



# Outsourcing and Offshoring: Implications for Services Productivity

*AIM Productivity Day, London*

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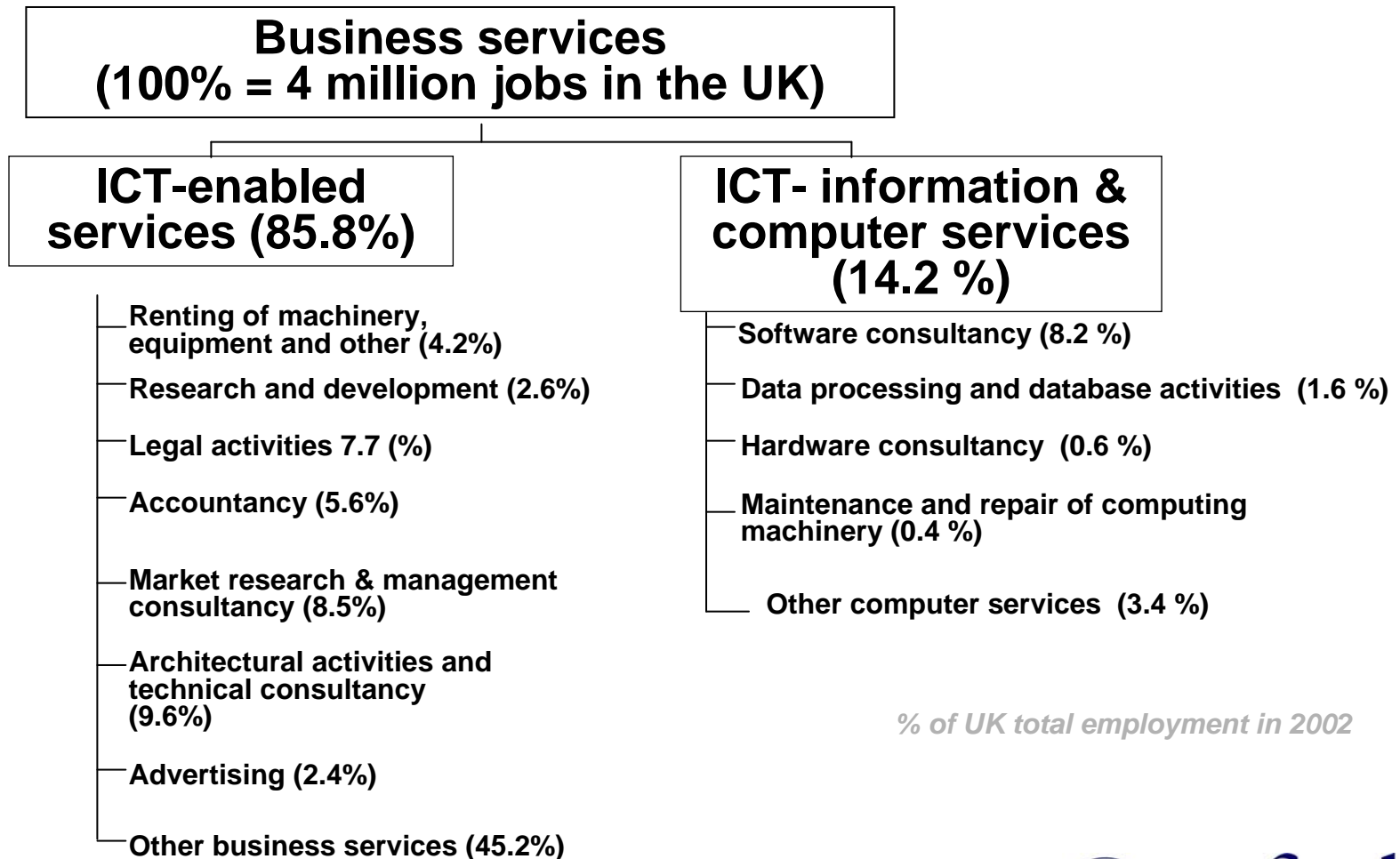


# AIM Research on Outsourcing and Offshoring Thus Far

(downloadable from [www.aimresearch.org](http://www.aimresearch.org))

- *The UK Productivity Gap and the Importance of Service Sector* (Rachel Griffith, Rupert Harrison, Jonathan Haskel, and Mari Sako), AIM Briefing Note, December 2003.
- *Offshoring of Business Services and its Impact on the UK Economy* (Laura Abramovsky, Rachel Griffith, Mari Sako), AIM Briefing Note, November 2004.
- *Sustainability of Business Service Outsourcing: The Case of Human Resource Outsourcing (HRO)*, British Academy of Management, Saïd Business School, Oxford, 14-16 September 2005.

