

## Advantages and Disadvantages of Offshoring



Advantages and Disadvantages of Offshoring - offshoring pros and cons

This article is about the advantages and disadvantages of offshoring and has been researched and written by Russell Bowyer.

In this article I am going to cover the following main headings about the advantages and disadvantages of offshoring:

1. What is offshoring?
2. Reasons for offshoring.
3. Advantages of offshoring.
4. Disadvantages of offshoring.
5. Offshoring vs outsourcing.
6. For what services and production can offshoring be used for?
7. What to keep in mind with offshoring.
8. Factors to consider when selecting an offshore outsourcing company.

So with the headings set let's begin with the first topic for the advantages and disadvantages of offshoring:

## 1. What is offshoring?



Advantages and Disadvantages of Offshoring - What is offshoring

Offshoring is the moving or relocation of one or more [business operations from one country to another](#). This is usually for the prime reason to take advantage of lower costs.

So offshoring is usually where a company shifts the location of a service or production to an overseas location. In doing so, many times the company will own or rent the factory or office space and employ the associated staff in that location.

### Offshoring can also be outsourced

It's also possible for offshoring to be outsourced too. Outsourcing is where the company buys services or production from a third party. Where outsourcing is linked to offshoring, the outsource is transferred to a different country.

Offshoring is not only for the reduction of costs, but in some cases will be for strategic reasons too. The business might be looking to tap into other markets. By having an offshore site near to the target market will allow this to happen more easily and with less associated shipping costs.

### Countries ideally suited for offshoring

Some of the leading countries in offshoring include China, India and the Philippines. So much manufacturing has been placed offshore in places like China, that it has raised heated discussions in the recent US presidential appointment.

If you look at the printed 'place of manufacture' on most things that you buy, which includes your iPhone, it will likely say 'Made in China.'

**Advantages and Disadvantages of Offshoring - Up to 70% labour cost savings can be achieved with offshoring.**

President Trump is looking to do what is known as 'Reshoring' (also known as onshoring, inshoring and backshoring) whereby manufacturing is brought back on to the shores of the original country that off-shored in the first place.

However, offshoring is not just about manufacturing, as functions ranging from computer programming and Research and Development (R&D) to call-centre and back-office tasks have all been off-shored too.

## 2. Reasons for offshoring



Advantages and Disadvantages of Offshoring - Reasons for offshoring

There are a number of reasons why a company would choose to use offshoring to another country. However, here is a list of the top five reasons why companies use offshoring:

### **i. Offshoring to lower operational and labour costs**

As already mentioned, the top reason why most businesses use offshoring is for lower labour costs. Cost savings of up to 70% on labour can be achieved from offshoring.

One of the largest cost overheads for many businesses is the cost of labour. And in today's competitive world there is continual pressure on prices and an ever increasing need to boost profits.

Whether the labour costs concerned are above or below the line, significant savings can be achieved. When offshoring is organised properly and outsourced to a country where the cost of employment is much lower, the savings can be huge.

However, proper research needs to be done to make sure the necessary labour skills are available in the country concerned.

### **ii. Offshoring allows companies to gain access to new markets**

By taking your company's place of production/manufacture or service supply nearer to an area will aid access to new and lucrative markets. Having a local 'Hub' will provide a platform for better and faster local delivery.

## **Advantages and Disadvantages of Offshoring - By offshoring you gain access to new markets around the world**

The transportation costs will be lower too, by taking the manufacture nearer to the market demand. It could also be argued that offshoring will mitigate business risk too.

### **iii. Access to a wider network of knowledge**

By moving a part of your operations to an offshore site will give your business access to a wider knowledge base. Most of the countries geared for accepting offshoring will have an excellent education system in place. Employees will be trained to a high standard. They will be able to deliver a high level of service, and at a fraction of the cost, when compared to keeping the same service onshore.

