

June 8, 2005

COMMENTARY

The Art of Outsourcing

 By **C.K. PRAHALAD**
June 8, 2005; Page A14

In the very partisan political climate in Washington, what is the one issue that is likely to bring Democrats and Republicans together? The fact that Sens. Charles Schumer (D., N.Y.) and Lindsey Graham (R., S.C.) will co-sponsor a China Currency Act is quite extraordinary. Their concerns and their solutions to the growth of imports from China -- be it textiles or consumer electronics -- are leading the U.S. to a more protectionist posture.

Export of service jobs to India is also a cause for politicians' concern, and the "Exporting of America" theme is never short of congressional attention. The assumption behind this fearful perspective is simple: Greedy managers in global firms are exporting jobs to cheaper locations without regard to the harm this causes to displaced U.S. workers.


I suggest that we look at this phenomenon with a different set of lenses, highlighting the emerging pattern of globalization and the new demands it imposes on global firms. If American firms are to maintain their competitive edge now and in the future, they need to get in front of these changes and direct them, not become isolationists.

The outsourcing of lucrative information technology and high-end manufacturing work is not new, at least between U.S. companies. EDS, IBM, CSC and Accenture built their businesses on outsourcing. Kodak outsourced all IT work to IBM in 1989. Xerox outsourced it to EDS in 1994. The government has been outsourcing work to CSC from the early 1980s. The motivation for outsourcers was always the same -- reducing capital expenditures and operating costs, accessing competence, and focusing on their core activities. Off-shoring of work to an overseas manufacturing facility is also not new. For over 30 years, U.S. multinationals have "off-shored" their manufacturing and R&D facilities in semiconductors, computing, chemicals and pharmaceuticals to the U.K., Germany, France, Ireland and, more recently, to China and India. Flextronics and Solectron built their business on outsourcing of high-volume electronics manufacturing by U.S. firms. So outsourcing to specialized vendors and off-shoring (internally or to an outside vendor) is accepted practice. Why then, is this debate happening now?

* * *

The current outsourcing of knowledge work is a new variant of the long history of outsourcing. Traditionally, EDS took over the entire IT work of a firm including most of the employees. In the current variation of outsourcing, driven by digitization and inexpensive telecommunications and ubiquitous connectivity, parts of work can be parceled out for remote delivery to a vendor. Key management processes can be fragmented. For example, sales-transaction processing and call centers can be separated from the entire sales and customer service activity and outsourced. Investment bankers can isolate routine analysis of a firm's performance from their overall investment recommendation. So, too, can patent

DOW JONES REPRINTS

 This copy is for your personal, non-commercial use only. To order presentation-ready copies for distribution to your colleagues, clients or customers, use the Order Reprints tool at the bottom of any article or visit: www.djreprints.com.

- [See a sample reprint in PDF format.](#)
- [Order a reprint of this article now.](#)

search from patent application, making of slides from a customer presentation, developing CAD drawings from purchasing decisions, or market research from product development.

It is this ability to fragment complex processes into their components -- as well as the search for the best and lowest-cost talent to perform it -- that is changing the nature of competitiveness. Also new is the fact that the work can be done almost in "real time" remotely. While work is done 10,000 miles away, Office Tiger, an investments analysis firm in Chennai, India, claims that it can deliver a routine performance analysis of a firm in less than three hours. It is the granularity of the effort that can be outsourced that allows customers to be more willing to experiment. Today, outsourcing is not a complex, board-level decision, unlike the outsourcing of all IT work during the '80s and early '90s.

The current phase of outsourcing will lead to multiple streams of competitive advantage for U.S. companies. Cost is one of them, and will remain at the core of the phenomenon. Quality is another. India has more than 40 software houses with a quality ranking of CMM 4 or 5. There are other benefits to outsourcing, too. Because remote development and delivery demands clear documentation, the process capabilities of both the customer and the vendor improve. Most often, for outsourcing to work, the U.S. customers have to get their legacy processes cleaned up. Many firms have found that outsourcing helps in better documentation of internal processes. Speed of reaction is yet another source of advantage. As vendors and customers work in time zones with a nine- to 12-hour difference, rapid response is possible. Finally, outsourcing allows firms to access a higher quality of skilled people for developing analytics. In just two years (2002-2003), U.S. firms conducting R&D in India have filed for over 900 patents.