# What is business services?



*% of UK total employment in 2002*

# Today's Focus

- What is different about reasons for outsourcing in *services* and *manufacturing*?
- Outsourcing of labour only vs outsourcing of tasks
- Implications for services productivity



# Products vs Services:

## Economics/Sociology 101

### Products

- Tangible artifacts
- Storable
- Production precedes consumption
- Standardized processes
- High K/L through automation

### Services

- Intangible
- Non-storable
- Consumption at point of production → proximity
- Customization
- Labour-intensive/  
knowledge work

# 'Productizing' services vs 'servicizing' products

- Services are 'noisy' control systems
- To improve services efficiency, we need to improve the control system via:
  - Process standardization and integration
  - Labour-saving technology
  - Mix-and-match asset-based delivery of services
- Make services look more like manufacturing!
- Skill needs are minimal

- Services are co-produced with consumers
- To achieve growth through services, we need to:
  - Customize as a source of value creation
  - Treat consumers as co-innovators
  - Rely on professional knowledge for judgment-based work
- Professional and technical work are central

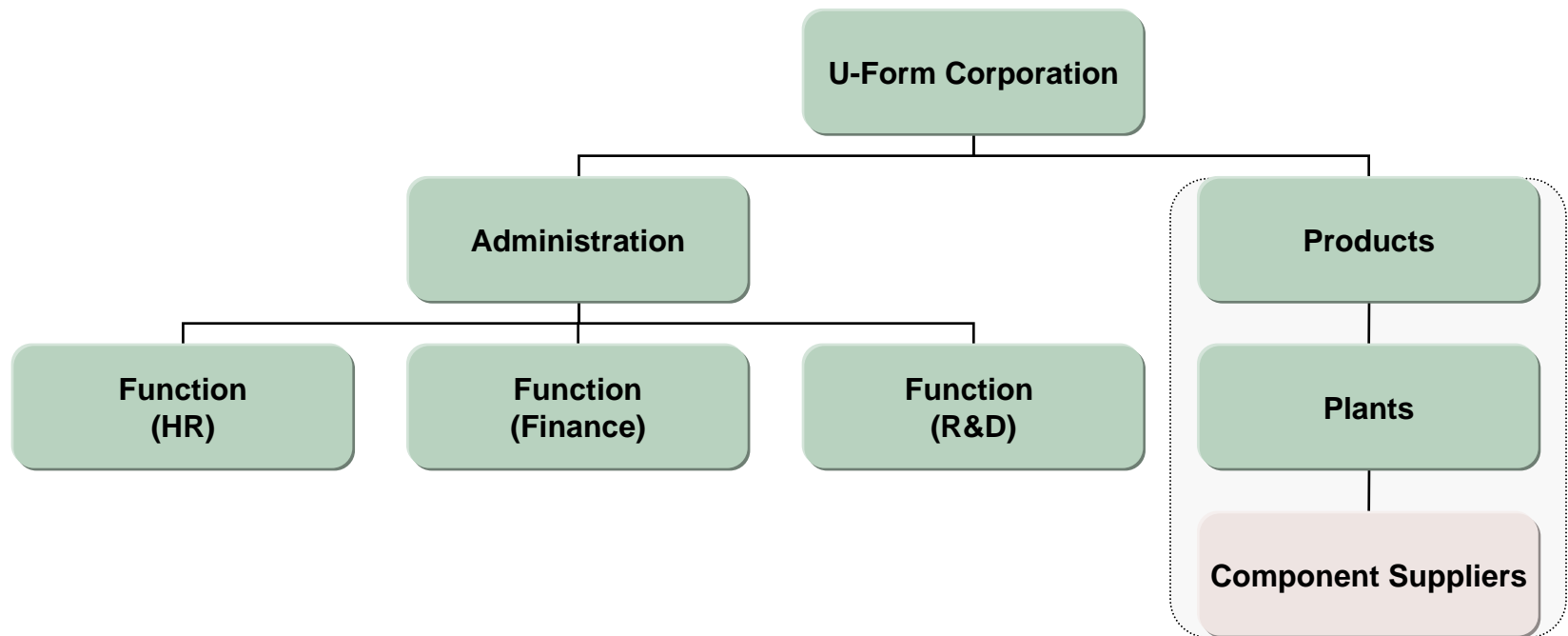
# 1. Outsourcing as Unbundling of Corporate Functions



