Globalization of work: Outsourcing and offshoring

Martin Kenney

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First it was manufacturing that crossed borders and oceans in search of cost efficiencies, now it’s the service sector that’s making the leap in increasingly larger numbers, said Martin Kenney in his address to the Global Executive Forum.

Just as China is the manufacturing center of the world, India is fast becoming the country of choice for the services sector. “We might think of physical work being outsourced to China and mental work to India” said Kenney.

“Services have been globalized and any activity not requiring direct interaction with the local marketplace or immediate physical delivery is susceptible to offshoring.”

Kenney clarified the terms offshoring and outsourcing. When a company in the United States contracts with another US company to perform specified functions, it’s called outsourcing. When a US company outsources to a company overseas, it’s called offshoring. “Offshoring can be accomplished either through a subcontractor such as Accenture or Tata Consultancy Services, or through a wholly owned foreign subsidiary or a captive unit in an existing overseas firm.”

The big growth in offshoring has been in services. “If you have kids, you probably don’t expect them to be a production engineer or a factory worker. You expect them to go into some of the service sectors, and that’s where the growth has been in the US economy, accounting for nearly 40 percent of private employment in 2003.

“And that’s why India is so interesting and why it’s so important to start to think about India’s impact on the global economy,” said Kenney. India is receiving the bulk of developed nations’ relocated business services, a growth rate of 30-50 percent a year. Already well established as a destination for software services, this sector is growing by 20-25 percent a year; the US accounts for 65 percent of this growth.

Significant savings

The economic downturn of 2000 caused multinational companies to look for ways to shave costs. India became the solution, with labor costs at 25-40 percent of what they are in the United States. The savings are not limited to just entry level or call center jobs. For example, in the US someone with five years of Java EE experience and a CS/EE degree earns $55,000-$80,000 plus benefits; in Bangalore the salary is $6,000 including benefits. A Ph.D. statistician in India earns $30,000-$40,000 a year compared to $200,000 in the US. Furthermore, Indian workers are skilled in a wide range of categories and are willing to perform the more mundane tasks that US workers are less inclined to do.
Globalization of work: Outsourcing and offshoring

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Can the US economy adjust?

A remarkable aspect of service offshoring is the rapidity with which it can occur. Manufacturing’s movement offshore was a gradual migration that began in the early 1960s. Though punctuated by dramatic factory closings, there was an opportunity for the U.S. economy to adjust. This may not be true in services where the “objects” are pixels and electronic pulses that can be transmitted by photons and radio waves (Cohen et al. 2000; Kenney 1997). A number of the firms we studied in India experienced vertiginous growth as they expanded from start-up to 5,000 employees in less than three years. When a large number and variety of firms experience such growth rates, the cumulative effect can be enormous indeed.

- Moving Services Offshore: A Case Study of an U.S. High-Technology Firm
  Martin Kenney & Rafiq Dossani
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Being able to realize significant savings is motivating more and more corporations to centralize certain global processes in India. IBM, Hewlett-Packard, Accenture, Dell, HSBC, Citicorp are all growing their Indian operations by 30 percent a year. JP Morgan Chase and Progeon are growing at 50 percent.

The processes being relocated go beyond software services. They include call centers, R&D, medical image analysis, data entry, equity analysis, financial analyses, human resources, global purchasing management. “We’re starting to see some pretty sophisticated equity analyses going on in India.”

Kenney talked about a multinational corporation that offshores its finance and non-finance processes to India. A whole spectrum of functions falls under those headings: sales administration, revenue accounting, accounts payable/receivable, vendor data management, inventory accounting, a customer response center and much more.

As multinational companies ramp up their activities in India, they are beginning to give select workers decision-making responsibilities, “something that two years ago I didn’t think would happen,” Kenney said. “They are not making the final decision but they’re doing judgment-based work. So they’re going beyond the preparation of statistical reports and other routine work.”

To keep this development in perspective Kenney stressed that “we’re still talking about very small numbers, one-tenth of 1 percent of the Indian population.”

