When separation hurts: off-shoring revisited

Angel Díaz – IE Business School
1. A reversal in off-shoring trends?
2. Why re-shoring?
   1. Cost issues
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Reversal? Why re-shoring? Cases Research Conclusions

• Foxconn´union issues: sign cheap China is no more (FT Jul 2013)
• USA companies rethinking offshoring strategy (Economist Jan 2013)
• Manufacturing, and American recovery? (IHT 2012)
• Those manufacturing jobs are lost forever (IHT 2012)
• Made in USA steadily losing longe time edge (NYT Sep 2011)
• The trouble with outsourcing (Economist July 2011)
• America flirts with a fate like Japan (FT Jun 2011)
• Time for Apple to own factories again (Asymco 10/15/2010)
• Outsourcing innovation? (BW March 2005)
Case of the Maquiladoras in Mexico

Pre 94: Border Industrialization Program

94-99 Boom: by 2000: 3700 Maquilas, 1.3 million jobs

00-03 China emerges: 900 Maquiladoras close, 300,000 jobs lost

04-?? Maquila revival: proximity networks in Central America?

In the maquila area: “time critical, high-value, large, complex, heavy products: autos, electronics, appliances” (Traffic world 2005)

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Reversal? Why re-shoring?: cost issues Cases Research Conclusions

- Increases in transportation costs, volume and stagnation of infrastructure
- US transport infrastructure feels strain of global trade (FT Nov 2004)
- Higher wages in China benefit Mexico (WSJ Sep 2012)
- End of the line for cheap workers (in China) (FT 2011)
- Study from BCG finds China manufacturing cost advantage over US to disappear by 2015. China labor costs alone will rise to 69% of US costs…before logistics, duties, inventories
- Hidden cost (of off-shoring: Contracting/ Transition/ Interaction) (WSJ June 2007)
- Investors don’t reward off-shoring announcements (Daniel et al. 2009)
Lenovo keeps production in house as foes outsource
(WSJ July 2012)
Global, lean networks are vulnerable

- Case WM: “Bangladesh fire deaths push retailer to demand safety improvements” (WSJ Nov 2012)

- Child labor case Ikea

- Case Philips New Mexico

- Case Tsunami Japan

- Case Ford 9-11
Why reshoring: social issues

1- IT spending has hollowed out (mid-income) job markets (Economist Sep 2010)

2- Merges & acquisition reduce employment in large companies, displacing it to fragile SME (Spain: of 2.8 mm companies, 3650 are large; USA: of 25mm, 99% are SME/SMB)

3- Loss of employment due to offshoring

Is high unemployment becoming structural in the west?
USA:

- 22-29% of jobs offshorable (Binder, Princeton WP 07, replicated by HBS 08)
- Is America facing structural unemployment (Economist debate Jul 2010)
- A university degree no longer confers financial security (Economist 9/3/11)

Spain:

- Imports of textiles from East grew 558,2% in 2004. 400 companies and over 15000 jobs were lost that year (50K more in the next three years). Whole areas devastated by job losses
- Unemployment at 27% (almost 60% for under 25)
The dark side of re-shoring

• **Taxation:** USA: 40% (central + state) vs. Canada: 26%; Mexico 30%; China 25% (down from 30%); Spain 30%; Switzerland 21%; Ireland 12.5%. Even zero in fiscal paradises or very small with taxation loops. Cases of Apple, Google…But customer pressure can help: Starbucks

• **Low labor costs moving** to South East Asian, Africa…

• It can be good to be **close to the market** (Airbus in China)

• Negative risk pooling (**all eggs in one basket**)
On going research:
Case Arinso/Northgate

Conclusions

<table>
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<tr>
<th>Country</th>
<th>No. of Projects</th>
<th>No. of Employees served</th>
<th>No. of Knowledgeable Consultants</th>
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<tr>
<td>BE</td>
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<tr>
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<td>373</td>
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</tr>
</tbody>
</table>

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Centralized technical backoffice for EMEA first installed in Poland
Experience was no good. Takes 3-4 years to train workers (initially conventional training, then on-the-job with mentoring), then they left: turnover was very high

What are the factors that decide on locating at Granada?
• Talent (skilled workers) is critical and Granada has:
  • a multicultural University with technical training;
  • good language skills thanks to Erasmus (one of the most active universities in this program);
  • high unemployment;
  • labor force who wants to stay home due to quality of life;
• local government support (although not very important for Arinso)

Potential of Spain for attracting knowledge clusters?
• Immense. Although offshoring activity in the sector is high (India 30-40%, Philippines growing strongly, Buenos Aires; but only 15-20% in Europe); competition for resources of company not backed by strong brand name is fierce, and much more supervision is needed: 20 to 80% of workers (Gartner). There are also many advantages in near-shoring: cultural affinity, less change management required, same time zone. However advantages of large cities (Madrid, Barcelona) not great due to higher cost of living and more competition for resources.
• Other companies in Granada are UNIT4 (Dutch) with 120-130 employees: “forget India, Spain is cheaper”

• In Granada Arinso started with 15 and currently has more than 500, plus 100 more in a backoffice related organization.
On going research: Spanish autosector

• Spain is second largest producer in Europe, 8th-9th worldwide
• Important local auxiliary industry (Antolín)
• Notable comeback last year
  – Ford absorbed Belgium,
  – PSA absorbed France
  – Renault absorbed France, Turkey
  – Nissan investing $170m
  – Other investing: Iveco, VW
• Reasons:
  – Labor and Unions negotiation flexibility
  – Reduction in labor costs
  – Know-how
Clusters and Knowledge diffusion

• A case study of **national culture and offshoring services**. R. Metters IJOPM V28 N8 2008
Location decisions


Risks


Cost and total factors

• The impact of ICT-enabled offshoring announcements on share prices E. Daniel, D. Kodwani, S. Datta. Journal of Enterprise information management v22 n3 2009

Conclusions

• Off-shoring is not always the best decision: Business cases frequently too simplistic by only considering labor costs or taxation
• Re-shoring can have many cost, risk and agility advantages
• Social impact of off-shoring could produce protectionist measure to hedge job losses
• Research on outsourcing/offshoring has focused more on knowledge diffusion (frequently transaction costs/resource based); location decisions (frequently analytically based) and less commonly risk and vulnerability issues
• A better understanding of total factors involved in off/re shoring decisions is needed to support business decisions