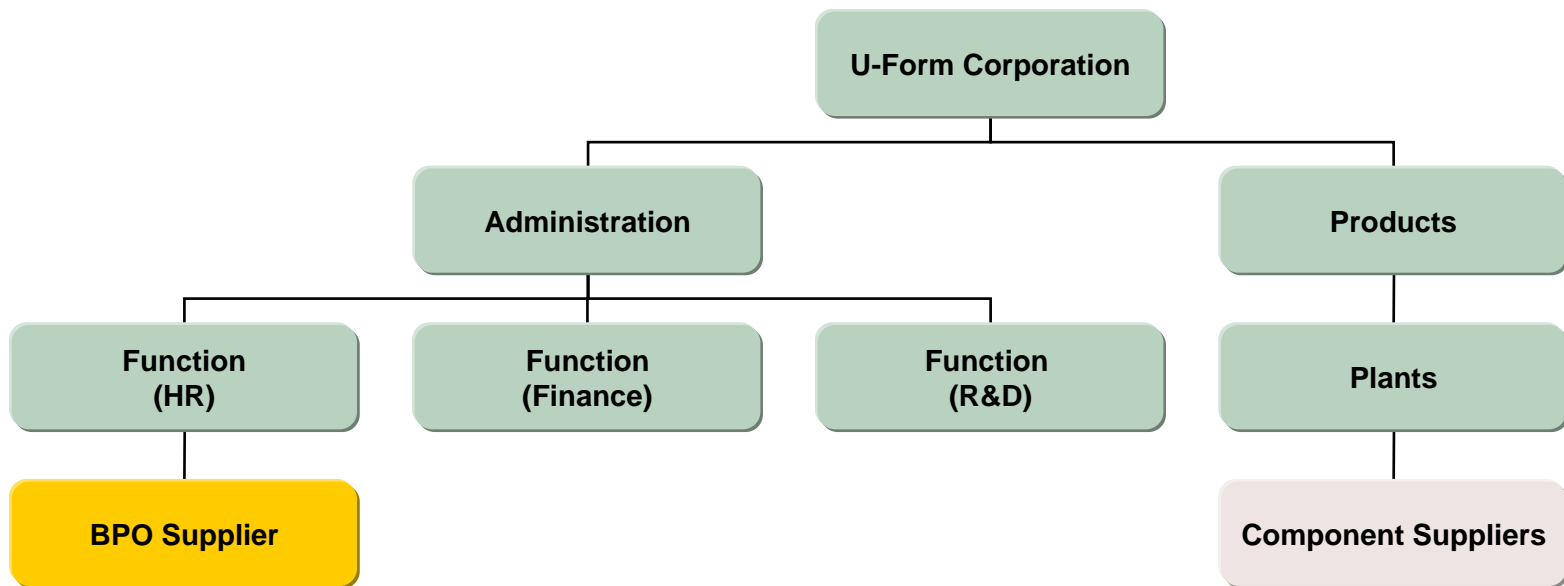
# Why is business services globalizing?

- ICT lowers cost of coordination
- ICT enables 'productizing' services
  - Separate out production and consumption
- So services and manufacturing are converging
  
- An important driver is MNC corporate restructuring
- Distinguish between two types of outsourcing:
  - Dis-aggregation of vertical supply chains (both mfring and BS)
  - Unbundling of corporate functions (BS only)

