Global competitiveness and offshoring

Increasing global fragmentation of the value chain process: Rising fraction of the value of the firm’s domestic sales consists of intermediate goods or services imported from foreign affiliates.

Globalization is not guilty of offshoring when companies are located in a business environment not conducive to competitive position due to low productivity, high labour cost, heavy tax and regulatory regimes, or adverse socio-political conditions!
Outsourcing strategy: From textile and automobile industry to services, R&D, call centers and innovation

- AMORA, Unilever, Decathlon (Poland)
- Karcher and Salomon (Romania)
- LOOK, Petit Bateau (Tunisia)
- Michelin (Mexico, USA)
- Cap Gemini (Eastern Europe)

- DOUX (Brazil)
- VALEO, PSA, RENAULT (Morocco, Romania, Latin America)
- SEB (Russia, Turkey, Mexico)
- TIMEX (China)
- Hugo Boss (Mauritius, India)
## Two-fold offshoring strategy

<table>
<thead>
<tr>
<th>Strategy 1: Horizontal FDI</th>
<th>Strategy 2: Vertical FDI</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Offshoring for producing closer to large foreign markets (either national market or springboard to foreign market)</td>
<td>- Global fragmentation of production process</td>
</tr>
<tr>
<td>Ex. Michelin, PSA, Renault</td>
<td>- Offshoring to benefit from lower costs (labor and taxes) and for re-importing output back in the home country</td>
</tr>
<tr>
<td></td>
<td>- Ex: Decathlon, Look</td>
</tr>
</tbody>
</table>

M.H. Bouchet SKEMA 2013 (C)
MNEs based in many of the major industrial countries are outsourcing their industrial and intellectual functions to providers based in the EMCs.

Source: Eiteman/Pearson, 2003  M.H. Bouchet SKEMA 2013 (C)
Outsourcing is one key element in total FDI outflows
FDI in/out China
IN = 4% of GDP, OUT = 2% GDP

OECD & WBGDI

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Incestuous globalization?

The bulk of trade and FDI capital flows is still within and between the 34 OECD countries.

2400 US companies employ 600,000 people in France while an equal number of French subsidiaries employ 460,000 people in the US.

In Europe, 60% of overall trade is within the EU (up to 80% for Netherlands, and 75% for Belgium).

France: 63% of trade within the EU and 50% in €Zone.
The global market place is a myth
The end of globalization?
(Alan Rugman-2000)

- Majority of trade and investment transactions are within regions
- There are just 500 MNCs competing in regional markets
- 50% of FDI within the 34 OECD countries
- 80% of FDI takes place in regional blocks
- Triad region: North America + Europe + Japan
- MNCs are regionally based and locally operated
From « outsourcing »
to « around sourcing »

For many MNCs, « Out » is over.

Google Finance was entirely conceived by the Google team in India and then Google engineers around the world fed into that team, rather than the project being driven by headquarters in Silicon Valley.

No barrier between thinking and implementing

Networks of production & services: Global fragmentation of production process
WHY OUTSOURCING?

1. Dynamic foreign market demand
2. Cost Competitiveness (exchange rates, wages & taxes)
3. Comparative advantage (manpower & natural resources, geographic proximity)
4. Technological progress & Productivity
5. Country risk
Why outsourcing?

1. Dynamic market demand & new international economies of scale in the globalization

= getting close to consumers!
The global megatrends:
Balance of power shift in the XXI° century

Population Of The West As % Of The World Population

Source: United Nations (April 2011)
Global Crisis = Spill-over effect = volatile & anaemic growth

GDP growth rates %

IMF-2013

M.H Bouchet- SKEMA (c) 2013
Nothing new on the West front: markets are shifting East outside the OECD

Source: Siemens 2013
Why Outsourcing?

