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

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
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?

<table>
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<tr>
<th>Country</th>
<th>Wage Rate (USD)</th>
<th>Wage Rate growth rate</th>
<th>Year in which wage rate = US</th>
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<td></td>
<td>2005</td>
<td>2010</td>
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<tr>
<td>Indonesia</td>
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<tr>
<td>United states</td>
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<td>26.76</td>
<td>2.9%</td>
</tr>
</tbody>
</table>

Source: Presentation of Jeff Wilke, Amazon.com
“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