MGT 377 Module 5 Lecture Notes
Global Outsourcing: Advantages and Disadvantages

We will learn about outsourcing and how one company navigated the murky waters of global outsourcing and offshoring. This is based on real events, but due to confidentiality agreements and a code of ethics, the name of the company that will be discussed will not be disclosed; however, it is a consumer and packaged goods company that specializes in food manufacturing.

Outsourcing Versus Offshoring

Outsourcing and offshoring are terms that are often used interchangeably, but there is a slight, but important, difference.

Outsourcing involves contracting with a supplier to manufacture something that is currently done in-house. This may or may not involve some degree of offshoring.

Offshoring is the transfer of an organization's functions to another country, regardless of whether the work is outsourced or stays within the same company. Organizations may choose to set up shop and produce their own products in different country or they may engage another organization to manufacture or produce their product.

For the company that is under discussion, the organization made a decision to both outsource and offshore their help desk functions for IT applications. For the new installation of IT applications, those applications were supported by an outsourced company located in the United States. Once the dust settled on the IT installation, the long-term support of those applications typically moved to an outsourced and offshored company in India.

Typical Costs Associated with Outsourcing

In comparing the cost of currently insourced products to outsourced products, the direct and indirect costs are fairly simple to assemble.

For direct costs, the company must capture the invoiced cost or price of the products, freight costs, and any tariffs. For indirect costs, the company must capture the cost of purchasing, receiving, inspection, and stocking costs.

Unfortunately, in arriving at a total cost of goods sold, it is not as simple as looking at only the quantitative factors.

Assessing the qualitative factors that go into a decision to outsource or offshore, companies must assess the ease of use when contracting with a company that may be halfway across the globe. In global outsourcing situations there are often language and cultural differences that must be overcome. Finally, time zones will become an unfortunate reality for managers needing to conduct teleconferences with their counterparts across the globe.

While these may be some tough factors to quantify in a cost analysis, they are important considerations when evaluating global outsourcing.

For the company that outsourced their long-term IT support needs, they experienced all of the aforementioned qualitative factors. And while not completely happy about the situation, the cost advantage to continuing to outsource their IT support needs superseded all of the qualitative factors and the company has maintained their global arrangement.

Sourcing Decisions

When making the decision to outsource or offshore a service or the production of components, companies can embark on several strategies.

Single sourcing with one supplier generally offers the greatest short-term cost savings and can become the foundation for long-term strategic partnerships. However, when embarking on a single-source strategy, company executives must realize they have created a “one horse race” for future negotiations and may increase their risk factors by having only one supplier.

In contrast, a strategy of *multiple sourcing* involves the use of several providers for the same good or service. Multiple sourcing can create positive competition among suppliers, but generally creates added coordination for the purchasing group and lessens the purchasing power of the organization.

Many purchasing professionals feel that a strategy that combines the best of both worlds is *cross-sourcing*. In cross-sourcing, the organization uses a single supplier for a component, but also buys a different component from a supplier with similar capabilities.
In this situation, the organization may capture a lower cost of goods by single sourcing components, but keep the door open to other suppliers in the event of an emergency or to access supplier insight.

The company discussed in this discussion created a cross-sourcing strategy. By keeping the IT start-up help desk issues in the United States and then offshoring the long-term IT support to India, the company was able to get the best of both worlds: local support for high-intensity issues, a low cost structure for long-term maintenance, and a secondary supplier in the event of emergencies.

Reasons for Outsourcing

So what are some of the reasons for global outsourcing?

First, would be the potential for *lower cost of goods*. Globalization has the potential to lower the overall cost of goods to the organization. In most cases, the component cost will be greatly reduced, but organizations must look at total landed cost with the inclusion of some qualitative factors to determine if outsourcing is the right decision.

Another reason for outsourcing is *improved quality*. It is sometimes hard for some company executives to stomach, but it is a hard reality in many situations that someone else can do the job better than your organization. Quality deserves careful consideration in any outsourcing decision.

Also, knowledge or *access to intellectual property and wider experience and knowledge* can help companies improve their products through unrealized synergies.

Next is *reduced time to market*. The use of an outsourced supplier can, in many cases, allow the manufacturing organization to parallel-path the development and manufacture of the finished good and thereby reduce the time to market.

Additionally, *risk management* is an important consideration in outsourcing decisions. Outsourcing some manufacturing may actually reduce the firm's overall risk management position by having multiple suppliers scattered throughout the world.

Finally, *financial incentives* are often another reason to consider global outsourcing. Just as cities and states do in the United States, some countries will use government funds to lure businesses to their country.

Disadvantages to Outsourcing

Although there are often advantages to moving operations or services, the road to outsourcing and offshoring is not always easy.

With offshoring, there is the potential for security issues with traveling managers and the potential for litigation problems further complicated by differing cultures, norms, and laws.

Just finding qualified and reliable suppliers can be difficult.

Global outsourcing also has a greater potential for the disruption of supplies. Shipping ports are notoriously plagued with problems that can lead to increased safety stocks.

While we did identify access to intellectual property and higher quality as potential advantages to outsourcing, the reverse is also true. Many outsourced and offshored products suffer from lower quality standards. Further complicating the situation is the resolution of the issue with a company halfway around the world and in a vastly different time zone.

Lastly, not all global companies play by the same ethical standards. In many cases, the outsourcing of manufacturing has led to pirating of knock-offs that are sold by the contracted manufacturing company into other foreign markets. Recapturing these lost revenues is a difficult process for most United States companies.

Summary

So what did we learn?

First, we learned that outsourcing and off-shoring need to be carefully considered before moving forward.

Potential advantages include: lower labor costs, lower capital requirements, access to intellectual knowledge, the potential for improved time-to-market, and greater risk management.

Second, we learned that potential disadvantages include: potential security and litigation issues, identifying qualified and reliable suppliers, disruption of supplies, low product quality, slow time to market, and difficulty in protecting confidentiality.

Third and lastly, we learned that all of these factors make the decision to outsource or offshore a difficult decision, but one that companies must evaluate and plug into their long-term strategy.