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BOOK REVIEW

# Offshoring: Economic Geography and the Multinational Firm

Loosely defined as the relocation of business processes from one country to another, offshoring is currently one of the most hotly debated aspects of globalization. As part of the global disaggregation of the value chain, it provides a critical template against which to view the intertwined issues of geography and the multinational firm. This disaggregation is the outcome of firms combining the *comparative advantages* of geographic locations with their own resources and competencies to maximize their *competitive advantage* (McCann and Mudambi, 2005). The interplay of comparative advantage and competitive advantage determines both the boundaries of the firm (outsourcing decisions) as well as the optimal location of value chain components (offshoring decisions). The importance of this analysis transcends the strategy of international business, for it is a key aspect of unraveling one of the most critical questions in modern social science – why are some nations rich while others are poor? One of the most important insights to emerge from Pyndt and Pedersen's new book is the crucial link between knowledge and value creation in the Danish context. This smile of value creation echoes findings in the US, where 'taking out costs' is the main reason to offshore (Lewin and Furlong, 2005). Thus, poor countries that host low knowledge, low value-added offshore operations need to think of these as stepping stones to operations with higher knowledge intensity and wealth generation (see Figure 1). Ensign's perceptive review draws out the essence of each case study and relates it to international business theory.

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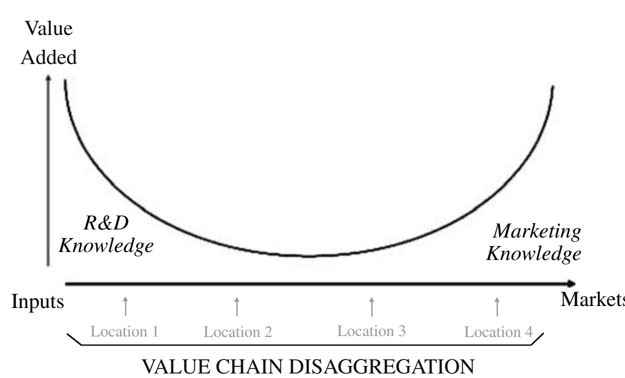


**Figure 1** The smile of value creation: MNEs, knowledge and location.

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# Managing Global Offshoring Strategies: A Case Approach

Jacob Pyndt and Torben Pedersen
Copenhagen Business School Press, 2006, 208 pages.
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This book provides a vibrant depiction of actual offshoring practices. The authors put forth eight cases in rich detail. These accounts of real-world scenarios highlight critical questions for academic research. In addition to eight chapters each devoted to an offshoring event at a Danish company, the text includes opening and closing remarks. The introductory chapter provides a strong summary of the phenomenon in general and the context in particular. Pyndt and Pedersen's overarching message is that there are many different successful strategies. They use a typology to present the phenomenon in two dimensions: internalization and internationalization. Within this typology, offshoring is synonymous with productive activity taking place outside the home country while outsourcing is productive activity taking place outside the enterprise. The cases then reveal that economic activity may be scattered along these different dimensions – even within a single Danish firm competing globally.

While the firms are all Danish, what Pyndt and Pedersen relay is applicable to other European, Asian, or American enterprises. And while the actors and events in the cases represent valid universal business situations, the cases exhibit a refreshing tone that is largely absent in most classroom cases. Further, the typical North American case deals with strategy formulation but seldom implementation or execution. Some of these cases move beyond the 'decision point' to provide a glimpse of what is called for, but still leave plenty of open questions for the reader to analyze.

The remark in the opening pages that offshoring is not a zero sum game, i.e., that the company that offshores and the recipient country both gain, needs to recognize the losses in the 'home' country. The offshored part of the business involves displaced workers and inputs no longer sought in the 'home' country. Outsourcing decisions 'have come under increasing scrutiny and criticism' (Graf and Mudambi, 2005: 254). This politically charged discussion usually begins with savings in labor costs (Ramamurti, 2004). Lewin (2005: 491) offers that, 'companies in countries with strong society/worker compacts may experience greater challenges in adopting and executing offshoring strategies.' Less tactfully, a myopic unionized workforce (stereotypically inflexible and with high wages) may lead to its own demise.

It is worth noting that offshoring may not be a discreet occurrence. Decisions on one activity may pull other activities toward outsourcing with them. Pyndt and Pedersen (pp 22–23) uncover that 'each activity in the value chain contains both advanced and standardized tasks. … we cannot say that production is standardized and routine-oriented, and subsequently conclude that it should be performed in low cost locations. … R&D activities encompass both extremely complex tasks and more simplified activities … each activity should be analyzed on a more disaggregated level.'

