In Defense of Responsible Offshoring and Outsourcing

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Let's get real — and back to basics.

In an era of high unemployment, and especially in this political season of economic nationalism, both parties outdo themselves with promises to "rebuild America." Yet, the imperatives of offshore facilities and employees are — and will remain — central to American companies' international competitiveness. A company's foreign sales can approach or exceed 50 percent; its non-U.S. employees can be 25 percent or greater of total workforce; its supply chain of third parties is vital.

Yes, everyone would agree that we have serious economic policy issues at home about creating jobs, stimulating growth, increasing exports, improving education, investing in R&D, encouraging high-tech manufacturing — and about reconciling the cost of any governmental initiatives with significant debt reduction. However, given partisan divisions about proper public/private roles, these issues will stay in flux — and will be distorted or obfuscated as the campaigns jockey for position — until after the election.

What is not in flux is this fundamental reality: American companies will, for a wide variety of reasons relating to global dynamism, continue to participate in this transformative era of global economic change by increasing activities and hiring workers outside the U.S., especially in fast-growing foreign markets. (They may also, on a limited basis, move some jobs back to the U.S. for certain domestic markets due to rising costs abroad and labor productivity at home.) Yet, politicians oppose — or at least do not defend, and certainly do not fairly explain — this most fundamental international dimension of global business reality. In the State of the Union, President Obama declaimed: "No, we will not go back to an economy weakened by outsourcing..." The Republican candidates largely stand mute on off-shoring because of jobless pain at
home and the difficulty of explaining that trade is only one factor causing unemployment. Offshoring and outsourcing today are like sex in the Victorian era: repressed or criticized in public discussion, much practiced in private behavior.

It is therefore vital for global businesses, which may be subject to exacting scrutiny, to defend offshoring with clear positions and clear actions regarding purpose, global standards and assistance for displaced workers. These have always been "must do's" in the long debate about labor markets in globalization, but clarity on these issues is especially necessary this year. So here, in brief compass, are my views on the responsible, competitive basics of offshoring and outsourcing which global companies must be prepared to embrace forcefully — and to articulate clearly in their communities, with their stakeholders and, as necessary, in the political maelstrom.

**Business Purpose.** Companies must step up and honestly explain why they offshore business functions and employment in a broad array of product and service activities to compete in a truly global economy. Among the strong (and standard) reasons that non-business people could understand, if properly explained (and if supported by the facts), are:

- The need to stay cost-competitive with companies headquartered elsewhere, either through reduced finished product/service cost or through supply chain efficiencies;
- The need to manufacture, assemble, provide services, and do R&D in order to understand and sell in a local market, and to attract great local talent for jobs that would not ever be offered in the U.S.;
- The need to have a significant employment or plant/equipment presence in a local market because host governments demand it;
- Because such a presence can also pull a company's high-end exports from the U.S.;
- Because a presence can strengthen that market's economy and thus increase U.S. exports over time;
- Because any products imported back to the U.S. can benefit consumers and the economy with lower cost (although foreign operations often sell in foreign markets).

**Use of Revenues and Margins.** Similarly, companies must be more forceful in explaining the uses of revenues and margins derived from offshoring/outsourcing's competitive cost structures and local appeal. They are key both to cash flow which finances dividends and to "net income" that drives stock price which, in turn, benefits shareholders (heavily American) — especially older individuals who are either direct investors or who rely on pension funds. The cash from high revenues and margins is
also often used to enhance the corporation: for improving its operations, productivity, technology and products, or for increasing reach and scale efficiencies through acquisitions. In a well-run, responsible company, only a tiny percentage of cash from global "profits" is used for executive compensation (an exception being some financial service companies where a high percentage of revenue goes to compensation).

**Working Conditions.** One of the traditional arguments against globalization is that multinationals offshore to emerging markets to avoid environmental, health and safety regulations in the developed world. In response to that criticism, international corporations have set — or should set — policies to assure decent working conditions overseas, both in their own facilities and in facilities of third party suppliers.

These policies cover such issues as: prohibitions on child and prison labor, wages and hours, living conditions, worker safety, adherence to environmental standards, non-discrimination and non-harassment. Importantly, the policies can be based either on local law or on standards beyond local law corporations voluntarily adopt. For example, multinationals might adopt a minimum age of 16 for child labor in all nations both for the welfare of child and for administrative convenience (child labor laws vary across nations).

These policies must be made real by implementing systems and processes in education and training, in leadership development, in protocols for qualifying and re-qualifying suppliers as well as for assessing second and third tier suppliers, and by imposing real sanctions when suppliers violate standards. Critically, the policies and their implementation must be subject to verification for credibility — either by inside or outside auditors, or in public reports from independent third party auditors (such as those established in the late 1990's under the Apparel Agreement between retailers and recently forced on Apple after working conditions in Chinese factories made the front-pages and led to global protests at Apple stores).

**Quality.** It is imperative that global companies ensure quality in their offerings with overseas input — whether complying with legal requirements or following self-imposed quality standards. Serious safety and quality concerns in offshored or outsourced components, ingredients and products are now a key part of the globalization debate. Lead paint in toys, antifreeze in toothpaste, tainted ingredients in blood-thinner medicine and unsafe food (for people and even pets) — these events have led consumers, parents, patients and regulators to question whether products using global suppliers are of sufficient quality and safety to protect American end-users — and end-users elsewhere in the world — from grievous harm. Companies must proactively address these concerns as a matter of course.
"Deverticalization" in creation of goods and services through use of third party suppliers does not relieve the ultimate seller from ultimate responsibility. The seller must assure tight contracting and a vigilant oversight "system" quality for items sold in the global marketplace to avoid defects that threaten functionality or, more importantly, that risk impairing health and safety.

Worker Transition at Home. Whether due to ethical concerns, to sound policy or to good politics, American multinational companies would be wise to use their balance sheets, when possible, to provide decent severance, job training and outplacement services to workers displaced in the U.S. Such company-specific efforts can be coordinated with governmental safety net programs, including Trade Adjustment Assistance. Aimed specifically at training, job placement, income support and health care for workers laid off due to international trade, this 50-year-old program was re-authorized last fall by bi-partisan majorities in both the House and the Senate. Its funding is not robust; it needs to be coordinated/consolidated with other programs for displaced workers (like unemployment insurance); its effectiveness in placing workers can be improved. But it is a program — and broader safety net concept — which multinationals should support and improve, in addition to programs for their own displaced workers, to assist those American workers adversely affected by accelerating global technology change and competition.

After the election, the American people and American companies face many difficult public policy issues on labor markets and competitiveness in the deeply interconnected national and international economies. But for now, one thing is sure: corporations involved in international competition across the globe must practice and, when challenged, defend, responsible offshoring and outsourcing in fast-growing international markets — and it is especially important for them to do so in this election year when the issue may be distorted, misunderstood or unpopular.

Such overseas activity is a fundamental piece of the great puzzle for the future: what is the proper mix of public policies and private actions that will allow U.S. corporations to compete globally — against corporations benefited by "industrial policy" in other "market capitalism" countries; and against the new class of corporate powerhouses from autocratic nations practicing "state capitalism," who benefit from their governments' blatant favoritism?

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