

## Offshore Outsourcing (O<sub>2</sub>) and Human Capital

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### Abstract

In recent decades the economic development of many countries is much more as a result of the innovative ideas of human capital, rather than the material inputs. Today many states have set as a priority the knowledge based economy, and this for various reasons such as the intense specialization in specific activities, the impetus of research & development, the requirements of the market demand, etc.. Human resources are determined the currency of every society, in promoting the economic development or smoothing any crisis. On the other side a new trend is growing faster and faster, the outsourcing offshoring (that I have denoted shortly O<sub>2</sub>), considering the alternative the oxigen of a firm regeneration. What actually happens? If we refer to recent developments O<sub>2</sub> and workforce training are mutually motivating each other. The development of technology and the ability to move freely brought the displacement of a range of activities from developed countries to developing ones, by increasing global labor turnover. This slipping initially motivated by the low cost of labor, is accompanied by two effects: Enhancing the importance of this production factor and finding alternatives for maintaining or increasing the level of employment in developed countries. The request for re/qualification of the workforce as per developed countries and the developing ones. The novelty of this paper lies in a cleave analysis of human capital as a determinant factor (labor costs, quality of work, education and training, etc..) of outsourcing offshoring.

**Keywords:** Outsourcing-offshoring, human capital, cost, skills.

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*"The worldwide pool of available-trained workers is much larger, and they are only a mouse-click away." Eduardo Porter, "The Bright Side of Sending Jobs Overseas," New York Times, February 15, 2004.*

### 1. Introduction

In recent decades, the economic development of many countries is the result of human capital innovative ideas of rather than the material input. Today, many countries have established as a priority precisely the economy based on knowledge, due to various reasons, such as specialization in specific activities, research and development, market demand, etc. Good examples of this are countries like the U.S, China, Germany and India, which are the leaders in terms of development trends. The competitive advantage of developed countries such as Germany or the United States is based largely on the level of education of their labour force (Garner Schwartz 2004). On the other hand, even the countries in development are not lagging behind. According to Kehal Singh (2006), many developing countries, which today are the leaders of global market in outsourcing/offshoring, have invested heavily in sciences, mathematics and engineering. For example, few people are aware that India in 1960s and 1970s realized major investments to establish education institutions offering competitive learning environments and that today a good part of the employees in off-shoring projects have graduated in these institutions.

Being in front of an overall globalization pressure, the qualification of labour force t has become indispensable, especially if we observe the absorption indexes and the struggle for absorbing foreign investment.

The economic entities, either public or private, have no more limits in the distribution of output and activities. According to Singh Aron (2005), with the development of outsourcing / off-shoring there is no more a localized organization, but an organization extended in many different forms.

An important factor in their horizontal and vertical expansion is opportunity to locate anywhere in the world. It is enough that the destination country has the characteristics or meets the requirements of multinational companies, where human capital is one of the motivating factors. Many researches (Carmel, 2003; Farrell, 2006 etc. <sup>1</sup>) rank labour force as one of the most important factors in terms of redistribution of activities outside the firm or/and abroad.

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<sup>1</sup> For more information see table 1- Role of Human resources in the selection of host country.

## 2. But what Happens in Reality?

If we refer to the recent developments, O<sub>2</sub> and the high skilled human resources are mutual motivators of one another. The development of technology and the ability to move freely has brought the displacement of several activities from the developed countries to the developing ones, thus increasing the global movement of labour. This shift, which initially was motivated by the low cost of labour force, is accompanied by two effects:

❖ **The increase in importance of this production factor and finding alternative solutions to preserve or increase the employment level developed countries.**

Many developed countries in Europe or USA have tried for years to prevent or prohibit the development of O<sub>2</sub>, through negative media coverage, governmental laws or trade-unions which exercise constant pressure on companies not to outsource their activities abroad. The given motivations are different, such as, for example, the safeguard of data security, or privacy rules, loss of jobs, decrease of national income, etc., (Suri, 2005).

