



University of Navarra

Anselmo Rubiralta Center for Globalization and Strategy

# Notes on Globalization and Strategy

Year 3 / No. 7 / January-April 2007

## Offshoring Grows Up

With the offshoring of services, we have entered the next phase. Even though cost savings remains the main reason for offshoring, talent is coming to the fore as a new factor that will determine whether a country is an origin or destination.

In recent years companies have begun to offshore services as well, thus ushering in what is called the second generation of offshoring.

As the world becomes more globalized, companies are exploring new ways of grappling with the challenges posed by growth. Offshoring production to developing countries has been a common practice for some time now. However, in recent years companies have begun to offshore services as well, thus ushering in what is called the second generation of offshoring.

IESE has generated the Spanish chapter based on a survey of business leaders from a wide variety of industries.

Based on the international results of this study, the ORN director Arie Lewin explains that the new age of offshoring has opened up a "global race" for talent. However, not all countries are participating in this global competition. As can be seen in this study, Spanish companies only offshore services with low added value, and they continue to limit their strategies to cost-cutting.

The ORN director Arie Lewin explains that the new age of offshoring has opened up a "global race" for talent.

Beyond – though not ignoring – the savings on costs, this new type of offshoring is characterized by building more dynamic, heterogeneous business teams, and by the quest for talent in emerging countries.

In the following pages you will find a detailed analysis of the latest trends in offshoring extracted from the study conducted by the Offshoring Research Network (ORN). This international project, spearheaded by Duke University, brings together universities and companies from all over the world to analyze the offshoring practices in different countries, as well as the financial, political, and operational risks they entail.

Does this mean that intermediate countries such as Spain cannot benefit from the advantages of second-generation offshoring? If they cannot be a destination for offshoring, what role should they play in this new stage?

To find answers to these questions and obtain insight into the complex reality of offshoring, we encourage you to read this newsletter.

Joan Enric Ricart  
Center Director

[www.iese.edu/globalcenter](http://www.iese.edu/globalcenter)

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The imminent shortage of qualified staff in the industrialized economies has spurred a veritable “global talent race.”

Access to qualified staff has become one of companies' top priorities when offshoring.

Finding talent is crucial in the realm of innovation, engineering, product development and R&D technologies.

## The Global Race for Talent is On

Industrialized economies need talent to remain competitive. With the challenge of globalization, searching externally for this talent has become essential. The author examines the challenges posed by the new generation of offshoring.

The offshoring of services is now entering a new stage. The early days of offshoring have been left far behind, those days when companies in the industrialized world began to offshore their production activities to developing countries with the sole goal of increasing their efficiency by reducing labor costs. In the early 21st century, the challenges we are facing are those inherent in an increasingly globalized world, and different challenges require different solutions.

The latest studies reveal that there is an imminent lack of qualified staff in the United States – especially in the fields of science and engineering – which pushes companies, especially those that are more technology-dependent, to seek talent beyond their national borders. This shortage, which is affecting all the industrialized economies, has spurred a veritable “global talent race” which will unleash changes in our way of understanding and managing organizations. For this reason, the new generation of offshoring is more focused on high-level innovation activities and the quest for talent in emerging countries.

### Competing for Talent

Although cost reduction considerations remain most important for companies when deciding to offshore, access to qualified staff has become more important in the past three years and is now the major engine in the new generation of offshoring. According to the annual report issued by the Offshoring Research Network (ORN) spearheaded by Duke University and Booz-Allen-Hamilton (BAH), 70 percent of companies regard this as an “important” or “very important” factor. And U.S. companies with the most experience in offshoring deem it “more important” than cost efficiency.

This fact speaks for itself. Companies that have been offshoring for years to lower costs have realized that, merely earning more and spen-

ding less is not enough to remain competitive. They have to offer a high quality product that is internationally competitive. The quest for qualified teams that are capable of this type of product development has thus become a strategic imperative. Finding talent is crucial in the realm of innovation, engineering, product development and R&D technologies. Thus, the pressure to reach overseas talent and deploying offshoring strategies to achieve it are trends that mutually reinforce one another.

### From Offshoring to Innovation

Traditionally, the concept of offshoring has been associated with moving IT services, customer care services and other business processes to a country with low labor costs. However, this type of offshoring has now reached its maturity. The new generation of offshoring stresses production and processing innovation. In fact, between 2005 and 2006, the offshoring of product development projects has increased around 40 percent. This volume is forecasted to rise 65 percent for R&D technologies and over 80 percent for engineering and product design services during the next 18 to 36 months.

