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Is Backshoring the New Offshoring?

by Vinay Couto, Ashok Divakaran, and Mahadeva Mani

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Is Backshoring the New Offshoring?

The business press is touting a return of offshored jobs to the U.S. — but we're not buying it.

by Vinay Couto, Ashok Divakaran, and Mahadeva Mani

Dell. Apple. American Express. Much hay has been made of the decision by these and other U.S. companies to scale back some of their offshore customer service operations after learning some hard lessons. In particular, companies discovered that angry customers have little tolerance for complaint desks located thousands of miles away in distant countries.

But do these repatriations of offshore jobs mark significant new attitudes toward offshoring? The business press appears to consider it a trend, even going so far as to point to a new twist: reverse offshoring or "backshoring," exemplified by information providers like India's Wipro and TCS, which have recently increased their presence in the United States.

This has sparked a lively discussion, much handwringing, and many articles in the Wall Street Journal, Business Week, and other business publications. But the question should come down to this: Are we witnessing a major shift in the direction and dynamics of offshoring? The answer, we have concluded, is no. Or, at least, not yet.

As the concept of offshoring matures and settles, companies and vendors can expect a natural rebalancing as they determine what work can best be performed where. The U.S. will, no doubt, gain and lose some ground in the process. Indeed, companies have begun to rethink their offshoring decisions in a way that ultimately will render "offshore" and "onshore" no longer meaningful or relevant. Instead, companies are making choices about the best place to do a given piece of work — be it offshore, onshore, or nearshore. As this transformation occurs, work is being spread throughout the world and companies are globalizing to keep up. But we're only at the beginning of that process, and we won't witness the full effects for quite some time. Traditional offshoring, as we know it, is by no means dead.

Backshore decisions are occurring now only under unusual circumstances. For example, when Dell's customers began to grouse about the perceived inability of foreign-sounding customer service representatives to solve their problems, the company's sales were already suffering due to complaints about poor product quality and service. Consequently, to eliminate a black mark on its reputation that it couldn't afford in a highly competitive market — and to remove the thorn in the side of customers who were in no mood for more inconvenience — Dell chose to repatriate telephone service operations from India to semirural locations in the U.S., such as Twin Falls, Idaho.

At present, moves like Dell's are fairly rare. In fact, a survey of more than 600 global companies conducted this year by Duke University found that three-quarters of

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U.S. businesses plan to offshore more customer service operations. Despite the falling dollar and relatively low labor and real estate costs in semirural America, the U.S. cannot compete with the economics or demographics of India and other emerging markets players. Although warnings about rising offshore labor costs make for juicy copy, the sheer number of new entrants into the skilled labor pool in developing countries will keep offshore labor prices competitive relative to the U.S. for the foreseeable future. Indeed, as America's baby boomers enter their retirement years, it will be hard for many would-be backshoring companies to find skilled workers in the U.S. to do the tasks that they offshore now. In negotiations with one of its unions last year, AT&T agreed to return home 5,000 customer service jobs from India. But CEO Randall Stephenson reported that the company couldn't find enough workers with the right skills to fill the jobs; AT&T had to saddle itself with an unanticipated training program to bring new workers up to snuff. The experience caused the company to slow down moves toward job repatriation.

Another force in offshoring's favor is the dramatic rise in fuel prices — and, more generally, in the inflationary pressures that are nipping at the heels of most developed economies. Rising fuel costs will undoubtedly cause companies to reconsider the economic merits of offshore manufacturing because of potentially prohibitive transportation costs. But these same forces will also, we believe, cause the demand for the offshoring of services to increase. Soaring commodity prices will hit not just manufacturers but all industries, making it more important than ever for companies of all types to cut costs rapidly without significant new investments. For example, airlines will be especially harmed by fuel cost increases and will almost certainly conclude that one of the few ways to earn a respectable return with little capital outlay is to offshore service operations. In addition, high oil prices tend to push down emerging countries' currencies, further highlighting the advantages of service offshoring.

The same cost-cutting pressures will affect innovation strategy. Company research and development will increasingly be shipped to low-cost countries to reduce expenses and increase speed in launching new products — or new versions of old products — in highly desirable emerging markets. It's an activity that could determine the difference between survival and collapse for many businesses. Some companies will find themselves betting their future on major innovations — for example, alternative-fuel automobiles or energy-efficient motors and appliances. And because many of these products will be targeted at the growing middle class in developing countries, companies will be more willing to move their crown jewels — product development and R&D — offshore, a less expensive alternative with close links to the customers they want to reach.

Nonetheless, it is possible that continuing pressures on global exchange rates will affect the offshoring strategies of U.S. companies. If the dollar continues to slide, cities like Spartanburg, S.C., or Tuscaloosa, Ala., could find themselves becoming homes for onshore service centers and selectively taking over some of the work currently performed overseas. But it is important not to conflate isolated moves of this sort with news about Indian companies such as Wipro and TCS scaling up their operations in the U.S. and declare that the nature of offshoring has changed.

No matter how these various scenarios play out, we believe offshoring will maintain its fundamental viability. Service providers have made significant investments to build up their businesses. After decades of being stymied by bureaucratic restrictions, they have finally begun to compete on the world stage. The combination of deregulation and technology (in the form of inexpensive, high-bandwidth global telecommunications) has enabled them to break through. Having tasted success, service providers are determined to stay in this game for the long haul, and they will take steps to remain competitive — even if it means sacrificing a portion of their margins during a short-term transition period. The economic attractiveness of service offshoring will remain — much more so than for manufacturing offshoring, which is more susceptible to energy pricing shifts because of transportation and logistics costs.

But service providers should not count on price alone to keep their customers. The next few years will be a period of reckoning for offshore service providers — and that will be good for this industry. Their customers will increasingly be Western companies under duress. These companies will demand a rapid and real payback, trouble-free transitions, and consistent service with a minimum of goofs — a reality that, for more than a few providers, has proven elusive. This, more than any other factor, could drive a new wave of maturation within the offshoring industry. Few things can promote discipline more effectively than price-sensitive buyers who are themselves on the edge. As the world demands more from its offshore providers, those providers may well cross a new threshold of capabilities. +

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