## **Advantages and Disadvantages of Offshoring Offshoring Allows Companies to Gain Access to New Markets Access to a Wider Network of Knowledge**



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Advantages and disadvantages of offshoring - access to new markets and wider knowledge network

For example, computer programmers and IT consultants are expensive to recruit in certain countries like in the UK and America, but not necessarily in places like India and China. However, the lower cost associated with employing the same skill level of a person in an offshore location, does not mean the knowledge and experience of that person would be less than that of a similar person employed locally.

You are also gaining access to a whole new employment market, where locally you may have a staff shortage of a particular skill set you need.



#### **iv. Delegation of routine and mundane tasks**

Companies requiring large amounts of routine data processed would certainly benefit from offshoring this type of service. Any processing which is labour intensive could be costly where the hourly rate is higher in an 'expensive' employment market.

Outsourcing these routine processes will not only save business costs, but also allow the business to focus on the businesses core objectives. Staff management and the associated HR headache is also off-shored at the same time.

#### **v. Call centres and call centre management**

Many business in the UK and America offshore their call centres to places like India and the Philippines. This can cause other problems, for example language or cultural differences. Accents can play a major role in the customer experience too, where both parties can find it difficult to understand each other.

There's no point in saving money by offshoring, when your other costs increase as a result of customer dissatisfaction. Or sales and profits decrease as a result of customer defection to the competition. This highlights the need for proper planning and the careful choosing of the offshore site for the outsourcing program.

### **3. Advantages of offshoring**



Advantages and Disadvantages of Offshoring - Advantages of offshoring

#### **i. Cost savings**

One of the main advantages to offshoring is the potential for cost savings. Any business which has significant staffing costs in a particular department that has potential to be off-shored, may benefit by offshoring this section of the business.

#### **ii. Property or real-estate cost reductions**

The knock-on effect of a reduced staffing overhead cost is a reduced need for space. Whether the company buys or leases its office or production space, either way there will be a reduced space requirement. Mostly property or real-estate costs in a region where staffing costs are high is also high. Whereas, many times lease costs or land purchasing costs will be cheaper in the offshore location.

However, care needs to be taken on this, as in countries like China, offshore companies cannot own the land out-right, but instead can hold a long term right to use it for 50 years instead.

### **iii. Other associated cost reductions**

There are many other costs associated with employing staff, which include light, heat, water costs, HR management, sickness, illness, uniforms and many more. By having reduced local staffing levels, these associated costs will also be lower in comparison.

### **iv. Risk management and sharing**

By having more than one location, your business is spreading its associated risk. This risk will be shifted to the overseas location, whether or not the off-shored service or process is outsourced or not. This is because certain components of your business process or production is shifted with the associated risk. The corresponding responsibilities of those processes are also transferred to the offshore location.

Where the offshoring has been carefully researched and planned, this will serve to reduced the overall business risk. This is especially true where the off-shored process or service is outsourced too, as the outsourcing company will usually be a specialist in the field transferred.

### **v. Offshore government incentives**

There are many governments who are keen to encourage offshoring to their country, as it creates employment and inward investment. Governments will often offer overseas companies incentives to transfer manufacturing and/or employment to their country.

This could be in the form of grants or other incentives, which could further reduce the costs for the company offshoring their processes.

### **vi. Offshore tax advantages**

We've all heard of the expression 'Tax-Haven', which is associated with countries that offer great tax breaks to overseas companies to locate a part of their business, to gain access to lower tax.

## 4. Disadvantages of offshoring



Advantages and Disadvantages of Offshoring - Disadvantages of offshoring

### i. Depth of language understanding

As already discussed one of the disadvantages of offshoring is the potential for a language barrier. So whilst most countries around the world recognise the universal use of the English Language, there are differing degrees of understanding and depth of knowledge.

It's all very well being able to converse in another language, but it's a different ball game when someone is challenged to discuss complex issues on a particular topic in business.

### ii. Accent barriers

In addition to the depth of language and understanding, is the potential accent barrier. This can be a challenge across regions of the same country, let alone from one country to another. so even where the person has a deep understanding of the English language, their 'local' accent can make it very difficult for them to be understood.

This is also true in reverse, as although the offshore individual may be understood, they may not themselves understand the UK or American accent either. This could be particularly true when the person comes from a region with a strong local accent.