These trends lead us to believe that innovation activities will be the basic pillar of the new generation of offshoring. The phenomenon is especially evident in small technology-based companies: 48 percent of them claim that their first offshoring experiences were related to product development projects, in which they managed to make small investments profitable and significantly increase their release into the market.

### Winning Away without Losing at Home

There is a widespread fear that, despite its advantages, offshoring will lead to the loss of qualified jobs in engineering and science. The ORN study reveals that these fears are unfounded and that, in the short term, the more

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qualified jobs are created offshore the fewer are eliminated internally. The data show that 90 percent of all the offshored R&D implementations in 2006 did not lead to the loss of jobs in the home country.

Nevertheless, these results only reflect part of what is happening. The reality is that the most qualified functions are being offshored to support growth strategies centering on innovation. And this is done using two approaches: the short-term, with the goal of lowering the costs derived from recruiting talent worldwide; yet also in response to the perception that in the long term there might be a talent shortage in the home countries.

To remain competitive, U.S. and European companies will have to adapt to the new organizational realities. Innovation activities must include knowledge creation capacities in dispersed teams in which the workers will become responsible for the skilled functions. Domestic companies will have to prepare their employees to redefine their roles; to learn how to deal with cultural and institutional frontiers; to communicate and collaborate in international teams; and to compete with counterparts in faraway lands.

## A Destination for Each Talent

In line with the trends toward increasingly globalized innovation, offshoring destinations are becoming increasingly specific to better fulfill the offshoring operations. While India is still many companies' favorite destination (due to its affordable yet qualified workforce), other countries such as China, the Philippines, Canada and Eastern Europe have developed advantages for offshoring.

China is emerging as the favorite destination to offshore product development and procurement projects thanks to its extensive and growing manufacturing base. The Philippines is also gaining ground as the preferred site for U.S. companies to install customer care centers and legal counseling services. Despite having higher salaries than China and India, Canada and the Eastern European countries are, respectively, the favorite sites for the U.S. and Western European countries to develop nearshoring activities

While Canada is attracting customer care centers, financial services and other business processes, Eastern European countries are attracting activities involving process and product innovation. German companies prefer to offshore to bordering countries due to their linguistic and cultural proximity, while U.S. companies prefer to offshore to Latin America, India or the Philippines.

## How Business Practice is Being Transformed

This new age of enterprise centered on globalized innovation activities will profoundly transform companies' business models, structures, and processes. In fact, major changes are already underway: the loss of managerial control, attracting and managing international talent and the need to learn how to cooperate and compete with a mix of local and international service providers.

1. **Managing and controlling innovation processes scattered around the world.** The major risks of offshoring involve losses in managerial control and operational efficiency. These new challenges have reduced the importance of those associated with location and language or cultural differences. Indeed, the more varied and complex the offshoring activities, the more difficult it becomes to sustain management and control.

To handle these problems, the most advanced companies are experimenting with new types of organizations, using web-based collaboration tools, increasing direct coordination, trying self-organization techniques and more adaptable structures that facilitate work in dispersed teams.

2. **Recruiting, developing and retaining global talent.** The pressing "global talent race" will require companies to not only discover where they can find talent but also experiment with new human resources strategies that offer opportunities to develop the new teams. The most experienced companies in offshoring regard staff rotation as a new key risk. More than ever, companies will have to nurture their corporate culture and identity to include employees with various origins and strike a balance between global human resources policies and local practices.

**The next generation of offshoring stresses production and processing innovation. Between 2005 and 2006, the offshoring of product development projects has increased around 40 percent.**

**Innovation activities must include abilities to create knowledge in dispersed teams in which the workers will become responsible for skilled functions.**

**Companies with extensive offshoring experience as well as those without it regard the loss of managerial control and operational efficiency to be the major risks when offshoring.**



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The trend toward increasingly globalized innovation is making offshoring destinations increasingly specific to better fulfill offshoring operations.

### 3. Working with local and international suppliers.

Until now, large companies that practiced offshoring have shown their preference for leaving their innovation activities in the hands of subsidiaries (captive organizations). In contrast, small companies have trusted professional service providers not only to handle the necessary technical requirements but also to absorb many of the risks associated with offshoring strategies. This, in turn, has created a demand for collabora-

tive skills, integrating the employees from the supplier into inter-organizational hybrid teams, and new governing mechanisms to ensure that the collaboration was effective.

