

# Chapter 2.5

## Offshoring: The Transition from Economic Drivers Toward Strategic Global Partnership and 24–Hour Knowledge Factory

**Amar Gupta**

*University of Arizona , USA*

**Satwik Seshasai**

*International Business Machines (IBM) Corp., and Massachusetts Institute of Technology, USA*

**Sourav Mukherji**

*IIM Bangalore, India*

**Auroop Ganguly**

*Oak Ridge National Laboratory, USA*

### ABSTRACT

The changing economic and labor conditions have motivated firms to outsource professional services activities to skilled personnel in less expensive labor markets. This offshoring phenomenon is studied from a political, economic, technological and strategic perspective. Next, an analytical model is developed for achieving strategic advantage from offshoring based on global partnerships. The model studies the impact

of offshoring with respect to the complexity and strategic nature of the tasks and presents a decision strategy for obtaining value through offshoring of increasingly complex tasks. The result is an integrated “24-hour knowledge factory” that is based on a sustainable global model rather than a short term fiscal model. This 24-hour paradigm embodies the shift-style workforce that evolved for the manufacturing sector during the Industrial Revolution and relies on a set of critical success factors in the current environment. A case example

is provided from IBM to illustrate these underlying critical success factors.

## PROLOGUE

*The idea of Citibank developing software in India makes no sense at all. Software needs to be developed by people who can meet frequently with the persons who will use the software, so that frequent interaction can occur among the concerned persons at all stages: prior to development, during development, and after development. Even if we assume that such interaction could occur without frequent face-to-face meetings (and I don't agree with this at all), the time difference between India and the U.S. will make it impossible for the concerned persons to talk by phone. Further, Citibank has virtually no presence in India, and doing business in India is very difficult; so if computer software has to be developed in Asia, we would probably do it in the Philippines where we have significant business presence and there are trained programmers who can interact well in India. In the context of our banking business, the cost on computers is very small. We are not looking for reductions in cost; we are looking for ways to expand our banking business.*

The previous opinion was conveyed by the then vice president of Citibank, Korea, in a meeting at the corporate headquarters of Citibank in early 1980s to one of the authors (Gupta) of this article. At that time, the latter was completing his MBA at MIT Sloan School and his doctorate in computer science. Based on his prior experience of working in India, he was trying to convince multinational companies about establishing new business endeavors in non-traditional host environments. If U.S. is the ideal place to produce certain kinds of goods and Japan is the right place for others, then India should be a good place to develop software on the basis of its core competency of having inexpensive, highly educated, English-speaking

programmers. After the previous interaction with Citibank in New York, the concerned author met with the top executives of Citibank in India and the idea progressed further. While the particular author opted not to join Citibank as an employee, the idea eventually blossomed into Citibank Overseas Software Limited.

## CURRENT SITUATION

With a growing labor market abroad and a challenging economic situation in U.S. and several other developed countries, large and small firms are making the push to outsource professional services to highly skilled personnel in less expensive labor markets abroad. A Nasscom-McKinsey study cited a 34% increase in Indian software and services export from 2004 to 2005, from \$12.8 billion to \$17.2 billion (Nasscom-McKinsey, 2005). This study states that by 2010, the U.S. IT and BPO offshoring market will be \$55 billion.

The current situation of reduction in costs vs. loss of jobs, at least in the short-run, bears some similarity to the dilemma faced by the automotive industry in the early eighties when some of the parts began to be manufactured in lower cost countries such as Mexico. At the time, some observers perceived that too many U.S. jobs were being sent offshore, and that the impact to the U.S. economy would certainly be negative. However, a detailed analysis of that situation highlighted the danger of adopting a restrictive policy. This analysis revealed that increasing global competition required the United States automobile companies to outsource manufacturing to a certain degree, or to risk losing the world market to other countries that could produce cars cheaper and better. As Lester Thurow puts it: "There were only two long-term viable alternatives: either half the car is produced in Detroit and the other half in Mexico, or the whole car is produced in Japan. By attempting to use legislative measures to tilt the balance in favor of Detroit over Mexico, one

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