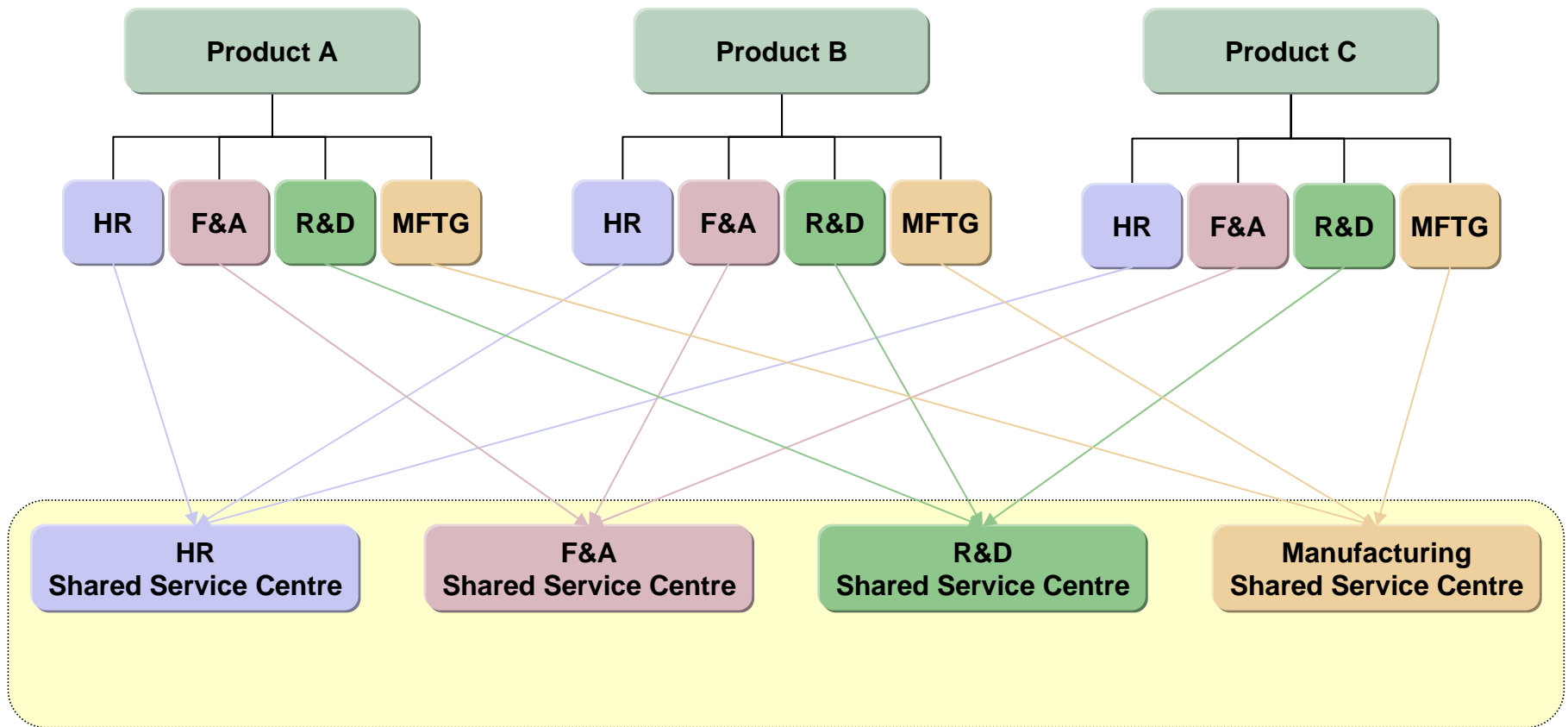
# Manufacturing mindset homes in on 'vertical disintegration' as outsourcing strategy



