The management of change: outsourcing and offshoring

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In the following article, Peter Sheldrake discusses the elements and drivers of globalisation and the implications of the growing trend in outsourcing offshore by Australian and overseas companies, including the benefits, concerns and emerging possibilities and challenges. This article and the accompanying questions and tasks for students could be used when examining globalisation as a significant change issue for large-scale Australian organisations in area of study 2 of Unit 4.

Go to ComNET <www.vcta.asn.au> and download the website references for Task 9 from Compak Supplements 2006.

The word ‘globalisation’ has achieved remarkable recognition in recent years—as a description of the current world in which we live, and as a symbol of many of the things people find wrong with the world. Here I want to explore what globalisation means for business, especially Australian companies, and to explore some of the issues that global trading presents. In particular, I want to examine the current ‘hot’ issue—outsourcing offshore.

ELEME NTS OF GLOBALISATION

First, what do we mean by ‘globalisation’. It seems there are three elements of this that can usefully be distinguished. First, for many businesses it refers to the fact that markets are now global, and companies sell their products and services around the globe. This has become even more striking as the Internet has enabled immediate, online selling and purchasing—anywhere, any time.

Second, globalisation refers to the sourcing of activities for the enterprise: products may be designed in the USA or Sweden, made in Chile or China, marketed through Belgium or Brazil, and the finances managed in India or Ireland. It is this sense of globalisation that is linked to outsourcing. For some countries, most noticeably the USA over the past year, outsourcing offshore, or offshoring, has become very contentious. It is seen to reduce costs, and at the same time reduce jobs for those working inside the country.

However, before we examine this issue more closely, it is important to recognise that, finally, globalisation is used in yet another sense. This is where the term refers to the increasing emergence of global institutions. There are two kinds we can immediately identify. The first is companies (the world’s largest company in terms of turnover is claimed to be Wal Mart, which currently has annual sales in excess of $250bn, an amount more than the GDP of many medium-sized countries). Equally important is a wide range of global regulatory bodies like the World Trade Organisation (WTO), the International Monetary Fund (IMF) and the World Bank. These bodies have done a lot to promote offshoring, by helping to reduce barriers to trade and investment, and encouraging countries to seek to offer products and services to one another. In many ways the effect of these measures has been to encourage low labour cost countries to take on tasks for other countries where these costs are much higher.

THE DRIVERS OF GLOBALISATION

Why has globalisation become such an important issue on the business agenda? There seem to have been two principal drivers. As we have just noted, international bodies have played a critical role. In particular, the WTO (and before that the General Agreement of Trade and Tariffs—usually known as GATT) has progressively introduced agreements and measures designed to reduce trade and tariff barriers, making investment and trade in other countries much easier than it used to be.

The second driver towards increasing globalisation has certainly been technological change. There have been two elements to this. The first was mentioned above—the impact of information technology and communications technology (IT) changing access and reach through the Internet, and especially the World Wide Web. However, a second and equally important change has taken place in transportation technologies,
especially through the development of containers and container-handling systems (as well as improvements in packaging, miniaturisation, and greater efficiencies in automotive and other transport systems).

While these two drivers have been critical, there is a third element to globalisation that has also played a key role, and this has been the slow emergence of new major industrial nations. After the Second World War, the USA was the dominant business nation. In the 1970s and 1980, Japan became the second big player, and slowly but surely, the countries in the European Union also returned to importance. In the last decade we have seen the first steps in the emergence of major Chinese companies and in the last few years Indian companies also. This is leading to a world in which there are major trading nations, and major enterprises, all across the globe.

Of course, it is important to see these things in perspective. The world has been ‘global’ before. While we can argue about the reach of the Roman or Chinese empires in the past, there is no doubt that the 18th and 19th centuries were times characterised by extraordinarily high levels of world trade, driven by the dominance of a small number of enterprises in the United Kingdom, and to a lesser extent in some other continental European countries. Globalisation is not new, but given the extent to which we see global corporations with operations spread all over the world, this current phase of globalisation seems to be particularly extensive. Today many companies have plants and centres in dozens of countries, and have complex supply links bringing these various operations together. Offshoring has become a way of life for many of the world’s larger enterprises.

