

Under the Buzz

Commentary on Strategy & Management Issues for Executives & Professionals in Enterprise Systems & Software Companies

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In this issue:

“Outsourcing & Offshoring: A Primer” – by Geoffrey Moore

The intensity of the debate on outsourcing and offshoring – two distinct activities that global corporations such as IBM include in terms such as ‘global sourcing’ – combined with a considerable fudging of the topic by the ill-informed nature of recent political dialogue and media coverage, has moved my colleague, Geoffrey Moore, to attempt to clarify the realities of this growing phenomenon. The result is this short primer.

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Outsourcing & Offshoring: A Primer By Geoffrey A. Moore

As expected, the twin topics of outsourcing and offshoring have captured center stage in the 2004 political campaign. But the quality of the dialog to date has suffered, in part because the topic is more complicated than it looks. Having spent the past three years deeply immersed in it, I'd like to offer the following as a primer for candidates from all parties and for all offices.

1. *There are two ideas here, not one.* Outsourcing refers to the transfer of work from one company to another, offshoring to the transfer from one country to another. One can outsource without offshoring (ADP does payroll for many U.S. businesses), offshore without outsourcing (HP manufactures printers in its own factories in Singapore), or combine the two (Dell outsources customer-service calls to India).
2. *Outsourcing: The Good, the Bad, and the Ugly*
 - *The good.* Outsourcing allows a company to get rid of routine work in order to focus more time, talent, and capital on its specialty. This allows it to increase its differentiation and competitive advantage, leading to more revenues and higher profits. Simultaneously, the same act of outsourcing creates revenues and profits for another company that happens to specialize in the type of work being outsourced. Both companies and their stakeholders profit greatly from the transaction.
 - *The bad.* Outsourcing creates significant execution risks in the short term through lack of clear agreements about service levels and accountability. In the long term, it results in a loss of expertise that may be sorely missed somewhere down the road.
 - *The ugly.* At the time it takes place, outsourcing disrupts and dislocates the work force in the customer company. Where entire communities are dependent on a single major employer, or where an entire sector is finding its workload under assault, it can be devastating to the social fabric.

3. *Offshoring: The Good, the Bad, and the Ugly*
 - *The good.* Offshoring is a powerful form of foreign aid. The best defense against terrorism is to root out poverty and hopelessness, displacing it with well-being and the opportunity for prosperity. Offshoring also creates significantly cheaper goods which keeps inflation down and improves the quality of life for consumers. And finally it facilitates access to emerging markets in high-growth economies.
 - *The bad.* Offshoring decreases the amount of work for the onshore populace, resulting in fewer jobs or a jobless recovery. (The recovery is not actually jobless at all, as both India and China are willing to testify.) It also creates downward wage pressures that threaten the quality of life for a heretofore insulated population.
 - *The ugly.* Global corporations can and do exploit workers and the environment by shifting work to countries where neither are highly valued.
4. *Economies are Darwinian.* Capital seeks out the source of highest risk-adjusted returns. Always. Public policy can modulate this phenomenon, but it cannot redirect it. Capital will simply go elsewhere. Without capital no economy can succeed; it is a vital nutrient. The only reliable sustainable response is to compete for capital by creating the most attractive returns. The result mirrors evolution in that both are governed by natural selection and lead to the survival of the fittest.
5. *Successfully competing against outsourcing.* Outsourcing is enabled by standardization and commoditization. Differentiated offerings break the model. If outsourcers cannot duplicate an offer, they cannot compete with it. Competitive focus, therefore, needs to be on *offer innovation*. The winning strategy is not to resist outsourcing but to use it to extract resources from commodity processes in order to invest them in more differentiated ones.
6. *Successfully competing against offshoring.* Offshoring, by definition, is enabled by locating the source at a distance from the customer. Adaptive customer interactions that leverage presence or proximity break the model. Competitive focus, therefore, needs to be on *business model innovation*. The winning strategy is to target a customer's time-critical and mission-critical processes where the risk of working at arm's length outweighs the reward of getting services from a cheaper labor pool.
7. *Implications for public policy.* The many facets of this issue call for multiple responses. Within different time horizons, different kinds of intervention are warranted, as follows:
 - *Long Term: Invest in innovation.* In a Darwinian context, we are not entitled to anything we can't win on the merits of our offers. Education, entrepreneurial enterprises, and advanced technologies are all proven breeding grounds for the next generation of innovation. Investing in infrastructure to enable the above has a high return.
 - *Medium Term: Invest in renewal.* In the medium term we have the opportunity to reach out directly to displaced workforces and help them retrain themselves to participate in innovative work. In this domain enterprises that currently host both the people and the work are best positioned to intervene, and public policy should focus on incentives for reeducation as an alternative to mass lay-offs and new-hires.
 - *Short Term: Retard the speed.* Outsourcing and offshoring cannot be prevented but they can be modulated. Governments can and should use regulatory power judiciously to provide temporary relief to targeted sectors where the disruption and dislocation are excessive. Every one of our trading partners does; there's no reason why we shouldn't too.

In closing, there is wide latitude for a variety of positions and platforms on these issues, and they will clearly benefit from vigorous democratic debate. That would be the high road in the campaign to come. One can only hope it will not be “the road less traveled.”

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Under the Buzz offers commentary on enterprise software and systems business and management issues. The goal is to provide provocative and accurate insights into the latest events and thinking shaping this continually evolving technology sector. *Under the Buzz* also provides commentary on strategies for building sustainable competitive differentiation and maximizing market valuation.

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