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Globalization: The Tendency of Increasing Sales and Production Through Outsourcing

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Abstract

The globalization of the world economy has relieved control over to the open-market rules and regulations, and that is of great significance for enterprises who aim to extant their activities into the new markets, because this would enable them to compete on equal footings with the other companies, such as local ones for instance. It is evident that multinationals want to be present where: (1) demand and supply can be met in the most efficient and profitable circumstances, and (2) the production factors such as labor, capital, and technology can be obtained and used at the lowest possible cost, this of course with the aim of maximizing their overall profits.

Keywords: Globalization, Outsourcing, Reallocation, Relocation, FDI, Global Economy, Market Penetration, Production Strategy, Communication Technology.

Introduction

This scientific research will try to illustrate some of the major implications with regard to increasing sales and production through outsourcing. It will also shed some light on the importance of production factors that influences economic development. It will also analyze comparative advantages that enable companies to compete with the ones located where production factors are low-priced. It is evident that it is hard to compete with companies located in certain regions where wages, and other factors of productions are so inexpensive. High technology and skilled labor force enhances the competitiveness of companies, and this in turn ensures high quality products and continued success of the companies.

In addition, this scientific research will show that increasing sales and production through outsourcing is an approach that senior managers implement in order to drive costs out of their operations as well as in order to increase sales and production with the aim of maximizing overall profits. This is because of the Globalization of the world economy which is endowed with a high technology and skilled labor force and other factors of production. This is indeed of great significance as it enhances the competitiveness of the enterprises, and this in turn ensures high quality and continued success in productivity and market entry.

The success of prosperous enterprises in the decades to come will be due to the expansion into the emerging capitalist economies and due to firm commitment to deliver the best in products and services for their customers through continuous improvements in people, technology and assets.

Increasing Sales and Production Through Outsourcing

Increasing Sales and Production Through Outsourcing[1] is an approach that senior managers implement in order to drive costs out of their operations as well as in order to increase Sales and Production with the aim of maximizing overall profits.

As product and process technologies have become more integrated, a product's cost and quality has become even more strongly pertinent on outsourcing. It is evident that companies do not usually undertake difficult tasks if the tasks can be avoidable or be done by someone else for them. Therefore, they would strive to subcontract with other companies, domestically or internationally based, that would carry out operations which are more expensive to be carried out by themselves. These days, however, price and cost of production can be avoided to some extent due to the wearing down of important first-mover advantages in the new economic opportunities. In the past, many leading companies, especially those that led by technical differentiation, found that they could reduce their costs of production by the advantages that they had in terms of technology. They believed that having the capital-intensive advantage is the most important factor in this regard. Nowadays however, these and other most profit maximizing companies recognize that outsourcing is an additional approach of reducing the costs of their operations as well as of increasing their Sales and Production with the aim of maximizing their overall profits. These companies that have chosen to subcontract their production and operations to either local or non-local firms are thus virtually limited to design work (including R&D), marketing and selling. Their role increasingly comes to resemble that of commercial intermediaries, the profits of these companies continue to rise.

The domestic company who seeks to expand or outsource certain operations, not only imports goods made in the company located in a certain region, usually labor-intensive or endowment-intensive, but also export capital goods to them. Certainly, outsourcing is beneficial for both companies, domestic and subcontracting one. That is because certain operations of a domestic company would be carried out by the subcontracting company, located there where realization of those operations is cheaper. Cheaper because of the factors such as production or and subsidies, etc. And eventually, products would be sold where there is purchasing power. (Committee of the Regions, p.8)

Indeed, cost-reduction objective is achievable most of the time when implementing subcontracting. As a result, companies would maximize their profits. It is for this reason that senior managers commit themselves to establish subcontracts. Goals and their objectives are set very clearly, so that to make sure that they are achievable. A company that meets those requirements is bound to make substantial progress.

