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Effects of offshore outsourcing on a nation

Amulya Gurtu^{a,*}, Cory Searcy^{b,1}, M.Y. Jaber^{b,1}

^a Austin E. Cofrin School of Business, University of Wisconsin, Green Bay, 2420 Nicolet Dr., Green Bay, WI, 54311, USA

^b Department of Mechanical and Industrial Engineering, Ryerson University, 350 Victoria Street, Toronto, Ontario, Canada M5B 2K3

ABSTRACT

This paper analyzes the effects of offshore outsourcing at a macro level for a nation. It contains trend analyses of national data to address the research question “Does offshore outsourcing correlates with economic growth and prosperity of the people at large and in the long run for an outsourcing nation?” by analyzing various economic indicators. This paper pays a special attention to how employment rates and revenues from imports are affected by offshore outsourcing. Further, the paper contrasts these trends for the USA and Germany. The analyses of the data collected show that offshore outsourcing affects a nation’s economic growth and the prosperity of its people. The findings suggest the need to promote local/regional manufacturing in/near the country of consumption.

Keywords: Offshore outsourcing; Social sustainability; Social costs; Globalization; Taxes; Import duty

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1. Introduction

Outsourcing of business activities is not a new concept, but the effects of offshore outsourcing of manufacturing activities are not yet completely understood. Globalization of sourcing has continued to expand and rapidly changed over the last two decades and has provided strategic advantages to organizations (Hitt et al., 2006). The fundamental underlying belief about globalization of sourcing is that it saves money because of economies of scale or the operating efficiency of the outsourcee (Ramamurti, 2004; Doh, 2005; Farrell, 2005). A key driver for outsourcing is that an organization may not have the competency to run a function or perform an activity. It may also not consider an activity or a function closely aligned to its core business, e.g., security or food services in an automotive organization, and therefore it is left to another party to manage. Either way, outsourcing ought to translate into growth in the bottom line (i.e., net profit), assuming no change in the top line (i.e., sales revenue).

The strategy to outsource is rarely expected to affect the top line of the sourcing organization. The expectation

of an increase in the bottom line as a result of offshore outsourcing is accompanied by some unstated assumptions. For example, there is the assumption that the cost advantage due to economies of scale, higher operating efficiency, or an advantage in currency conversion, will be maintained by the organizations fulfilling the outsourcing needs. There is also an implicit assumption that there is an infinite supply of fossil fuel and, hence, transportation cost will increase in line with normal inflation over time (Bonney and Jaber, 2011). However, the supply of fossil fuel is finite, and its prices are affected by demand and supply. Hence, the cost of fossil fuel, despite the recent lowering of crude oil prices, and in turn the cost of transportation has been increasing at a rate much higher than the overall inflation (Gurtu et al., 2015).

There are many interrelated areas of offshore outsourcing that have not been explored either at all or in sufficient detail. This paper addresses those under-researched and important parameters, and provides insight into the effects of offshoring on the outsourcing nation and its people at a macro level. However, it is not possible to address all of the possible parameters that are affected by outsourcing in one

* Corresponding author. Fax: +1 920 465 2660.

E-mail addresses: gurtua@uwgb.edu (A. Gurtu), cory.searcy@ryerson.ca (C. Searcy), mjaber@ryerson.ca (M.Y. Jaber).

¹ Fax: +1 416 979 5265.

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paper. Specifically, the paper addresses the following research question: “Does offshore outsourcing correlates with economic growth and prosperity of the people at large and in the long run for an outsourcing nation?” The USA and Germany are used as examples to explain how a nation’s financial situation, e.g., increase in national debt and budget deficit, is affected by offshore outsourcing and how this affects a society. The focus in this paper is particularly on the changes in employment and imports related to offshore outsourcing. The analyses show a steady decline in employment in manufacturing as well as a decline in collection of revenue from import duties, while imports related to offshore outsourcing have been increasing. This paper further suggests a number of measures to counter the negative effects of offshore outsourcing.