So long as offshoring becomes a key element in the new businesses, and its practices become widely accepted, local and international service providers will gradually become more professional and make efforts to become partners in offshoring.

## Spain: Offshoring with Reservations

While some countries are already immersed in the new generation of offshoring, Spain seems to be lagging behind. The main culprits seem to be uncertainty about the profitability of this type of project and a lack of experience.

The phenomenon of offshoring is marching onward in all countries and in all directions. There is now talk of a “second wave,” in which the offshoring of production activities has given way to moving higher added value services to emerging countries. The goal is not just to grow more but to be more competitive.

This process, however, does not yet seem to have gotten underway in our country. The study entitled “Offshoring in Spain: Causes and Consequences of Offshoring of Services,” conducted by IESE as part of the Offshoring Research Network (ORN), reveals that Spanish companies still tend to only offshore services requiring staff with low qualifications, and that when they do offshore, their reasons are more related to cost-cutting and gaining market share. That is, more than participating in the “global talent race” neck-in-neck with the major industrial countries, Spain is still in an “initial phase.”

Why this delay? Are Spanish companies not as well prepared to take advantage of the benefits of offshoring? What are executives afraid of? The Spanish chapter in the ORN study offers a vivid snapshot for understanding the factors driving and inhibiting offshoring in Spain.

### The Risks of Offshoring

Cultural differences with the host country (49 percent) and corporate resistance (44 percent) are the two main risks that Spanish business leaders have pinpointed when offshoring. These contrast with the international results, in which the fear of jeopardizing operational efficiency and quality of service – the most significant in Holland (52 percent) and the U.S. (68 percent) – rank top on the list.

The fear that customers will not accept it (43 percent) and the loss of managerial control (42 percent) are the second most important factors hindering Spanish companies from venturing into offshoring initiatives. This perception may well indicate that Spanish executives are more reluctant to change than their English-speaking counterparts.

Along with the risks perceived by companies that are already practicing offshoring, we should also take into account the factors that are leading the other companies to think twice. The factors most often cited by respondents to explain their refusal to offshore include uncertainty about the profitability of this type of project, the idea that the companies are not large

Cultural differences, such as language, are regarded by the business people surveyed as one of the main stumbling blocks to offshoring.

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enough, and lack of knowledge of the techniques involved. In other words, the majority of companies would venture to offshore if they had a greater guarantee of the profits to be earned and if they felt more capable of doing it.

## Facing Fears with Advantages

Companies that have chosen to offshore their services tend to rate their results positively. The first is cost savings. This factor, which is vitally important for Spanish companies (88 percent), has been the leading cause of offshoring all over the world. Indeed, more than 80 percent of the companies surveyed in the ORN countries acknowledge that they use this principle when making decisions. Even in markets such as the U.S., the leader in the so-called “global talent race,” saving on costs is the leading reason for offshoring in 91 percent of the companies.

This goal of lowering costs to increase profits is coherent with the fact that the functions most often shifted to other destinations are related to customer care (44 percent) and basic IT services (54 percent).

In view of the importance that companies place on costs when offshoring, it is interesting to discover the results of their incursions abroad. According to the ORN study, the savings achieved by Spanish companies that have practiced offshoring exceed their initial plans. These companies have lowered their costs around 30 percent, a figure that is even more meaningful if we bear in mind that 70 percent have achieved these savings in less than one year.

Other reasons leading Spanish executives to offshore are the opportunities for growth in new markets (68 percent) and the desire to be more competitive in their own country (51 percent).

Unlike the other countries surveyed, access to qualified labor is still one of the least important causes for Spanish companies, with only 36 percent of respondents citing this factor. This does not mean that there is no demand for staff in general. The mere fact that more than 70 percent of the companies surveyed are practicing or considering offshoring is a symptom that there is a labor shortage for certain jobs and that looking for skilled labor abroad is the ideal solution.

Saving on costs has been the main reason for offshoring for more than 80 percent of the companies surveyed in the ORN countries. In the U.S. this figure soars to 91 percent.

The majority of Spanish companies would venture to offshore if they had a greater guarantee of the profits to be earned and if they felt more capable of doing it.

## Risks taken into account when offshoring an activity (percentage of companies surveyed)

	Spain	Germany	Holland	U.S.A.
Customer acceptance	43%	21%	24%	46%
Loss of control	42%	33%	44%	48%
Corporate resistance	44%	n.d.	32%	36%
Cultural differences	49%	33%	36%	28%
Security of data	29%	14%	24%	55%
Quality of service	40%	28%	52%	68%
Recovery from disasters	28%	18%	n.d.	n.d.
Operational efficiency	32%	39%	46%	55%
Staff rotation	33%	26%	25%	40%
Loss of intellectual prop.	19%	20%	38%	40%
Political consequences	18%	22%	4%	22%
Staff demotivation	16%	31%	n.d.	n.d.
Political instability	24%	14%	21%	22%
Instability*	26%	13%	n.d.	n.d.