On the other hand, many government agencies, while trying to absorb investment, are being informed on the types of outsourcing and their adaption to the needs and capabilities of the host country (Graf & Mudambi 2005). The US President, Obama, stated in 2012, that he disapproved that American companies seek for qualified workers in China or India. For this reason, he asked the Congress to make available to schools and teachers, the necessary resources to train students in US (The Economic Times, 2012).

❖ **Increasing demand for high skilled labour force in both developed and developing countries.**

Outsourcing, offshoring and O<sub>2</sub> have brought changes in occupational and professional identity and are creating new challenges for government drafting their policies for education and training, and for the professional associations thinking about upgrading the capabilities. (Sako, 2005)

Precisely, this erosion of workforce has obliged many U.S. think tanks search for strategies increasing the skills of labour force in knowledge- intense industries or activities. (D'Aveni, 2004).

In 2011, the Malaysian Minister of Human Resources, S Subramaniam, asked urgently a reform related to the training of workers, expressing his concern about the low level of high skills jobs (about 28%). The Malaysian government invested 500 million Ringgit to increase the skills of workers in the framework of 2011-2015 development plan. (The Economic Times, 2011).

Education is on the means a society can use to promote economic development and mitigation any crises, especially, when the economic boundaries between countries are fading more and more and the domino effect in the world cannot be called anymore "unusual", (here it is sufficient to mention the Eurozone financial crisis in).

The trend of offshoring / outsourcing should be first studied; in the perspective weather a country is ready to meet the market requirements by making available a skilled labour force. The purpose of this paper is to study the role of education of labour force in Albania, referring to the potential of human capital, the nature of development policies, the profile of the companies operating these last 5 years and their readiness to respond to the requirements of foreign companies foreign while providing the required activities.

## 3. Literature Review

The role of human resources, treated in all studies having in their focus the factors which affect in the selection of the host country.

*According to Emmanuel (2009), "human resources is an inclusive concept which refers not only to human capital- health and education of an individual- but also to mentality, his view of the world, values, emotional stability and other personal features....., while human resource development as the process of increasing human resources, competencies, skills, intelligence and talents of the members belonging to a particular organization and to all people in a society".*

Intelligent countries strive to make attractive the "brainpower industry", through education of their population. An example is the Indian government, which in 2005 established the National Knowledge Commission with the purpose to make India not only a manufacturing society of knowledge, but also a consumer society and distributor of knowledge. Emmanuel (2009)

The table below gives some of the main studies on the selection of the host country, where the importance of human capital is seen in different perspectives. In their study, Graf & Mudambi (2005) have analysed human capital in five dimensions: availability of labour, experience, quality, cost and cultural distances. The first three elements influence positively on the growth of O<sub>2</sub> while the two others influence negatively.

According to Oshri, Kotlarsky, & Willcocks (2009) the skills required through localization in one place, include business technical know-how, leadership skills, foreign languages and the ability to learn and create new things (innovations).

According to "Professional Digest" (2013), two factors determine the degree of offshoring of activities to another country: the size of talents pool offered by this countries and its geographical position. It is very important for the successful outsourcing of activities to control the level of workforce training and demand-supply ratio in terms of density of the labour force, but forgetting education and the risk of diminution.

**Table 1.** Human Capital role in the selection of the host country

Authors	Year	Title of paper	Motivator factors of destination (Human Resources)
Carmel	2003	The New Software Exporting Nations: Success Factors	Orientation and national traditions; size, human capital; composition; language skills, managerial skills.
Graf & Mudambi	2005	The outsourcing of IT-enabled business processes: A conceptual model of the location decision.	Availability; experience; quality; cost; and cultural differences.
Farell	2006	Smarter Offshoring	Availability of workforce with the required skills; The size of the domestic sector which provides information technology services and other business functions.
Liu, Berger, Zeng, & Gerstenfeld	2006	Where to Outsource: Selecting an Offshore Outsourcing Location	Culture / Language; Expertise / Sustainability in the supply of labour force.
Oshri, Kotlarsky, & Willcocks	2009	The Handbook of Global Outsourcing	Market size for the required skills and capacity in the long-term.
Liqin,	2011	Study on the Ability for Jilin Province of China to Undertake Outsourced International Service	The quality of the workforce; Technological skills.
A. T. Kearney	2011	Offshoring Opportunities Amid Economic Turbulence	Experience and evaluation of the quality of the services sector in the distance; Availability of labour force; Education and Language; Risk of attrition.