A pressing issue

How and to what extent offshoring will affect the career paths of US college graduates in the future is a pressing issue. Kenney was told by a woman from a major international bank that the bank is increasingly hiring junior analysts in India whereas it used to hire graduates from the top Ivy League schools in the US. A graduate with an economics degree would become a junior analyst at a starting salary of $45,000 a year and move up rapidly from there.
Globalization of work: Outsourcing and offshoring

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The bank will still hire in the US, Kenney was told, but the new hires won’t be paid bonuses anymore because they’ll be working on the same team with Indians who are being paid far less. Looking down the road 10 years, she said it won’t make sense economically to have a junior analyst in the US.

How can American university graduates develop the skills they need to become senior decision makers of an organization if they can’t get work at the entry level?

“Many universities are thinking about what the American engineer of the future looks like,” said Kenney. “He or she probably looks more like a networker that pulls together different elements from different locations around the world. How many of those jobs will be available is another issue, but those are the kinds of things educators are now thinking about, particularly in engineering. In the social sciences, we have not yet started to think about the effects of services offshoring on the students of the future.”

All is not rosy

India’s continued growth depends on how it deals with challenges that are clamoring for attention.

“Indian universities are in trouble because they’re losing their smartest mathematicians, statisticians, etc. to global companies with offices in India,” said Kenney. “An Indian professor gets paid little more than a call center employee and can be hired away for $20,000-$25,000 a year.

“The best graduate students in India have come to the United States because, generally, the graduate level education in India is poor to mediocre.

“The Indian government is aware of the problem; whether they can do something about it is another question.” Lacking adequate funds, the government is moving slowly in making improvements to its university system. The Chinese government, meanwhile, is making a huge investment in upgrading its universities, knowing that’s the only choice if they’re going to compete in the global arena.

“Another problem for India is a lack of seasoned middle level management, a condition that also afflicts China. But it’s particularly evident in the services sector where the growth is so rapid that you’re a seasoned manager if you have a year or two experience.

“How large will this services offshoring be? It will be a repeat of manufacturing. How fast will it develop? Operations are growing at 30 percent per annum so it could be very fast if it continues.

“Nowadays a Silicon Valley venture capitalist tells an entrepreneur that they must have a strategy about India and China,” said Kenney. “As a result, firms are global almost from their inception. The team starts in the valley but almost immediately they’re building a software operation in India as back office and they’re thinking about manufacturing in China.”

Policy dilemmas at state and local levels

The relocation of services offshore has the potential to reorganize the global economy in the same way as the movement of manufacturing to China has been emblematic of a reorganization of goods production. For the developed nations already reeling from the continuing loss of manufacturing jobs, the emergence of India and the Philippines as outsourcing options for firms aiming to lower the costs of
providing services creates significant policy dilemmas. State and local governments are considering laws forbidding the offshoring of government-related services. These protectionist responses may increase if the current trends continue but are unlikely to affect private sector decisions.

- *The Impacts of Service Offshoring on Nonmetro America: Thinking about the Future*
  
  Kenney & Dossani

**Growth in the services sector**

According to the U.S. Bureau of Labor Statistics in the fourth quarter of 2003, 83 percent of the U.S. non-farm employment was in the services, and only 11 percent was in manufacturing.

During the 1990s more than 97 percent of the jobs added to U.S. payrolls were in services (Goodman and Steadman 2002: 3). Of these, business services and healthcare accounted for more than half of the total growth. Moreover, business-oriented services grew from 30 percent of the total service employment in 1988 to 36 percent of the total employment in 2001, while consumer-oriented services fell from 55 to 52 percent (Goodman and Steadman 2002: 8).

One recent study estimated that call centers alone employ as much as 3 percent of the work force of the U.S. and there are estimates that this will increase to 5 percent in 2010 (CRM Project 2002).

- *Moving Services Offshore: A Case Study of an U.S. High-Technology Firm*
  
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