The qualifications of the workforce in the destination appears to be the most important factor when deciding on an offshoring country.



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Access to qualified labor is still one of the least important causes for Spanish companies, with only 36 percent of respondents citing this factor. This is not true of access to staff in general.

Despite the beginning of the “global talent race,” forecasts indicate that in the upcoming months the same type of activities will continue to be offshored as until now.

## Strategic reasons driving Spanish companies to practice offshoring (percentage of companies surveyed)

	Spain	Germany	Holland	U.S.A.
Redesign of industrial process	43%	41%	57%	54%
Cost cutting	88%	84%	80%	91%
Growth strategy	68%	42%	56%	66%
Improving redundancy (replication)	50%	9%	20%	23%
Access to qualified staff	36%	45%	64%	67%
Increase quality of service	44%	22%	55%	54%
Competitive pressure	51%	68%	55%	57%
Accepted industry practice	43%	43%	40%	34%
Change in the rules of the game	38%	n.d.	n.d.	n.d.
Access to new markets	23%	33%	33%	15%
Increase in speed	41%	25%	58%	47%

Source: J.E. Ricart y P. Agnese, “El offshoring en España: causas y consecuencias de la deslocalización de servicios”, November, 2006.

## All Right, Let’s Offshore, but Where?

Companies headquartered in Spain show a clear preference for India (24 percent) and Latin America (24 percent) as their offshoring destinations. For reasons of cultural and linguistic affinity, Latin America (along with Mexico) is one of the favorite regions when undertaking activities with a certain added value. These features help to make the move, infrastructure deployment (if needed) and later communication with headquarters more clear and fluid. The preference for India is due to the presence of multinationals headquartered in Spain that are seeking to lower costs.

Unlike countries such as Germany, which offshore certain services to Eastern European countries, nearshoring arouses very little interest among Spanish companies. Conversely, there are signs that Spain could play a role as an offshore destination for multinational companies, and as a nearshore destination for large European companies.

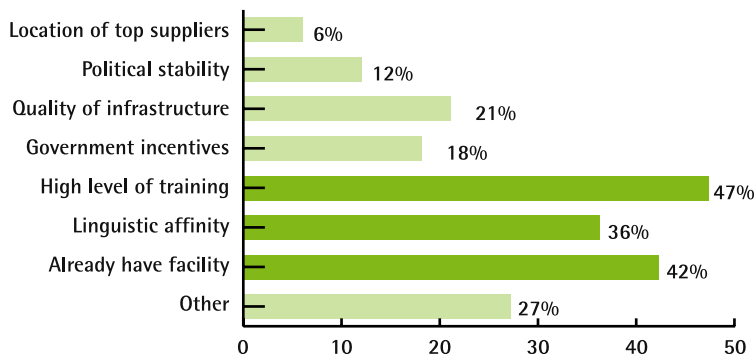
Once companies have decided to embark on a new offshoring project, the choice of destination becomes the number one decision. Along with the aforementioned cultural affinities – especially linguistic affinities – and the quest for lower costs, the qualifications of the workforce (47 percent) in the destination is the most important factor when deciding on a country. Likewise, the company’s experience in the region with previous facilities (42 percent) is also relevant. All of this seems to indicate that companies are more demanding when hiring abroad than in their own country.

## Looking Ahead

Despite the slow deployment, the offshoring of services is making headway among Spanish companies. The results of our study reveal that around 24 percent of the companies that do not yet practice offshoring are considering it, and in general those that already offshore have plans to step up the number of projects abroad.



## Factors that determine the choice of an offshoring destination



Source: J.E. Ricart y P. Agnese, "El offshoring en España: causas y consecuencias de la deslocalización de servicios", November, 2006.

Spain could play a role as an offshore destination for multinational companies, and as a nearshore destination for large European companies.

Nevertheless, it seems that Spain will still need some time before it joins the so-called "talent war." In their plans for the forthcoming months, executives mention continuing to offshore the same type of activities as they have until now, mainly customer care services and basic IT activities. So, for the offshoring of activities such as product design or engineering services to gain momentum in our country, the market – both origin companies and their suppliers – needs to be more mature and executives need to be more confident about the capacities of

the destination countries. These two conditions will probably be achieved as this type of activity becomes more widespread.