### iii. Cultural and social barriers

Every country has different cultural and social practices. These may be easy to adjust to or to accommodate, but they need to be considered carefully when choosing the offshore location. This will include differing religious holidays and social habits to be accommodated.

### iv. Communication styles

People from different areas within the same country may have differing communication styles. For example, many from the US are very confident and talk in

a straight forward manner, whereas someone from the Philippines is likely to be more reserved and may take offence to this direct approach.

## **v. Time-zones**

Depending upon the distance between the originating company and the offshore location, there may be a time-zone difference. Without organising appropriate shift patterns in the offshore location to align with the time difference, it could mean that there are gaps in communication times.

## **vi. Security issues**

Providing access to and the sharing of data across a single location carries security risks. So this risk is multiplied many-fold by shifting a part of the operation or service to an offshore location.

In order to minimise this security risk, there will need to be tight IT networking protocol and safety measures in place to achieve this.

## **vii. Loss of Intellectual Property (IP)**

The risk of losing control over IP is heightened when production is taken offshore. Taking legal action against breaches of IP within ones own territory is costly, so doing this from one country to another will multiply this cost considerably.

## **viii. Other higher offshore costs**

Whilst the cost of labour in the offshore location might be up to 70% lower, there are other costs which can be considerably higher. For example, the cost of electricity in China is significantly higher than it is in America. This cost can sometimes be two to three times higher than a similar cost in the USA. There are other costs which can work out considerably higher in places like China, so these need to be considered carefully.

# **5. Offshoring vs outsourcing**



Advantages and Disadvantages of Offshoring - Offshoring vs outsourcing



As already defined, offshoring is the moving or relocation of one or more business operations from one country to another. Offshoring involves taking on premises (either leasing or buying) in the offshore location. It also means the company will be responsible for employment in the offshore location too.

Whereas outsourcing is where a company buys either services or production from a third party. The whole responsibility of the service or production is shifted to a separate entity, thereby transferring the risk associated with the process to this third party business.

Outsourcing allows for greater flexibility to the company that is outsourcing the service, subject to agreed contractual terms. Whereas with offshoring the commitment is more for the longer term and there will be a larger upfront investment needed.

This doesn't necessarily mean that the product or service is outsourced abroad, although it can be.

A company that outsources services or production to a foreign country, is seen to be 'offshoring the outsource'. Alternatively, it may be that only certain sections or processes of the off-shored operation are outsourced in the overseas territory instead.

## 6. For what services and production can offshoring be used for?



Advantages and Disadvantages of Offshoring - For what services and production can offshoring be used for?

There are many services that can and are off-shored. Some of which have already be mentioned in this article so far. One such service is call centres, which come in many forms.

The offshored call centre can include a customer support function, technical support for domain hosting or IT support, plus other call centre centric services.

Many companies look at offshoring their accounting and book-keeping function, as this is one of those mundane processes that can be a significant cost to the business. With the advance of cloud-based accounting software, this makes for offshoring the

accounting function much easier. More and more companies are switching to a paperless office setup too, which means that staff location and where the data is processed doesn't matter too much anymore. With cloud-based data, once the information has been processed, access to the data is made easy, and from any location

However, as already mentioned, the security of data becomes more risky where it is shared across different offices and territories. So a robust security system needs to be in place, which can come at a considerable cost.

Taking manufacturing offshore to produce goods ranging from TVs to mobile phones and other electronic devices through to a variety of games and toys, to name a few which are regularly off-shored by companies looking for cheaper production costs.

Other services that can be off-shored include HR, design services (including product design), research and development, engineer support, plus many more.

## 7. What to keep in mind with offshoring



Advantages and Disadvantages of Offshoring - What to keep in mind with offshoring

If your business is considering an offshoring option, either for a service function or of a production process, there are a number of things to keep in mind at the planning stage.

### i. Why offshoring?

Firstly, stand-back and review why you are considering offshoring in the first place. If for example, if like most businesses considering offshoring, you are doing it to save costs, make sure you've considered all of the cost implications.