* * *

The real debate ought to center around the best way for U.S. firms to import competitiveness -- not "export jobs." Firms compete across the globe -- Motorola against Nokia and Samsung, GE against Siemens, GM against Toyota, and Intel against AMD and TI. Global competition is primarily about inter-firm, not inter-country, rivalry.

Global firms are not just looking for the next source of competitiveness. They are also looking for new markets to grow. The largest markets for cellphones today are in China and India. India is adding nearly two million phones per month. China is one of the largest markets for Caterpillar and is emerging as a large market for cars. Yes, India can be a source of competition for "well-paying jobs." But it is also a growing market for Dell computers, Microsoft software, Motorola cellphones, Whirlpool appliances, and Oracle databases. For example, while technicians work at these remote call centers and other "outsourced" operations, the hardware and software tools they use are made by U.S. firms. Globalization is creating a new form of interdependence. To focus on "independence" and "self-sufficiency" in this era is foolhardy.

The crux of the debate needs to be reframed. If global firms have to compete effectively for global markets as well as retain their position in established markets, they must have the ability to improve their cost, quality, time-to-market and capacity to innovate. This requires a continual search for talent and a willingness to change the internal processes of managing to keep ahead of competition. The current wave of outsourcing is motivated by this desire to innovate ahead of competition.

The longer-term prognosis for the developed world demands that global firms learn to source talent from developing countries such as China and India. Given the demographics, it is estimated that the U.S. will be unable to fill more than a million jobs by 2010. Aging populations and worker shortage are likely to be major problems in Germany, France, the U.K. and Japan. Either one allows for more immigration to fill jobs or rapidly learns to outsource work and have it done remotely in India, China, Eastern Europe, Russia or the Philippines. The firms that learn to innovate quickly by managing differently -- with granular partitioning of workflow and efficient coordination of the fragmented parts -- will retain

competitive advantage.

There was a time in the 1980s when Americans fretted about Japanese competitors and how they would take over all the key industries in the U.S. As we look back, the firms and industries which were willing to adapt and innovate have done very well: IBM, Intel, H-P, GE, Dell and Motorola have not disappeared. They are still leaders in their fields. All of them access global talent to retain their competitiveness. Consequently, the key question for U.S. firms should be: How are we going to leverage the talent and markets in China and India to enhance our competitive advantage world-wide?

The current outsourcing phenomenon is the start of a new pattern of innovation in the way we manage. The ability to fragment complex management processes and reintegrate them into the whole is a new capability. It allows us, in the short term, to take advantage of the talent outside the U.S. In the longer term, it allows us to cope creatively with the emerging labor shortage caused by an aging population in developed markets. The time to learn to manage with a global system of knowledge, products, services and component vendors is now. We should celebrate the process that imports competitiveness and creates new jobs. Fear is for losers -- and for Lou Dobbs.

Mr. Prahalad is the Harvey C. Fruehauf professor of Corporate Strategy at the Ross School of Business at the University of Michigan. He is also chairman of The Next Practice, and the author, most recently, of "The Fortune at the Bottom of the Pyramid: Eradicating Poverty Through Profits" (Wharton, 2004).

URL for this article:

<http://online.wsj.com/article/0,,SB111818929927353590,00.html>

Copyright 2005 Dow Jones & Company, Inc. All Rights Reserved

This copy is for your personal, non-commercial use only. Distribution and use of this material are governed by our [Subscriber Agreement](#) and by copyright law. For non-personal use or to order multiple copies, please contact Dow Jones Reprints at 1-800-843-0008 or visit www.djreprints.com.