# Corporations are unbundling their corporate functions as well as their supply chains

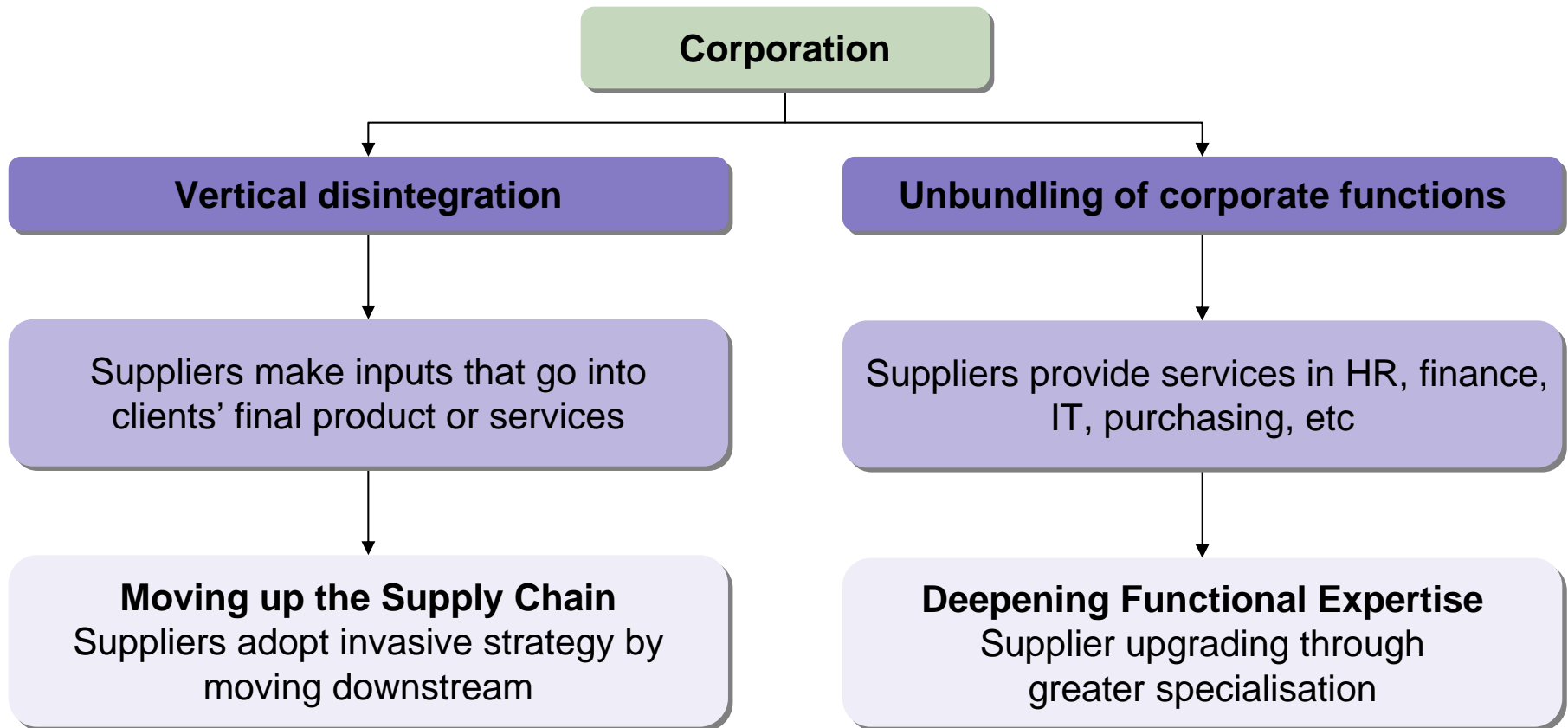


# Business service outsourcing is about the unbundling and rebundling of corporate functions esp. in M-form