2. Home job market deficiencies

- Foreign sourcing of cheaper job inputs = competitive requirement!
- Shrinking working population
- Gap quality & quantity supply/demand in the job market
- Globalization of labour markets, not only for low-skill assembly-line jobs but also for jobs requiring advanced computer and engineering skills!
Working population growth rate 1960-2050
EU’s Age Pyramid  current and projected (2050)  
Active population shrinking = dropping growth potential = productivity challenge

Source: CPE et Commission européenne (2005)
Markets, consumption demand, working population, and demographic expansion

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2030</th>
</tr>
</thead>
<tbody>
<tr>
<td>60+</td>
<td>23%</td>
<td>35%</td>
</tr>
<tr>
<td>20-59 (Working age population)</td>
<td>21%</td>
<td>30%</td>
</tr>
<tr>
<td>0-19</td>
<td>56%</td>
<td>48%</td>
</tr>
<tr>
<td></td>
<td>21%</td>
<td>17%</td>
</tr>
<tr>
<td></td>
<td>25%</td>
<td>22%</td>
</tr>
</tbody>
</table>

Source: Statistisches Bundesamt, INSEE
Made In Mexico
More manufacturing is shifting to Mexico as productivity-adjusted wages surge in China

Wages per hour

Sources: Boston Consulting Group, Nat’l Institute of Statistics
China’s Offshoring south-south and south-north

- China’s growing FDI flows toward South-East Asia to benefit from cheap labour force and to bypass export quotas and trade barriers in the OECD (Cambodge, Lao, Bangladesh, Vietnam, Macao) = 115 mega factories
- China’s FDI in Europe: COSCO in Greece, Great Wall Motors in Bulgaria, "Châteauroux Business District" to get the « made in Europe » label
- Chinese FDI has risen two-fold in 2005 to reach > $12 billion (including offshore centers)
- China’s FDI 2010-13 >$60 billion/year
EMCs’ multinationals

- China: (Shipping Cosco, Great Wall Motors, world leader in electronic products TCL, Lenovo, Huawei, Haier, ZTE, Konka Group Corp. China's best-selling colour television manufacturer, Sany…)
- India: Ranbaxy and Dr. Reddy’s, world leaders in pharmaceuticals, Mittal, world leader in steel production (Arcelor), computer services and software (Infosys, Wypro)
- Taiwan: Acer
- Brazil: world leader in steel production (CVRD, VALE) + Petrobras
- Dubai: world leader in port management and containers (Dubai Port World)
August 2010: Volvo's Chinese owner Geely plans to broaden product range and build vehicles in China. The $1.8 billion sale of Volvo was the largest acquisition by a Chinese auto company of a western automaker: control of a global brand + access to advanced technologies. Good to compete against GM and VW in China!

June 2012: Sweden's Saab sold to a group of Chinese, Japanese and Swedish investors who plan to convert the company into a manufacturer of premium electric vehicles for China and for the global market! (Saab had filed for bankruptcy in 12/2011)
Spring 2012: SANY leading Chinese manufacturer of construction machinery buys Putzmeister in the high-tech region of Germany’s Bade-Württemberg: global leader in construction material and trailer mounted concrete pumps (€500 million) and symbol of German Mittlestand!

Summer 2012: Chinese-owned Putzmeister acquires one of Europe's leading manufacturers of concrete truck mixers: Intermix, in a deal worth $10 million
Why Outsourcing?

3. Large potential market + stable country risk

http://www.orientsoftware.net/software-outsourcing/why-outsourcing-to-vietnam

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Most attractive EMCs

Country risk (economic and political)
(0 = low stability, 100 = high stability)

High Risk

Low Risk

Market potential*
(0 = low potential; 100 = high potential)

* Based on weighted score of market attractiveness, market saturation and time pressure scores
Source: A.T. Kearney

Size of the bubble indicates retail sales of food, drink and tobacco in $ billions, excluding taxes, in 2005

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Targeting the growing middle-class?

Shares of Global Middle-Class Consumption, 2000-2050

- Others
- European Union
- United States
- Japan
- Other Asia
- India
- China

Source: OECD.

M.H. Bouchet SKEMA 2013 (C)
Potential market demand OECD & EMCS?

Middle class’ arbitrary threshold? = individuals who earn $>4000 < $17,000 = 500 million in EMCS in 2012

Source: Carnegie 2012  M.H. Bouchet SKEMA 2013 (C)
How defining « midle class »?

High correlation Cars & Consumption per capita

Income-based measures tend to underestimate the swelling middle class’s size and growth rate in many EMCs. Using the Car index? (Uri Dadush-Carnegie 2012)

Countries with the largest increase in cars in circulation 2006-10

Source: World Bank

Source: Ward’s World Motor Vehicle Database

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From outsourcing to "re-sourcing"?

Growing number of MNCs (Japan, France, US...) relocate their production and service centers back to head offices in the home country.