While this is taking place, Spain cannot remain indifferent to the challenges of offshoring given that all the countries will either be origins or destinations of this type of strategy. Perhaps this is the right time for Spanish executives to review their internationalization strategies and decide which role they would like to play in the future.

## About the Study

The study "Offshoring in Spain: Causes and Consequences of Offshoring of Services" is the Spanish chapter of the Offshoring Research Network (ORN), an international initiative spearheaded for the past two years by Duke University – Fuqua School of Business (North Carolina, U.S.A.) under the leadership of professor Arie Lewin. In addition to IESE Business School, the Spanish research partner, other business schools involved include: Copenhagen Business School (Denmark), Manchester Business School (United Kingdom), Rotterdam School of Management

(Holland), Otto Beisheim School of Management (Germany) and Université Libre de Bruxelles – Solvay Business School (Belgium). The study also has the global collaboration and sponsorship of Booz-Allen-Hamilton.

All the countries participating in the ORN use the same survey in order to make international comparisons and understand the differences between countries and cultures. The Spanish survey yielded 56 valid responses on 156 different implementations of offshoring.

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## New Challenges, New Opportunities

Offshoring poses huge challenges to intermediate countries such as Spain. Should they become a point of departure or a destination for offshoring? The director of the ORN study in Spain suggests that perhaps the best bet is somewhere in the middle.

**The main industrialized countries in the world are already offshoring services as a strategy for growth and competitiveness. Where does Spain stand in this new age of offshoring?**

The data from the study conducted by the Offshoring Research Network indicate that Spain has lagged somewhat behind in this race due to lack of incentives and accumulated experience. However, some of the offshoring projects undertaken in South America by large Spanish companies, such as Atento with Telefónica or important financial entities such as Grupo Santander, have been quite successful. It is still too early for an in-depth assessment of the results of these ventures, but our study reveals that the cost savings obtained (up to 30 percent) tend to exceed initial expectations.

**It seems that only large companies can benefit from offshoring services...**

It is natural for large companies to initiate the first offshoring experiences through their captive branches or through the services of large global suppliers (Accenture, IBM, etc.). These companies work with enormous fixed structures that allow them to cover hundreds or thousands of jobs in the offshoring destinations, yet the cost of such projects is difficult for an SME to handle. Nevertheless, new service providers better adapted to meet the needs of SME's are beginning to emerge. This is the case of a company located in Spain that operates

with a mobile structure in Peru. The concept is simple: management in Spain discovers the customers' staffing needs and offers to recruit technical staff that receive training from the supplier in Spain and then work remotely at Peruvian prices. As this type of supplier begins to become more common, SME's will be able to enjoy the benefits of offshoring.

**Can Spain become an offshoring destination for the rest of the world?**

Spain can play two roles: an offshoring destination for multinationals, and a nearshoring base for European companies. For the time being, the economic and social welfare, along with the natural resources, the favorable cost structure (compared to more advanced markets) and the climate make our country an attractive destination for multinationals' offshoring projects. However, there are still only a few examples of European nearshoring in Spain.

**The recent European Union expansion does not play in favor of Spain...**

There is no doubt that the enlarged EU has created new markets that are easy to access and offer relatively cheap and qualified labor. However, the possibility exists of becoming an offshoring in-between for certain European activities in developing countries, which can be managed from Spain, taking advantage of market knowledge and the value provided by a more similar cultural environment.

**In which industries can we act as middlemen?**

Acting as middlemen will most likely be impossible with industrial production activities in which the disadvantages of distance are difficult to offset. However, it should be possible with certain services which can be subdivided into front office and back office jobs.

This can be achieved in highly developed markets with qualified experts, such as in banking. Spain is a country with highly developed banking services, demanding customers and highly trained human capital. This expertise has led to the appearance of companies offering specialized services in European countries, such as information technologies for banks. These suppliers have highly qualified professionals managing their projects and customer relations from Spain, yet at the same time they subcontract the more mechanical jobs (programming or helpdesk) to countries such as Brazil and India.

**So, offshoring can turn Spain into a "land of opportunities."**

Yes, but what today seems like a fascinating and novel business opportunity tomorrow will become a strategic need that cannot be ignored. Perhaps now is the right time for Spanish executives to review their strategies and begin to look abroad, especially towards Eastern Europe and Latin America. Tomorrow may be too late.

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