'Breaking up an existing supplier network in a high-cost environment and starting from scratch in a low cost setting is extraordinarily time consuming and expensive' (p 24). Proximity is more than co-location. A company must consider its evolving relationships with suppliers and its strategic and future positions, including 'the importance of a short mental and geographic distance between production and the R&D department' (p 68). Danfoss, a manufacturer of mechanical and electronic controls found 'co-location led to diseconomies of scale' (p 113).

Implications for theory follow from the quantity and quality of in-depth interviews and fieldwork. While no heavy-handed consolidating truths are put forth, sound insights are offered. The cases point to the finding that 'the time and expense of negotiating, writing and enforcing contracts, which are necessary to mitigate exorbitant information and coordination costs' (p 26) must be weighed in the decision to offshore or establish a captive unit. A quote from Danfoss' CEO demonstrates cultural issues: 'we need to drink a lot of tea before the Chinese are ready to discuss prices' (p 111).

It took footwear manufacturer ECCO many years to integrate the entire value chain from cow to shoe. Quotes from executives revealed an understanding of ownership advantages that is both deep and complex. Maintaining control over particular inputs and managing their flow and assembly is vital. Even defining production is difficult; does assembly or providing finishing touches constitute making a product? My laptop computer has a label 'designed in California assembled in Taiwan.' A thorough description of ECCO's products and competitors is offered as well as their current operations in Portugal, Indonesia, Thailand, Slovakia, and China.

GN ReSound, one of the largest players in the hearing aid industry, grapples with the globalization teeter-totter: 'seeking low labor costs could easily become a mantra at the expense of common sense. A pivotal question was how GN ReSound could preserve important knowledge flows between R&D and different production units, recognizing that some components contained GN ReSound's core technology' (p 67).

Several of the cases tease out employee-level details and interpersonal relationship. In moving production to Hungary, the medical supplies company Coloplast found that Danish collective agreements prevented bringing in foreign workers at lower wages so training was performed in Hungary. Surprisingly, Danish employees felt they were 'giving something' when they went to Hungary to provide training. While the Hungarian facility was expected to operate at lower cost, it defied expectations in terms of quality, even exceeding the home country facility. The Coloplast story showcases knowledge exchange in the real world. Danes overly simplified instructions in transferring knowledge; Hungarians were able to absorb much more. The process was initially construed as one-sided, but ultimately 'Hungarian employees clearly had something to give the Danish workers in terms of production planning and quality controls' (p 94). Active learning displaced passive learning and a situation-specific forum for sharing know-how was created.

Offshoring processes consume 'substantial managerial resources' (p 95). Coloplast moved production to Hungary but continued sourcing material from a supplier in Denmark only to discover that the supplier was purchasing the material from an intermediary in Germany who purchased the product from Hungary. While disintermediation is often associated with offshoring (Graf and Mudambi, 2005), there remains a strong necessity for amalgamation of processes, consolidation of functions, even the elimination of tasks identified by those performing them.

Danfoss' foray to 'find better geographical spots for its production activities and explore coordination between them' (p 115) is something that theory predicts would enhance earnings. However, there have been few observations and even fewer examples providing details, mechanics, and operational color. For instance, a Danfoss VP reveals, 'having tried out several initiatives without the desired effect, we turn to the last resort, which for us is offshoring' (p 113); 'specific plant relocations could not be considered in vacuum without taking the network dynamics into account' (p 116). While most of us collect observations at the proverbial '30,000 feet,' Pyndt and Pedersen fly close to the ground, have walked the landscape, spent time with the participants, and triangulated in order to obtain a full picture. Danfoss also adds an additional data point to support Kelly's predicted simultaneity of production and consumption or 'prosumption' (Lewin, 2005), since it '… believed that customer-adapted production would become increasingly important' (p 117).

Danisco, a large producer of food ingredients, provides a raw view of efforts to harness knowledge exchange in a multidivisional, multinational company. The view of the company's inner workings is not a rosy picture of best practices as difficulties and turbulence are encountered in this major undertaking. Offshoring is messy at the interpersonal, team/department, and business unit levels. Pyndt and Pedersen have used their privileged access to provide a unique picture of what did not work and what experiments failed.

