



PROFESSOR ROBERT KENNEDY offers practical steps to manage the offshoring revolution.

Globalization and the Services Sector

New Book Offers Strategies to Leverage Benefits from the Offshoring Revolution

In their new book, *The Services Shift: Seizing the Ultimate Offshore Opportunity* (FT Press), authors **Robert Kennedy** and Ajay Sharma explore ways that outsourcing and offshoring are now impacting the services sector (accounting and finance, customer care, market research, etc.) as well as those who perform service functions within the manufacturing sector (product design, logistics, and marketing). And while globalization in the services sector may seem like a sea-change to some, it's really just an inevitable continuation of existing trends, the authors say.

Kennedy is the executive director of the William Davidson Institute and the Tom Lantos Professor of Business Administration at Ross. He finds that most managers in the services sector know something important is happening but are struggling with how to think about it. Is this shift an opportunity or a threat? How should they get started? What pitfalls should they look out for?

"Our book is a non-technical, managerial book that aims to give readers a framework on how to think about the off-

shoring and outsourcing phenomenon," Kennedy says. "It's a practical guide that talks to managers about what's happening, why it's happening now, what the opportunities are for managers, and what the future holds."

In conjunction with the book's February 2009 release, Kennedy sat down for a Q&A with *Dividend*.

DIVIDEND: Offshoring is a controversial subject. Do you see it as good or bad?

KENNEDY: Much of the controversy comes because people don't understand what is happening. The language used often implies moving jobs here or there. But what's really happening is companies are looking to improve productivity, cycle times, and the talent they employ. In many cases, the best solutions are in the firm's home country. But in more and more situations, firms simply can't find the talent they need in the U.S. or Europe.

That's why pharmaceutical and technology companies are opening R&D labs in India and China. They might save a little money. But the real challenge is to find people with the skills they need to compete.

Strategies to improve efficiency always cause dislocation in the short term. Technological innovation displaces workers. Trade in natural resources or manufacturing displaces workers. And now trade in services is displacing workers. These

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“It’s the people who can solve unstructured problems and create robust, low-risk processes who are going to be in huge demand.”

adjustment costs are short term, but they are vitally necessary to improve long-term living standards — not only in the U.S. but in developing countries as well.

The political discussion has become very separated from the practical reality of competition. Intelligent people can disagree on whether globalization is good or bad for the country in the long run. I think it’s good for the country in the long run, but I respect the opinion of people who feel otherwise. But that’s an issue for policymakers. The issue facing managers is how to be efficient, how to develop better products and get them to market quickly. We wrote *The Services Shift* so that managers will know why, how, and where better business solutions may be available.

DIVIDEND: You spoke about offshoring as a way to improve productivity, cycle times, etc. But doesn’t the decision to move certain work offshore mostly come down to cost?

KENNEDY: Many firms are initially attracted by potential cost savings. But what they find is that going offshore forces them to re-engineer their business processes. In many cases, it turns out that the productivity improvements from re-engineering vastly exceed the labor cost savings — often by a factor of 10 or more. So offshoring is about many things: wages, re-engineering, access to best practices, access to the best talent, etc. In the early days, it was primarily about cost. But as the industry develops, those last few items are becoming more important than labor savings.

DIVIDEND: What are some of the most common mistakes you see when people decide to move work offshore?

KENNEDY: Probably the biggest mistake is not doing the proper due diligence up front. There are thousands of firms in India and elsewhere that offer these services. I’m amazed at how many U.S. firms will talk to the salespeople here, maybe send somebody for a one-day site visit, and then turn over their accounting or customer support processes. Companies need to make sure the partner has a track record, they have a brand image that’s worth protecting, and they understand and follow the service-level agreement.

The other thing companies traditionally haven’t done very much of is systematic risk management. While there are huge potential benefits to going offshore, you also are taking on a variety of risks.

DIVIDEND: Can you talk about some of those risks?

KENNEDY: Well, there’s country/location risk: Is war going to break out? Will local regulations change? Will power outages affect your business? Will labor costs rise?

Then there’s a set of migration risks: What happens when you start mapping the process and getting it from here to there?

There also are business operations risks: Will the work be done in the same way or will it be done differently? In many cases, the work is actually done better.

And finally, you have to think about hold-up risk: You move these things offshore, sign a contract, redeploy people, and then your supplier comes back six months later and says, “My labor costs have gone up and power’s more expensive. You need to pay me more.” What are your options?

DIVIDEND: How does this shift in the services industry affect the type of skills and management style required in an organization?

KENNEDY: In the traditional model, the career path is vertical. The key to getting to the next stage is having the most detailed domain knowledge. The signs of success tend to be very visible, i.e., bigger office, bigger expense account. In this new model, the path is horizontal, the organization is flattening out, and the signs of success are not so visible. You may have someone sitting in a cubicle managing a billion dollars and 5,000 people. If this person does their job well, they can save the company tens of millions of dollars, but nobody says, “Oh, nice office.”

In terms of skills needed to manage a remote operation, they are not function-specific, but rather process-specific. You need to manage analytically: How are we going to track your performance day to day and week to week? What measures are fair and accurate to do that? Second, you have to be much more process-oriented. When there’s a mistake, the response isn’t just to fix it but to figure out why the mistake happened and determine what can be done to prevent similar mistakes in the future. Third, you need people who are comfortable in a cross-cultural environment.

People like industrial engineers and MBAs often have these skills because they’re comfortable with numbers and understand the range of functions. It’s the people who can solve these unstructured problems and create robust, low-risk processes who are going to be in huge demand, because this is one of the key ways companies are creating value these days. ✪

—Dan Shine with Deborah Holdship