#### 4. Recent Developments

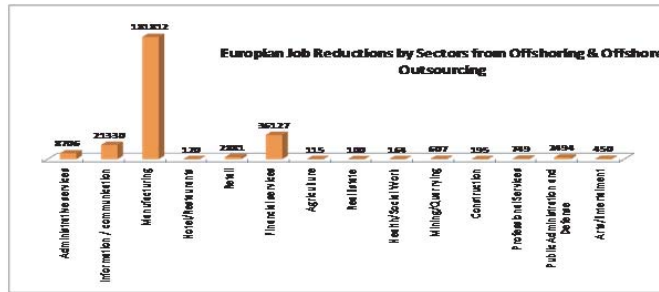
Almost all reports discuss the growing importance of value in international chains, accompanied by a spread of production networks across the globe. In Europe for 2010-2014, about 63 companies offshored their activities outside the borders (offshore and O<sub>2</sub>), mainly in the manufacturing sector activities (Eurofound, 2014). According to OECD, the value of imported intermediate inputs accounts for 25 % of total exports in OECD countries. If a country, gets involved in value chain market it increases revenues from exports, increases the number of employees and also indirectly affects positively in areas such as management, technical know-how and access to new technologies (World Economic Forum, 2013).

Among other things, nowadays companies are looking for educated and trained employees, especially in technical fields. The most important reason for outsourcing is achieving a competitive advantage through the acquisition of a skilled workforce with a cheaper cost.

Another concerns of our times, is the cost trade-off versus quality and quantity of workforce . The solid presence of these factors has made two Asian countries, like China and India to be leaders of outsourcing (Radwan & Fernando, 2005). According to Farrell, Laboissière & Rosenfeld (2005), 11% of jobs in the service sector can be accomplished in distance everywhere in the world, thus turning into priority the employment and training /education for specific functions. The Labour Statistics Bureau, in an analysis of 2007 in USA, it was estimated that over 30 million employees (20% of the workforce) carry out tasks which could be realised also outside the borders (Levine, 2012).

The sensibility of this phenomenon has affected Europe as well, as due to offshoring the number of jobs lots are counted over a quarter million (Eurofound, 2014), while US in 2013 has outsourced outside the borders (O<sub>2</sub>) 2.637.239 jobs (The Countries of the World, 2014).

**Figure 1-** Reduction of employment by sectors from offshoring and O<sub>2</sub> in 2001-2013



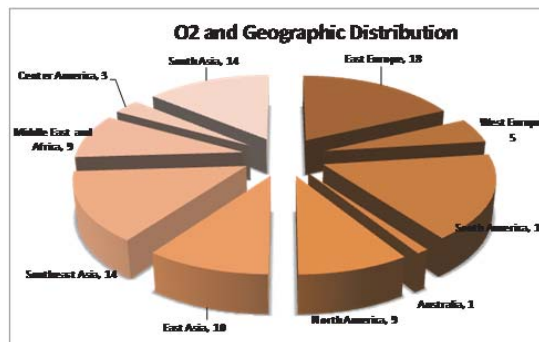
**Source:** (Eurofound, 2014)<sup>2</sup>

According to statistics (Eurofound, 2014), few new jobs are created in Europe by offshoring. Even the service sector is associated with a decrease in employment in EU countries with 44% Kirkegaard (2007).

