hong Kong, and Singapore



So What Will Be the Future?



And what are the long-term implications?

Country	Wage Rate (USD)		Wage Rate growth rate	Year in which wage rate = US
	2005	2010		
Indonesia	0.58	0.77	5.9%	2134
China	0.93	1.39	8.4%	2067
India	1.45	2.03	7.0%	2076
Mexico	2.5	3.09	4.36%	2164
Thailand	2.9	3.97	6.5%	2066
Czech republic	5.4	10.86	15.0%	2018
South Korea	11.5	23.03	14.9%	2012
United states	23.2	26.76	2.9%	NA



“When to Offshore?”

- **Let’s consider the two extreme options**
 - Offshore and chase the lowest factor costs
 - Always produce where demand is – a home-based strategy



“Factor-Cost” Based Strategy

- **Offshoring in general suggests a “factor-cost” based strategy**
 - Factor cost differences are enormous
 - The larger supply chain compounds the differences
 - Offshore locations are developing capabilities in higher value products
 - While the full costs of global outsourcing need to be added, the differences are still often large
 - The comparative advantage argument suggests focus on other industries



When will a home-based strategy work?



But can a company outsource completely?



Grove's question: Scalable manufacturing companies

- And what will be the end game?
- What are the implications for specific industries
- What are the implications for public policy
- And what are the implications for company strategy

Some final thoughts

- **Whether and where to offshore**
- **When to stay in developed countries**
- **The dynamics of offshoring**
- **Importance of manufacturing and operations to both developed and developing countries**