corporations



A large global market (\$500 billion) is projected for BPO/BTO

# Different upgrading opportunities for suppliers in two types of outsourcing



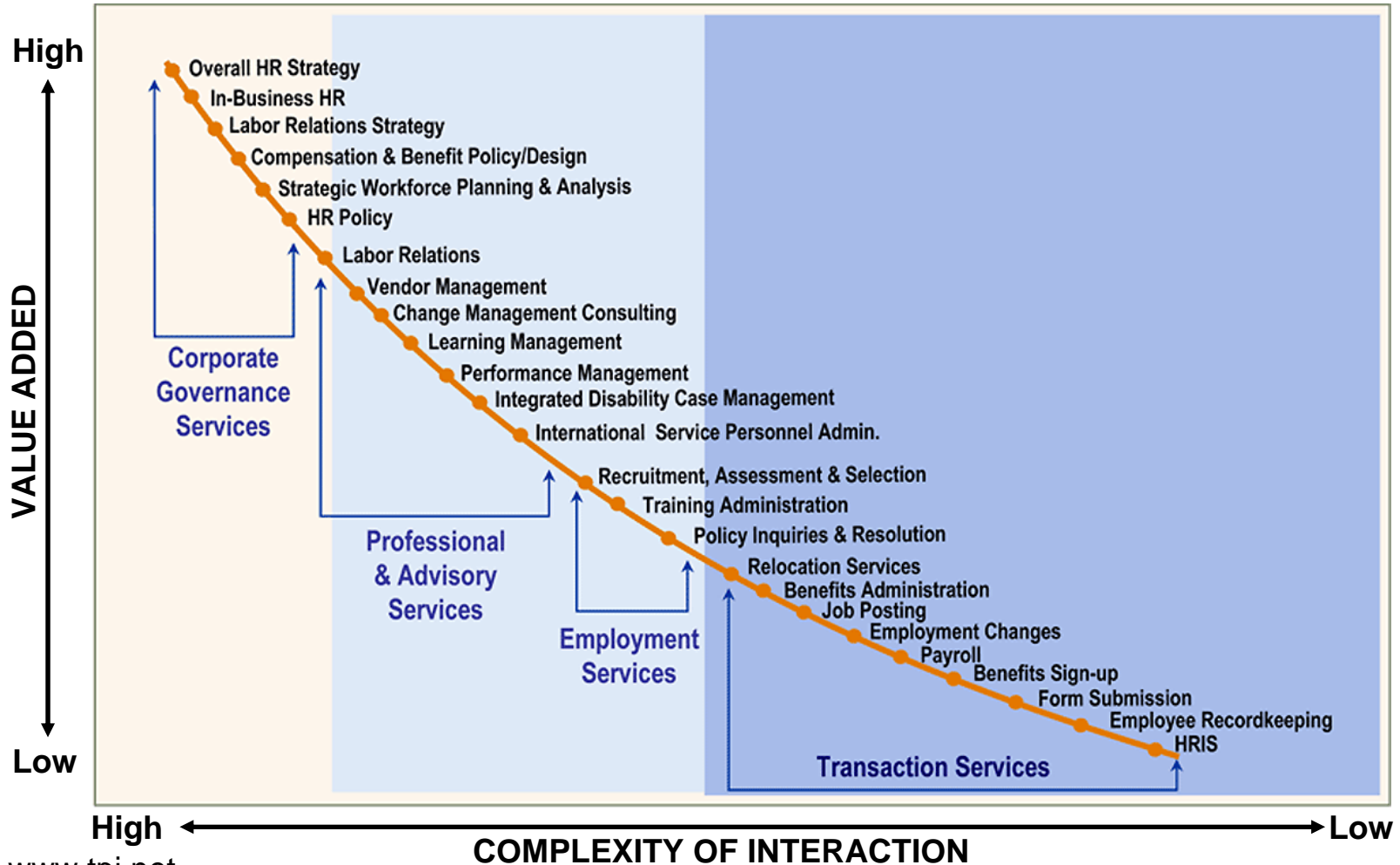
# Implications for Sectoral Classifications