This has happened and continues to happen due to technological developments and liberalization of economies, which make possible (1) the diffusion of diverse geographic distribution, and (2) a more visionary businesses.

According Tholons (2013), for U.S. firms, the transfer of activities is a strategy to search capacity with higher value. European firms main goal is to reduce costs, increase efficiency and flexibility, while for Asian firms this strategy enables concentration in the core activities and standardize the activities.

**Figure 2-** 100 Main destinations of O<sub>2</sub>.

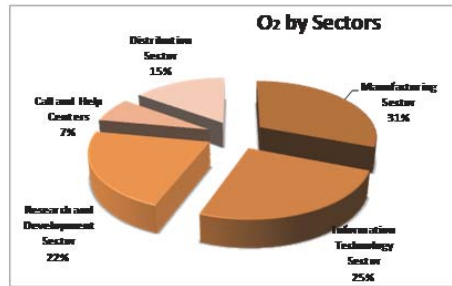


**Source:**(THOLONS, 2013)

Eastern Europe, Southeast Asia and South America are among the most preferred locations.. O<sub>2</sub> rate is different by sector. The sector with more O<sub>2</sub> is the manufacturing sector, followed by technology sector, the information sector and research and development sector.

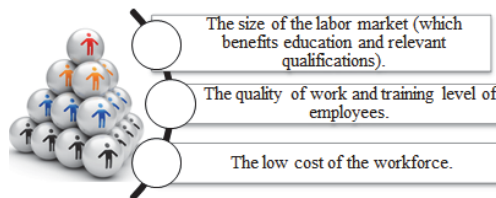
<sup>2</sup> The data used are statistics of Eurofound for 2001-2013. Eurofound is established in 1975 by the EU Council to improve lifestyle and working conditions. Countries involved in the statistics are Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Greece, Germany, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Norway, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden and the United Kingdom.

Figure 3- O<sub>2</sub> by sectors.



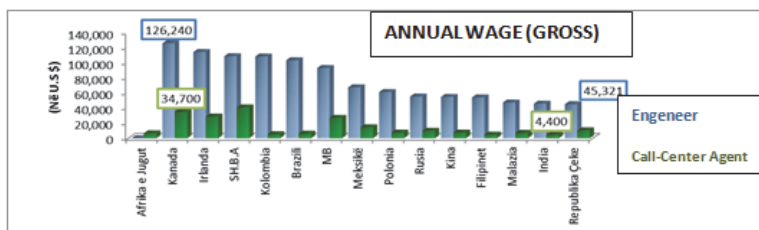
Source: The Countries of the World (2014)

Reallocation of activity in the manufacturing sector has decades that happens, even a great impetus of O<sub>2</sub> expansion in this sector are technological innovations that have facilitated and expanded the range of activities that early were judged as unspeakable (Kirkegaard, 2007). In the Information Technology sector although the dominant factor of O<sub>2</sub> is the cost-effectiveness, another motivational factor is the availability of world class talents. For customers firms of O<sub>2</sub>, the focus is on technical skills, education in the field of information technology and research and development level of destination countries. From the **offer** point of view, destination countries compete through the availability of workforce which is professionally trained, the size of this reserve and language skills. For Jensen & Pedersen (2011), comparison lies not only at the macro level (between countries or sectors) but in the nature of the activities carried out also. The picture is more colorful if should make a distinction between standardized activities (not main) and that are more advanced such as the research and development. But essentially every decision is based in the cost of inputs and efficiency in their use. This translates into technology, skills, economic development level, ease in the transfer of the product, etc.



In assessing the **cost of workforce**, the developing countries continue to enjoy the advantage of low wages. India's case is typical, where as simple professions and that that's require a high degree of qualification, have lower salaries compared to some countries in Europe and USA (Sridhar & Bharadwaj, 2006). Even the countries of Central and Eastern Europe have lower wage levels compared with the European Union. Poland, which leads as destination O<sub>2</sub>, has an average of the monthly salary as the half of the average monthly salary which is given in Germany (BBC, 2012). In Asia "the cheaper labor power" is found in Vietnam (O<sub>2</sub> destination site), with an average monthly wage of about 186 \$ (Carter, Bédard, & Bist, 2013).

