

The global trade in outsourcing

Jonathan Shih, of *Market Development Financial Institutions* at UBS, looks at the challenge of outsourcing.

As the world evolves, it faces many challenges and therein opportunities, which have both a macro and micro impact. Outsourcing is an economic trend today, a cause for much debate, and provides a good example of both a challenge and an opportunity that affects the political and economic structure of the world and the individual working lives of its people.

Prima facie, outsourcing is a modern reflection of classical economic trade theory. Countries have different endowments of factors of production, at the most simplistic level labour and capital, and produce those goods and services in which they can best utilise their factors of production. Countries trade these goods and services, and overall welfare increases. It is, of course, a little more complex than that but the fundamental idea is important to bear in mind when considering outsourcing, which is largely consistent with classical economic theory. It also helps to avoid a misconception that outsourcing is the cause of economic change when in fact it is akin to an effect brought about by more profound economic forces.

Call centres in India are often cited as an example of outsourcing in practice. To some extent it is the relatively low labour costs in India that attract companies to outsource these activities, but that in itself is not sufficient. Most workers at the call centres are well educated, motivated and able to communicate effectively with clients from around the world, thereby delivering high quality client service. Technological solutions have also been found in the areas of

communication and client data protection to enable call centres to locate in India. In this way, barriers to trade have been overcome.

Whilst there is some truth in the argument that outsourcing involves the pursuit of low labour costs, outsourcing also pursues low capital costs. For the purposes of the low capital cost argument, capital is defined in its classical economic sense as a factor of production which has itself been "produced" and is not entirely consumed when it is used to produce other goods and services. A country such as the USA is relatively highly endowed with capital compared to India, and is well positioned to offer those goods and services that can best utilise that capital. The challenge is to produce the types of goods and services that the rest of the world demands. In this regard, the special skills that the US labour force possesses should not be forgotten as these enable the country to offer high quality services, particularly when labour is effectively combined with capital. The optimal combination of capital and labour arguably forms the crux of the issue.

Global companies are forced to combine capital and labour as effectively as they can in order to compete and to survive. In this respect, outsourcing is not new conceptually; for many years companies have been identifying opportunities domestically to focus on their core competencies and to outsource certain activities which they previously performed themselves in order to improve efficiency and/or service. The scale and the scope of activities that can be outsourced have

increased over time, and today even banks can outsource many of their activities to other banks. What we are also experiencing today is the integration of the outsourcing concept into what is fast becoming a truly global market place where both goods and services trade. As trade becomes ever more free, global competition will increase, and with it comes the expectation that outsourcing will follow suit.

Indeed, outsourcing may be one means of ensuring survival for companies that are effectively trading with each other on the basis of their core competencies. It might also be regarded as a less radical alternative to relocating a business overseas in its entirety. However, outsourcing should not be regarded as a panacea for companies. Furthermore, the social costs associated with outsourcing certainly exist and cannot be understated; in particular, outsourcing might help to reduce international inequality whilst increasing intranational inequality. In any event, it will be necessary for governments, companies and individuals to carefully think out their approach towards outsourcing, probably on the assumption that there is little that they can do to alter the concept, whose origins can be found in the long accepted and ultimately beneficial practice of trade. ■

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