There will be certain increased costs associated with the off-shored function, like communication costs. Different time zones will likely add another layer of costs to the offshore function too.

Other additional cost considerations will include additional travelling costs and IT support across countries and possibly continents. Plus items or commodities which cost more in the overseas territory, like gas and electric need to be considered too.

## **ii. Employ an offshoring expert**

Consider employing an 'offshoring expert' to help guide you through the process. It might be the government of offshore country will have an expert to help you through the process. However, bear in mind that this government official from the overseas territory may be biased, as they'll be keen to secure your business for employment and export reasons.

## **iii. Offshore location in relation to your business and other markets**

The location of the offshoring country in relation to your business must be a consideration. This applies with regards to dealings between your local office and the offshore office and the logistics of this, plus the locality of local markets.

If you have identified a good local market in a particular region, you then need to choose an appropriate offshore location which is close to this, whilst at the same time looking to achieve the required costs savings too.

Relative time-zones are another consideration, which will impact on local staff as well as staff in the offshore location. As already mentioned, this could add a layer of cost to your offshoring process, which needs to be taken account of.

## **iv. Write a list of the offshoring pros and cons**

Write down a list of the offshoring pros and cons. One list having the pros of offshoring and the other having a list of the cons of offshoring. Compare the lists and weigh up the two lists.

## **v. Commodity costs in the offshore location**

As already mentioned, utility and processing costs can be higher in places like China. So keep these in mind when working out the overall cost saving you'll make by transferring production to an overseas location.

# **8. Factors to consider when selecting an offshore outsourcing company**



Advantages and Disadvantages of Offshoring - Factors to consider when selecting an offshore outsourcing company

There are many factors to consider when outsourcing a section of your business. However, these become even more critical when you are looking at outsourcing in an offshore location.

The following should be considered when choosing an offshore outsource company:

### **i. Pricing**

Pricing will always remain the primary motivation for offshoring. But this is also top of the list when looking at outsourcing too. I wouldn't say that pricing should be at the top of the list when you are looking at outsourcing in isolation, be this locally or offshore, as quality of service and product must be a top priority too.

### **ii. Available skills and knowledge**

Are the necessary skills and knowledge available in the country you intend to offshore to. But more importantly, if you chose to outsource the offshoring, does the out-source company have the right level of skills and knowledge necessary to fulfil the service you intend to outsource to them.

Make sure you understand the level of staffing resources available. Check they have the right level of appropriately qualified staff and supervisors to ensure a smooth service delivery.

### **iii. Quality of service and production**

Depending upon the market you sell to, will depend upon the 'level of service' or 'production quality' you aim to achieve. However, whatever the required level is for your business, you should put this at the top of your list of checks. Shoddy goods or bad customer service could cost more than the amount saved by offshoring in the first place.

### **iv. Quality of the management team**

When you outsource any service or process, you need to know your process will be in capable hands. Make sure you get to know the management team heading up the outsourcing company. What are your objectives and what is the company vision? Make sure the leaders in the outsourcing company align to these.

### **v. Have a watertight Service Level agreement (SLA)**

Agreeing to terms up front in any partnership is crucial to a better understanding of the relationship. So by having a well thought out and written SLA will make for a better outsourcing function.

## **vi. Reliability and flexibility**

Obtain references and testimonials. Speak with other companies that are using the outsourced service or production before committing to the service. Where possible, test the service out and monitor how reliable the company and its staff are. Also establish how flexible the outsource company is in terms of any potential ups and downs in your business, be it seasonal or other reasons for business fluctuations.

## **v. Communication**

Two way communication is vital for any good working relationship. So interviewing the management team alongside the key team members is a crucial step in identifying a good match for an outsourcing company. Make sure the staff that will be facing either your staff and/or your customers have a good command of your local language and that there isn't too much of an accent problem.

## **vi. Credit checking and company stability**

If you decide to outsource a service or a section of your production to a third party, you need to know that the business will be around in a few years' time. Carry out whatever credit checking you can to ensure the stability of the company concerned.