Figure 4- Gross Annual Wage by Professions



**Source:** (Tholons, 2013); (IMD, 2013)

Low cost often does not justify the quality of the work in the destination countries. In an analysis done by (Deloitte, 2012), the main reason of the outsourcing contracts termination is exactly the quality of work. In assessing the quality of work in these destination countries, trials are different. According to (Oshri, Kotlarsky & Willcocks, 2009), workers in these countries tend to be more motivated by the work for the reason of higher payments than usual salaries. However, even when employees have proper education again has problems with the quality of work. In their study, (Farrell, Laboissière & Rosenfeld, 2005) highlighted the problems regarding lack of language skills, focus on theory at the expense of practical knowledge and the gap on the cultural adapting (such as lack of interpersonal skills, attitude towards teamwork or labor flexibility, which are contrary to the norms of international companies). According to (Oshri, Kotlarsky & Willcocks, 2009) a factor which improves the quality of services is the training of the workforce.

When it comes to activities global market, its size comes narrowed by distance of countries-destination, culture in these countries, the socio-economic development level, the activities' nature etc. This approach is reinforced by the **size of the human resources reserves**, especially skilled workers. A common feature in European and American labor market is the increased demand for skilled workers versus that unskilled (Author & Dorn, 2009).

According to (The National Association of Manufacturers, The Manufacturing Institute and Deloitte & Touche, 2003) "The biggest challenge for America is not the low cost of products manufactured by the manufacturer with low wage levels in developing countries, but has to do moreover with high quality products realized by highly skilled employees in emerging economies". If 2003 is considered remote, this trend appears in the IMD report of (2013), as one of the most influential developments in the global overview of competition for 40 future years.

**From a cheap workforce towards an intellectual power with favorable price** - the world is running out of a competition model based on cheap labor power towards a model based on a free intellectual power. In total India, Russia and China have 14 million students, as much as America. These students quickly return to professionals eager for success, which are relatively affordable and highly motivated. Through technology, these minds (brains) can be accessible to the entire globe. (IMD, 2013)

Knowledge of English is a very important incentive of the O2. For example, all Eastern Europe countries, as part of the Tholons map (2013), are listed as English speaking countries and positively assessed in PISA test.

**Table 2-** Percentage of English-speaker population.

Eastern Europe	Percentage of English-speaker population	Order in PISA- test
Bulgaria	25%	47
Croatia	49%	40
Czech Republic	27%	24
Estonia	50%	11
Hungary	20%	39
Poland	33%	14
Romania	31%	45
Russia	5.48%	34
Slovakia	26%	35
Slovenia	59%	21
Ukraine	-	-

**Source:** Tholons 2013, Wikipedia (Wikimedia Foundation, Inc., 2014)

The education system in these countries is much improved in recent years especially in science, technology and engineering being accompanied by a high number of admissions in universities (Oshri, Kotlarsky & Willcocks, 2009). What is observed in the Eastern European countries is the difference in approach of the education system. If under the communist regime **high school** was compulsory for the entire population of these countries, English language today is involved in almost 100 % in the second cycle of education. The disadvantage of the population size (excluding Russia) compared with other Tholon's map countries (Philippines, Brazil, etc), is compensated by a skilled and educated workforce. In the Asian continent India is the leading country in terms of educational level, which has a big stock of talents, especially in the information technology industry. Number of employees in the IT and ITES - BPO from 1999-2000 to 2011-2012 is decoupled, reaching 2.77 million employees. Every year to the Indian workforce are added 2.5 million graduates, of whom 300,000 engineers and 150,000 professionals of information technology. According to (IMD, 2013),



India is ranked 20-th in terms of the education system, and in the 22-th place in the university education with 634 universities. (IMD, 2013)

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