**IMPLICATIONS FOR AUSTRALIA**

All this has had important implications for Australia. For a long time, we have been a major supplier of raw materials or semi-processed goods to other nations—these have ranged from wool to countries like Italy, where they have made jumpers and other woollen goods; iron ore and coal to countries like China to help them power the growth of their manufacturing sector; and bauxite and alumina to companies around the world, for canning goods and drinks, and allied activities.

** Outsourcing non-core operations**

However, in the past our involvement with other countries has largely been through seeing opportunities in terms of a simple export business model—we sell things to others. Slowly, we are now coming to terms with the possibilities presented by the current global world. This means that we could not just sell raw materials, but actually outsource the use of those materials and others, to make goods for us, keeping the design, knowledge management and marketing in Australia. Indeed, many have argued that if we do not start such an outsourcing strategy, we will find international competition getting tougher and tougher as we try to challenge companies whose manufacturing costs, for example, are driven down by using cheap labour in emerging countries.

A good example of this comes in the instrumentation field. The design and development of scientific instruments has been a niche in which small Australian companies have excelled over the years. However, our labour costs are high, and our excellent instruments are costly. If we wish to remain a leading supplier in this area, specialising in some types of instrumentation (especially in areas like biotechnology where we have a worldwide reputation), the actual manufacture of components and assembly should be undertaken in low-cost countries like China. Even some of the detailed design work can be outsourced to countries like India and Brazil. We need to keep control of the key scientific elements in design, the patents, and the development of partnerships with major users. However, much else can be done for us, more efficiently and more cost effectively than we can manage.

** Outsourcing our technical know-how**

Another interesting area is knowledge management, especially when we look at such activities as customer relationship management (CRM). We are developing some very sophisticated systems in supermarkets and retail stores in Australia and instead of just applying these to running these businesses better, we could be
offering the same services to companies around the world. Similarly, we have developed some very sophisticated farm management practices using IT and satellite imaging. To date, we have tended to see these systems as improving our own agricultural sector. However, perhaps we should be focusing on these systems in themselves, and seeking to have them used around the world, outsourcing their application to countries where labour costs and land availability are more conducive to large-scale crop farming.

THE EFFECTS OF OUTSOURCING
Benefits and concerns
Each of the examples described above makes the same point from a business point of view. If a company is involved in areas where labour costs are an important part of the business activity, it is important to see if these can be reduced by using labour offshore, choosing locations where these costs are much lower.

The cost savings have to be balanced against the other costs involved in offshoring, of course. Transportation costs have been dropping, but they can still be a major element where the business makes products, and the manufactured goods are large or heavy. Not all offshoring involves physical goods, of course. Airlines and banks have used call centres offshore to offer 24-hour service, and to reduce their overall costs. Increasingly in certain specialised areas we are finding that even expert tasks can be offshored. A number of hospitals use radiological staff in countries like India to assess patient MRI scans, as they can do this using digitised information, sent virtually instantaneously, again benefiting from the fact that their labour costs are much lower than our own even for highly trained professionals.

Of course, there are concerns about outsourcing. If we ask other countries to manufacture for our companies, what happens to the jobs of those who had previously done this work in Australia? There are many arguments about outsourcing and its effects, but it is undeniable that there are two clear consequences: those whose skills are now being replaced by outsourcers will lose jobs; and second, while new areas of employment often arise, they tend to require new skills. There are at least two sorts of new skills. Some are knowledge based—like the design skills referred to above. For many workers, retraining in these areas is often impossible. The other sorts of skills are in emerging or new areas of activity, especially in the delivery of personal services, such as aged care, health care and child care. As some critics have argued, these may be less well paid than other jobs that have been lost to outsourcing.

Emerging possibilities
Are there other possibilities? There are two you might think about. First, perhaps we can be an ‘in-sourcer’, and bring in work from overseas. There are some obvious examples—the reverse of what we see at present. Australia companies could offer design skills, or knowledge management skills, for major manufacturers in countries like China where the advanced skills base is small and limited. We also have some areas of ‘natural advantage’ like tourism, and we could be offering ideal working conditions for some categories of staff working for multinationals who want a better lifestyle.

Second, there are some other roles we can play. One that is emerging in importance is being an intermediary—an idea that Singapore jumped on many years ago. Singapore is a small country, and has virtually no natural resources. However, it carefully positioned itself as an entrepot—a ‘port’ that received, assembled and delivered goods, taking in cargo from Europe and North America, and then shipping it on to Southern and Eastern Asian destinations.