2. Literature review

While there is a lot of literature available emphasizing the benefits of outsourcing, there is relatively little literature that systematically reviews the negative effects of offshore outsourcing on a nation as a whole. As an example, Meyer (2004) argued that the role of multinational organizations is very important in the development of emerging economies and found that the role of multinational enterprises due to outsourcing in developing economies is a net positive. However, Funk et al. (2010) investigated consumer behavior towards the willingness to purchase products with “branding, design, manufacture, assembly and part sourcing” from various countries and found that consumers are reluctant to purchase such hybrid products which are a result of offshore outsourcing. Kahai et al. (2011) have acknowledged the hardships faced by thousands of workers and many communities due to offshore outsourcing, yet ultimately argued in favor of it due to the prosperity it brings to many workers and communities in outsourcee countries. In their research on information technology (IT) services, Pfannenstien and Tsai (2004) focused on the cost savings benefits of offshore outsourcing. They too acknowledged the loss of jobs in the IT industry in the outsourcing country and did present the challenges of protecting intellectual property in the case of offshore outsourcing, but did not otherwise deeply examine the adverse effects of outsourcing. Incidentally the question of protecting intellectual property in offshore sourcing has been raised in recent times as well (Zhou et al., 2014). Nassif and Roe (2009) also acknowledged the problem of job losses due to outsourcing and explored potential solutions to this issue. They attributed the present high school education system in the USA as the driver of outsourcing and recommended implementation of foreign language requirements and more rigorous math and science programs in high schools. This is a novel argument, as the USA has generally not had a shortage of skilled workers and other literature does not indicate that the quality of American high school education is a driver for reversing offshore outsourcing or job losses.

The globalization of economic activities is not a new concept; however, many challenges associated with globalization continue to persist. Aizenman and Jinjark (2009) explored the impact of globalization on tax collection in developing countries between 1980 and 1999, and concluded that it become harder. The authors found that globalization shifts “tax revenue from ‘easy to collect’ (tariffs and seigniorage) towards ‘hard to collect’ taxes (value added and income

taxes)”. They also observed that “trade and financial openness have a positive association with the ‘hard to collect’ taxes, and a negative association with the easy to collect taxes”. Keuschnigg and Ribi (2009) studied the impacts of outsourcing of labor-intensive activities to low-wage economies and concluded that outsourcing raises unemployment and social welfare costs for low-skilled labor. The authors found that outsourcing helps only a small section of people at the top in corporate organizations in outsourcing nations. They also suggested changes in unemployment insurance policies to take into account these realities. Bahrami (2009) examined the longevity and financial impact of offshore outsourcing and concluded that offshore outsourcing will continue to exist and expand. According to the author, it is an irreversible process due to its advantages and the USA should embrace it as a fundamental structural change for the good of the larger population in the world. The author also added that offshore outsourcing is beneficial for the economy as a whole in the long run.

McBeath and Ball (2012) addressed the challenges of technology transfer between locations and suggested five key themes for successful knowledge transfer. These themes are (i) “willingness to share information”, (ii) “willingness to receive information”, (iii) “explicit knowledge transfer”, (iv) “tacit knowledge transfer” and (v) “verification”. Zhang (2011) analyzed the impact of offshore outsourcing on unemployment and found that an increase in aggregate employment comes at the cost of intensifying resource misallocation, which causes a net welfare loss to the outsourcing country. Briggs (2005) presented a case study about outsourcing of new claims processes at Blue Cross of Northeastern Pennsylvania to India in 2003. According to Briggs, the biggest motivator for outsourcing was the significant savings in salaries (one-third of their counterparts in the USA). However, Briggs (2005) noted that management had concerns regarding the “quality” of work being outsourced. In a balancing statement, he mentioned that there are no guarantees that domestic outsourcing companies are any less risky and that it is a false sense of security to assume that just because the employees are in the USA, quality is assured. Park and Ro (2013) discussed some of the issues in sourcing decisions and how they can impact the quality of performance of a product. They recommended a greater need for a study on the impact of performance due to outsourcing decisions. Maruchek et al. (2011) also expressed concerns about product safety in offshore sourcing and identified four areas, “regulation and standards, product lifecycle management, traceability and recall management, and supplier relationships”, for improvement to reduce product safety issues.

Greenemeier (2001) raised the idea that offshore outsourcing is considered as a strategic choice due to the sluggish economy and the aftermath of the attacks of 9/11 on the USA. The author also argued that savings from IT outsourcing can be as high as 25%, which is motivating IT organizations to look for offshore options. Tafti (2005) addressed the risks associated with offshore outsourcing in IT and presented a framework of how a firm can overcome them. Aves (2001) studied outsourcing of furniture manufacturing and presented a twelve point checklist for minimizing risks. Stamm (2005) observed the outsourcing paradox especially for firms leaning their operations. The author found that offshore outsourcing by organizations added a factor of complexity in managing their supply chains. The author also mentioned

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