Why?

- Rising labour cost, transportation costs, credit access, country risk, customs delays, FDI obstacles, regulatory framework, bureaucracy and corruption
- Discriminatory government practices: procurement rules, opacity of legal system, intellectual property abuse... (China)
Outsourcing and Job Losses?

Do FDI and outsourcing create large unemployment « at home »?
Offshoring and social impact?

Major cases of offshoring in France:

- PSA, Michelin, Perrier, Hoover, SEB, Moulinex, Danone, Metaleurop, Grunding, Myris, Flodor, Flextronic…

Regional and sectoral impacts?

- Alsace, Lorraine, Clermont, Soissons, Aulnay…
- Soissons region: Liquidation of Wolber (subsidiary of Michelin) : 90% of tire tubes are now imported from Asia
Offshoring & External trade = limited factors in Net job destruction!

- 1990s-2010: No massive transfer of OECD jobs to foreign workers
- France 1990s: around 13500 jobs/year lost (50% toward OECD countries, equivalent to 2.4% of industrial employment) Rapport INSEE
- 2000-2011: 36,000 jobs/year lost due to offshoring, but 40,000/year highly qualified jobs created due to higher market share (foreign companies alone create around 32,000 jobs every year in France)

# The impact of offshoring on jobs in Europe (2009)

<table>
<thead>
<tr>
<th>Total job loss</th>
<th>Offshoring job loss</th>
<th>Offshoring as % of total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>UK</strong></td>
<td>200,706</td>
<td>Germany</td>
</tr>
<tr>
<td><strong>Germany</strong></td>
<td>108,233</td>
<td>UK</td>
</tr>
<tr>
<td><strong>France</strong></td>
<td>45,405</td>
<td>Portugal</td>
</tr>
<tr>
<td><strong>Poland</strong></td>
<td>27,117</td>
<td>France</td>
</tr>
<tr>
<td><strong>Netherlands</strong></td>
<td>22,111</td>
<td>Slovenia</td>
</tr>
<tr>
<td><strong>Sweden</strong></td>
<td>16,691</td>
<td>Denmark</td>
</tr>
<tr>
<td><strong>Czech Republic</strong></td>
<td>14,949</td>
<td>Ireland</td>
</tr>
<tr>
<td><strong>Spain</strong></td>
<td>13,963</td>
<td>Italy</td>
</tr>
<tr>
<td><strong>Hungary</strong></td>
<td>10,960</td>
<td>Finland</td>
</tr>
<tr>
<td><strong>Italy</strong></td>
<td>7,467</td>
<td>Sweden</td>
</tr>
<tr>
<td><strong>Finland</strong></td>
<td>7,240</td>
<td>Hungary</td>
</tr>
<tr>
<td><strong>Slovenia</strong></td>
<td>6,327</td>
<td>Poland</td>
</tr>
<tr>
<td><strong>Ireland</strong></td>
<td>5,697</td>
<td>Slovakia</td>
</tr>
<tr>
<td><strong>Belgium</strong></td>
<td>5,266</td>
<td>Belgium</td>
</tr>
<tr>
<td><strong>Denmark</strong></td>
<td>5,234</td>
<td>Austria</td>
</tr>
<tr>
<td><strong>Portugal</strong></td>
<td>4,478</td>
<td>Spain</td>
</tr>
<tr>
<td><strong>Lithuania</strong></td>
<td>3,398</td>
<td>Netherlands</td>
</tr>
<tr>
<td><strong>Slovakia</strong></td>
<td>2,383</td>
<td>Czech Republic</td>
</tr>
</tbody>
</table>

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FDI in France: what about France’s socio-economic attractiveness?

Foreign companies employ over 2.5 million jobs in France, they account for 20% of R&D and 1/3 of French exports are linked to foreign business implantation.

New investments by foreign companies have permitted “the maintaining or creation of 30,000 jobs/year since 1998”.

However, France’s attractiveness to FDI is dropping since 2008. The UK is n° 1 with 680 investment projects in 2011 and 30,000 new jobs, followed by Germany (600 projects and 17000 new jobs) and France (13000 jobs/year with 600 projects)
For the EU, the increase in services jobs related to manufactures global value chain is even bigger than the decline in manufacturing jobs.

