

# 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

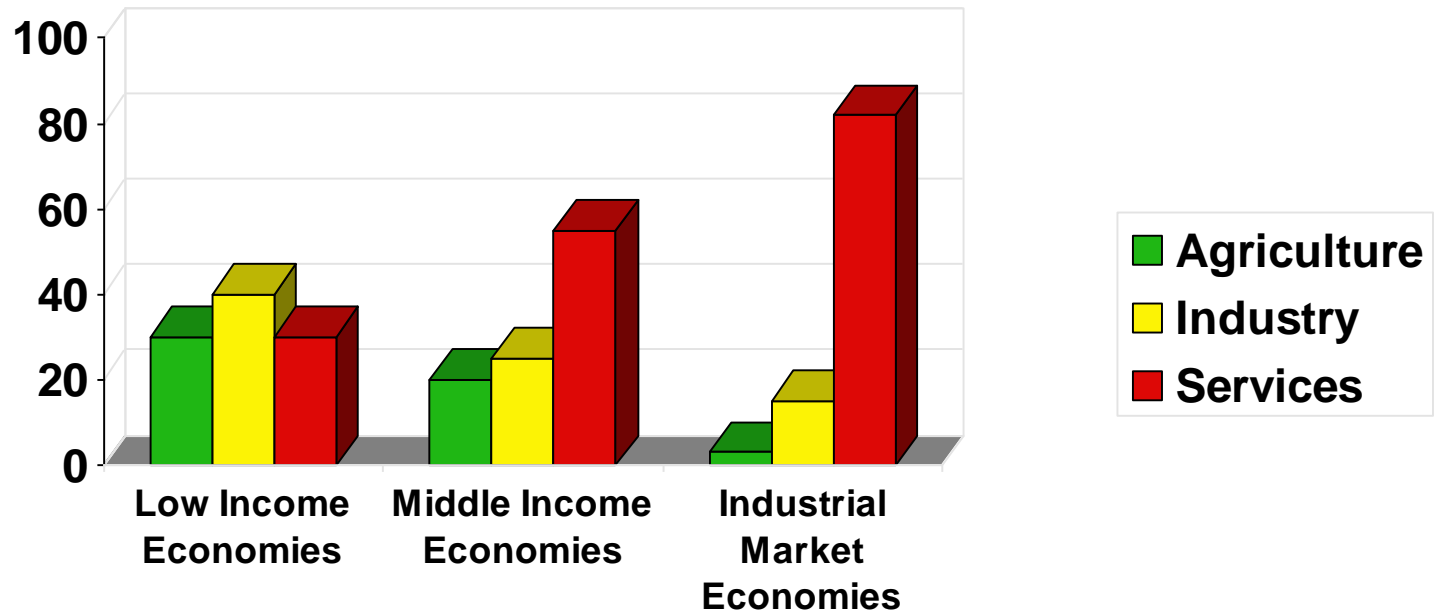
- **Employment in manufacturing has gone down from 50% to 14%**
- **A similar shift took place in agriculture.**
- **Can we (societies such as the U.S.) source goods from China and other locations?**

**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



Sources: US Bureau of Labor statistics, 2007 World Development Indicators, The World Bank

# 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





# Extent of Offshoring

(cont'd)

- **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?

Country	Wage Rate (USD)		Wage Rate growth rate	Year in which wage rate = US
	2005	2010		
Indonesia	0.58	0.77	5.9%	2134
China	0.93	1.39	8.4%	2067
India	1.45	2.03	7.0%	2076
Mexico	2.5	3.09	4.36%	2164
Thailand	2.9	3.97	6.5%	2066
Czech republic	5.4	10.86	15.0%	2018
South Korea	11.5	23.03	14.9%	2012
United states	23.2	26.76	2.9%	NA



# “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**



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