- Vertical markets
- Horizontal expertise
- Domain knowledge

# Blurred boundary between 'front office' and 'back office' processes in corporate functions

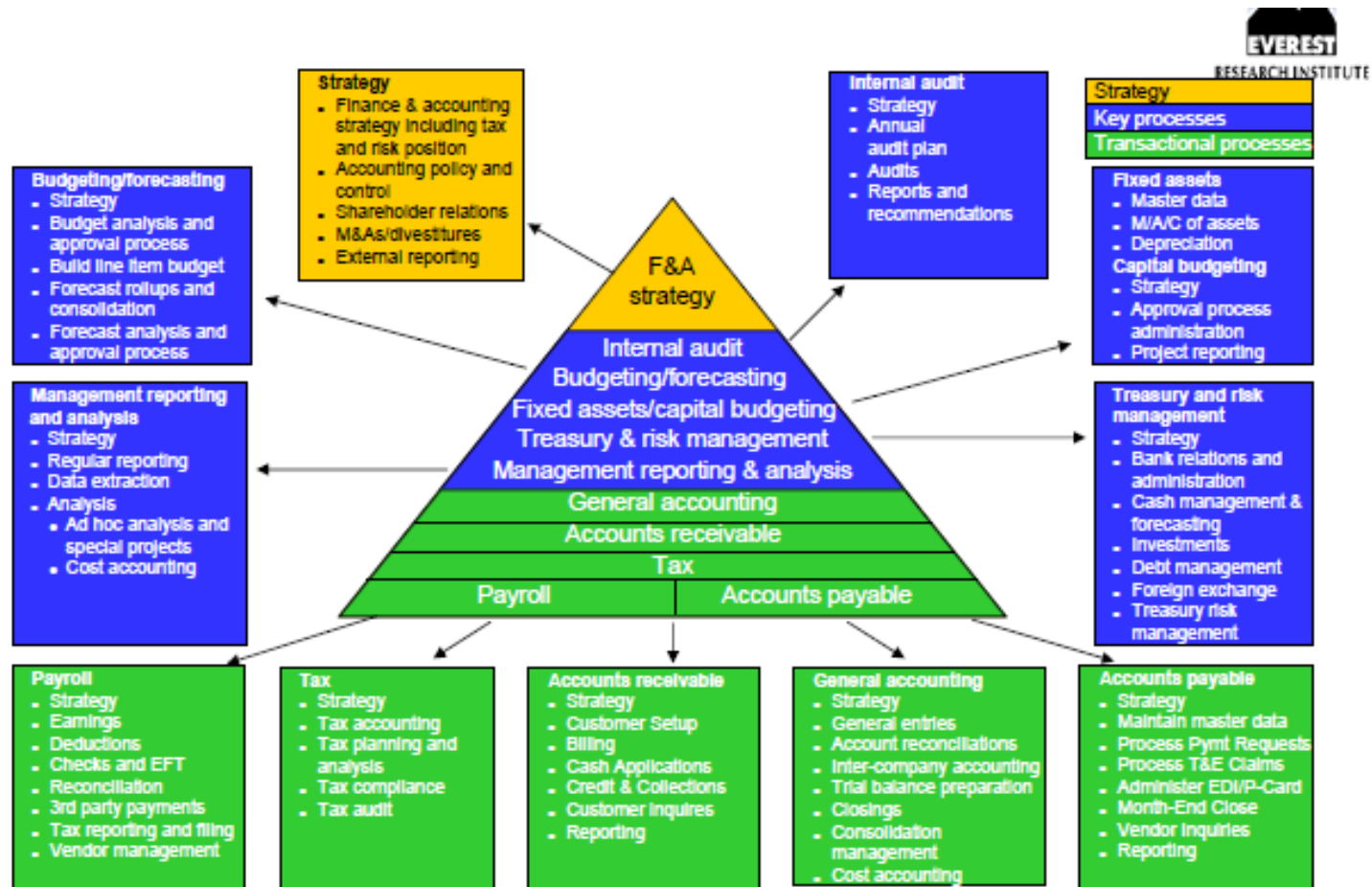
- Customer Relationship Management (CRM)
  - Call and contact centres
- Human Resources (HRO)
  - Payroll and benefits administration, recruiting
- Finance and Accounting (F&A)
  - Accounts payable, tax accounting
- R&D/ engineering/ IT software

# Which HR processes are 'back office'?



Source: www.tpi.net

# Which F&A processes can be outsourced?



Source: Everest Research Institute, August 2005

## 2. Outsourcing to Turn Fixed Costs into Variable Costs



# Three Strategies in Outsourcing

- Type I: Disaggregation of vertical supply chains
- Type II: Unbundling of corporate functions
- Type III: Outsourcing of labour

# Labour-only outsourcing: What is being externalized?

## *Ownership of Capital Assets*

		<b>In-house</b>	<b>Outsource</b>
<i>Employment Contract</i>	<b>Direct</b>	Hire Temporary Workers	Leasing of Machinery and Equipment
	<b>Indirect</b>	Agency Labour	Contracting Out



# 3. Implications for Services Productivity

# Productivity Implications

- Unbundling of corporate functions to cut 'overheads'
  - Buyers benefit from cost reduction, economies of scale, process standardization
  - Suppliers develop greater expertise through finer specialization in mass or niche markets
- Labour-only outsourcing enhances productivity
  - Buyers benefit from better capacity utilization
  - Suppliers (labour placement agencies) also become more productive from greater specialization
  - Agency labour is 'services bought', so do not appear as clients' headcount

# Conclusions

- Contrasting notions of services place different emphases on sources of productivity growth
  - ‘Productizing’ services: process standardization, economies of scale, etc.
  - Services are about customization, knowledge work
- Firms are unbundling their corporate functions as well as disaggregating their vertical supply chains
  - Business service outsourcing is much about the former
  - Need to rethink the linear notion of value chains
- Labour-only outsourcing (via labour placement agencies) is prevalent in business services
  - Turning fixed costs into variable costs, esp. where capacity utilization is difficult to predict