Today we need another kind of intermediary—people who can assemble relevant knowledge, and use it to bring together skills and requirements. In particular, there is a pressing need for ‘digital intermediaries’, people who can find the right digital material needed by someone—whether it is technical information, or simply planning an itinerary. The advantage of this kind of work is that you can do this anywhere, but you do need clever, digitally adept people, and Australia has many of these.

One of the problems associated with outsourcing manufacturing to countries such as China is the environmental impact—industrial pollution and automotive pollution are becoming a major challenge.
1 Using the article and your textbooks, define the following key terms:
   a globalisation
   b outsourcing
   c offshoring
   d insourcing.

2 In your own words, summarise the drivers of globalisation as outlined in the article.

3 In a two-column table, list and explain some of the advantages and disadvantages of outsourcing to Australian businesses.

4 Explain some of the steps you would envisage a large-scale organisation would take before outsourcing any of its operations.

5 Identify the stakeholders that might be affected by a business deciding to outsource some of its operations offshore. Discuss how they would be affected.

6 Identify and explain the strategies management could use to overcome resistance to offshoring by these stakeholders.

7 Working in pairs, on a large sheet of paper brainstorm what globalisation means for Australian large-scale organisations, including:
   • advantages
   • disadvantages
   • how Australian businesses could take advantage of globalisation
   • impact of globalisation on internal areas such as management structures, organisational culture, operations management and human resource management.

As a class, discuss the results of your brainstorming session. Add any new points to your sheet.

8 Use a concept map to create a summary of area of study 2 in Unit 4 for revision purposes. Include the following areas in your concept map:
   • change management
   • driving forces for change
   • restraining forces for change
   • a change management theory
   • tactics used for effective change management
   • globalisation—its key elements and drivers
   • outsourcing—advantages and disadvantages
   • impact of globalisation on the internal environment of large-scale organisations.

9 Research five examples of outsourcing offshore by large-scale organisations and the impacts of the move—both positive and negative. For each company, state:
   • the business function(s) being outsourced offshore
   • the reason(s) for going offshore
   • the drivers of the move (for example, improved communications technology)
   • expected benefits
   • potential risks.

Suggested references
• ‘Going global: outsourcing HR offshore’, Human Resources website, 27 July 2005, <www.humanresourcesmagazine.com.au>. Type the title in the search box, or go direct to <www.humanresourcesmagazine.com.au/articles/21/0c032921.asp>. This article discusses the outsourcing decisions of a number of companies, including Proctor & Gamble, Qantas, Optus and Coles Myer.
• Kraft Foods media releases, <www.kraftfoods.com.au>, click on → Newsroom:
  – ‘Kraft Foods Australia announces closure of Broadmeadows facility’ (11 January 2006)
  – ‘Kraft Foods Australia to outsource warehousing’ (18 May 2006)
The challenges we face today
That leaves two more challenging problems. First, as we outsource, so we may be contributing to other problems that are not so visible. One example is environmental issues that are aggravated by outsourcing manufacturing to a country like China. Those who have visited China in recent years will be aware that industrial pollution (as well as automotive pollution) is becoming a major challenge. The more we outsource manufacturing to countries like China, the more we get rid of our pollution problems by creating even bigger ones elsewhere.

The other problem is even more controversial. As countries become more and more involved in outsourcing, their companies begin to work across national boundaries. This raises all sorts of issues about sovereignty and where the limits of national responsibility over companies are reached. Perhaps this is a further step in creating a truly global world, and a consequence we should applaud, just as we should be pleased to see standards of living improving in most countries. However, not everyone sees it that way.

At the beginning of the 21st century, the processes of globalisation, and with them outsourcing and offshoring seem unstoppable. Of course, this may change. However, in the immediate future this is unlikely to happen. In this environment, the issue for Australia is simple: outsource and offshore to allow companies to remain globally competitive—but create other problems; avoid those problems, but live with uncompetitive enterprises, and see our economy decline. Choices are never easy, but many Australian companies are starting to choose the former course, as Rip Curl did when it decided to move its manufacturing offshore. Next it will be Vegemite being made in Cambodia ... or perhaps it already is!