Change in number of workers, millions, 1995-2008

Source: Timmer, de Vries, 2013
Offshoring & External Trade = limited factors in Net job destruction!

- USA: While EMCs competition may have driven low qualified job losses in some sectors, layoffs occur for reasons unrelated to cheaper imports.
- Interplay between demand shifts and productivity growth explains 80% of job losses. Trade + offshoring explains 20%.
- In the US, the trade deficit explains the loss of 700,000 jobs in manufacturing with 400,000 jobs added in service sectors.
- Forces such as technological change, investment overhang, and changing consumption behavior are key causes of job losses.
1980-2007: US unemployment rate has fallen significantly despite steady increase in imports.

- U.S. MNCs have consistently employed the vast majority of their employees within the U.S.

Since the 2008 crisis, unemployment increases while trade deficit shrinks!
Blaming China?

2006-2012: US average trade deficit with China is stable and reaches $250 billion, $22 billion/month, equivalent to 2% of GDP
US growth and job dynamics I

Given the current growth in the population of working age, the US economy has to add about 1.7 million jobs a year simply to keep unemployment from rising (150,000/month!)

But in the dynamic and everchanging American business environment, job growth is the net result of something between 14 and 15 million new jobs created and 13 million old jobs destroyed each year.

Offshoring and import competition have had little impact on unemployment (e.g. U.S. MNC goods imports from affiliates abroad are roughly constant over the last ten years, while the share of service imports rose slightly). At worse, the transfer of US jobs abroad to foreign affiliates amounts to 1.16% of US private employment.

Source: Offshoring, Import Competition, and the Jobless Recovery
Charles L. Schultze/06-2004/Brookings
Economic growth and job dynamics II

• In the US, every $ of corporate spending shifted offshore (mainly to India & China) generates $1.13 in new wealth for America’s economy.

• America’s offshoring advantage stems from cheap labor costs in Asia and dynamic exports to US companies abroad.

• 70% of workers ousted in favour of offshore alternatives find new work < 6 months!

Source: McKinsey Global Institute
Trade and job dynamics III

Net job creation = Lost jobs due to imports from Asia or LAC – job creation through the production of US exports to EMCs

2000s: An increase in US exports led to 2 million new jobs in knowledge-intensive sectors and their suppliers

The NY Fed shows that the NET number of US jobs lost due to international trade is small: 2.4% of total US employment
Offshoring and US Unemployment?
London School of Economics Center for Economic Performance (May 2012)

- LSE’s analysis found that offshoring tends to increase productivity and reduce costs, which can prompt firms to expand domestic hiring enough to offset the jobs lost to workers overseas.
- “Offshoring has no effect on native employment in the aggregate: increasing offshore jobs by 1 percent is linked to a 1.72 percent increase in overall U.S. employment of native workers.
- Offshoring also tends to push native U.S. workers toward more complex jobs, while offshore workers tend to specialize in less-skilled employment.
Conclusion: Globalization is not guilty of LT structural decline in manufacturing employment

- Decline in the share of industry/GDP and of industrial employment due to service externalization: 25% of jobs lost stem from service outsourcing (maintainance, food, computer, communication, logistics). All in all, the share of industry in GDP is not 14% but rather 33%!

- The share of manufactured goods demand in GDP decreases as income grows even though prices decrease.

- Manufacturing competitiveness is based on productivity increase and productivity increase is the main source of employment decrease! Productivity rise explains 30% of lost jobs. And foreign competition around 35%. 

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Decline in manufacturing employment share in total employment 1980-2030 (unless productivity growth stops?)

- Japan
- Southern Europe
- Nordics
- Continental Europe
- Mature economies
- United Kingdom
- United States

1 Assuming that sector productivities will grow in all countries/clusters at the same rate as they did in the mature economies sample between 1996 and 2006; real value added forecast from IHS Global Insight.

SOURCE: IHS Global Insight; EU KLEMS; McKinsey Global Institute analysis

M.H. Bouchet SKEMA 2013 (C)
Are EMCs scapegoats?

The EMCs and offshoring are not to blame for structural unemployment in the OECD. Ongoing productivity increases impact on sectoral and employment shifts: manufacturing output increases while employment decreases (<10%)!

In the meantime, there is rising demand for workers in services (tourism, health care, IT, and higher value-added activities).

Key challenge: R&D, innovation, education & training!