MAN B&W Diesel, supplier of large engines for ships, provides a glimpse of a proactive response. Offshoring has been a mainstay of this company for decades. Nevertheless, as the competitive landscape continues to shift we are offered hints on what follows the initial rounds of offshoring and outsourcing. Will the firm become a hollowed out corporation left holding a paper bag with nothing in it or will it find a way to rapidly move up the value chain as link after link is gobbled up by rapidly developing economies? How can licensing work under regimes where intellectual property protection is weak? The key – perhaps not even fully realized or visible to MAN B&W Diesel – appears to be making oneself valuable and striving to remain indispensable. Positioned as the 'strategic center' (Mudambi *et al.*, 2004) between its various suppliers and customers, MAN B&W Diesel has been able to wield influence and power. Though knowledge and power may be regarded as substitutes (Ensign and Hébert, 2005), MAN B&W Diesel took no chances, basing its commanding authority on both market control and private knowledge. It monitored barriers to entry closely and sought to compartmentalize its business processes (e.g., 'leave a vital production step/component out of the Chinese licensees' facilities' (p 160). One transition, perhaps inevitable, was that Hyundai Heavy Industries, 'simultaneously a customer, a collaboration and development partner, a competitor, and a supplier … would liberate itself gradually in order to initiate in-house production' (p 157).

Ribe Maskinfabrik, a traditional steel producer, was forced by cost pressures to outsource to Eastern Europe and later to China. In the process, as noted by the CEO, great-grandson of the founder, 'a new type of company has evolved with fewer hourly-wage employees and more white-collar workers' (p 174). Today the company's business is helping others outsource operations. Ribe Maskinfabrik saw itself as a 'conductor', 'matching supplier capacity, quality and know-how with clients needs' (p 172). The ultimate success of Ribe Maskinfabrik's new direction has not fully played out. The claimed expertise in the area of offshoring is based on very limited experience. Does doing something once make one an expert? Ribe Maskinfabrik's new role as 'matchmaker' necessitated new abilities; the 'consultative capability' to 'optimize sourcing choices, yet sustain well-developed liaisons with suppliers' (p 178). While cashing in on relationships may be viable even in the long run if new friends can be made, it is inevitable that keeping old relationships becomes harder as new relationships displace old ones. Trust-based relationships invariably get pushed aside in the hunt for ever-lower costs.

GPV, a knowledge-based supplier and strategic outsourcing partner in mechanics, electronics, and printed circuit boards is concerned that with over 50% of sales coming from 10 customers it is 'vulnerable to purchase stoppages by its large customers' (p 185). GPV showed foresight by asking tough questions of itself: 'the critical issue was to identify how they could add value for customers' (p 187). GPV found that it 'had to upgrade its activities in order to move higher on the value-chain' (p 187) other than through low-cost production. GPV acquired additional capacity when ABB externalized its production facilities in Norway and Thailand. GPV also took over Esko-Graphics' electronics division in Switerland and launched its own production facility in China. Through these actions GPV hoped to 'offer competitive outsourcing solutions', but in order to do so it would be crucial to 'stay ahead of low-cost producers by increasing the value added for customers' (p 190).

While Pyndt and Pedersen conclude that 'there is no standard strategy template that can be applied when responding to offshoring opportunities' (p 195) there are some commonalities – lessons to be learned and applied. As the value chain is fragmented, functions must be divvied up as sub-processes. The car companies are cited as a lead example setting the pace in this process. It is unclear whether an auto company, produces, delivers, or manufactures the vehicle? Is design synonymous with development? While it has been acknowledged that customers will consult with competitors; should customers – now involved in much of the value chain process – be insulated from suppliers and other providers of outsourced inputs to prevent them from acquiring product directly (such as in the Coloplast case)? If companies like BMW, Chrysler, and Porsche outsource the entire production of vehicles to a manufacturer like Magna or Karmann, what is to prevent the consumer from trying to buy from the manufacturer or the manufacturer from trying to directly reach the buying public? How much value is added by the emblem and hood ornament?

While the decision to 'go abroad' is often a reactive behavior, Danes as executives are very proactive – they are doers. As in most enterprises, individual actors in these eight cases play a prominent role. At the same time that there is much splintering of activities and fragmentation of processes there is a need to pull things together and reorganize – even if only temporarily until the next shift uproots activities.

Offshoring decisions are characterized by a high degree of ambiguity (p 201); 'these choices involved *what* to relocate, *where* to locate it and under *what* kind of a configuration' (p 201). The papers in the present *JIBS* special issue on Offshoring adeptly address a number of these issues in great detail. Duke University CIBER's Offshoring Research Network (http://offshoring.fuqua.duke.edu/) is worth exploring for an overview of how companies are approaching offshoring – including the drivers of offshoring, the business processes being offshored, and the countries receiving the work.

Pyndt and Pedersen conclude that cost cutting is not sustainable as a basis for offshoring because it is easy for competitors to replicate. This differs strikingly from Porter's (1980) contention that cost leadership may be a persistent strategy – though he and others have recently revisited this view to acknowledge that it might increasingly become the domain of firms emanating from emerging economies.

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