In addition, outsourcing is another extension of Adam Smith's division of labor. If we follow up on this theory then we can conclude that it leads to specialization. This in turn has consequences on the domestic employment. Specialization requires specific skills that are attributed to different people; the more skills there are the more people necessary to produce different goods for which specialization is required, hence division of labor takes place. And as a result we will obtain more qualitative goods and in the long run less costly goods, this of

[1] For further analysis of this line of thinking please see: Coase, 1937; Williamson, 1985; Grossman and Hart, 1986; Hart and Moore, 1990; Holmstrom and Roberts, 1998, et cetera.)

course as a result of the labor specialization to produce those goods for which they are specialized. Specialization can in this sense be a catalyst for employment growth as well as of quality improvement and reduction of costs, which of course will result in profit maximization.

However though, this has a detrimental effect on wages. Theoretically speaking the larger the work force the smaller the remuneration for those employed. But, this phenomenon is only in the short run, because in the long run as the labor force specializes on the production of certain goods which as explained above are less costly and of higher quality, then the sale of those goods would increase. This as a result will have a positive impact on the profit maximization of the company and hence on the wage increases as well.

Another important result of specialization is indeed with regard to diversification. As efficiency increases and costs are reduced in a competitive market, the firm is encouraged to modify and improve its product. And therefore, new products, better products are invented each year as the competition gets tougher. As new products and better products are invented each year this will lead to diversification and greater satisfaction of the consumers. And so with greater satisfaction of consumers the sales will increase and this will have a positive impact on the growth of the company. There will be indeed a win-win scenario as the consumers will be happy and the company will enjoy growth. This as a result will have a positive impact on the profit maximization of the company and hence on the economic development in general.

High technology which requires skilled labor force is another important factor that influences economic development. This is a comparative advantage that enables companies to compete with the ones where production factors are cheap. It is evident that it is hard to compete with companies located in certain regions where wages, and other factors of productions are so cheap. High technology and skilled labor force enhances the competitiveness of the company, and this in turn insures high quality and continues success of the company. (Gonzales, p. 74)

Countries where, wages and other factors of production are higher as compared to other regions, are challenged to somehow balance off this disadvantage. In this regard they come up with different incentives such as through simplifying the rules and regulations of doing business, that is in order to be more attractive for the companies to invest there.

The main outlines of expansion issue for the future in the new markets is the efficient implementation of the open economic guidelines that would be in accordance with the most advanced economic systems of the EU countries for instance or of the guidelines of the WTO in this regard. There should be even more guidance and counseling, more adequate job training and retraining programs for the outsourced employees in order to be efficient to carry out jobs of a certain enterprise that is seeking to outsource certain operations. For the expansion to be successful, pertaining factors need to be perfected even further; in this regard for instance, training programs must be improved and measures must be developed to facilitate expansion of potential enterprises into new markets. (Timothy, p. 25) Also, for the expansion to be successful high technology and skilled labor force are of great importance; this enhances the competitiveness of these enterprises, and this in turn ensures high quality and continues success into the new market.

The expansion effort, however, also needs to be centered on strengthening the whole managerial system, in order to encourage entrepreneurship and self-sufficiency. This is undoubtedly a major goal to be achieved during the expansion phase, because not only do the new markets need to build an operational market free from excessive government control, but most importantly, private enterprises need to function as independent entities that can survive without public support, or subsidies. That is in order for the potential enterprises to be able to keep lead, which would be so, provided that they compete on the same bases as the other local companies. It is evident that it is hard to compete with the companies located in certain regions that are subsidized by local government programs for that matter as this will distort the base of competitiveness, and therefore this will hinder the continued economic growth and prosperity of enterprises that expand their business activities into the new markets.

However though, in order to assure continued economic growth and prosperity of enterprises that expand their business activities into the new markets, there should be a continuation of adequate implementation of open economic guidelines. Indeed the continued economic growth and prosperity of enterprises that expand their business activities into the new markets is linked with the efficient implementation of the open economic guidelines which are in accordance with the economic systems of the EU countries for instance or of the guidelines of the WTO in this regard. For this to be so, Senior Managers of the potential enterprises that aim expansion into new markets need to make sure that the above mentioned factors are being respected and implemented into those markets. If they do so and if it is the case that the implementation of the open economic guidelines which are in accordance with the most advanced economic systems, such as of the EU countries for instance or of the guidelines of the WTO in this regard, then these enterprises will be able to compete and even be able to keep lead and be prosperous enterprises into the new markets and beyond.

Again, senior managers of the companies that aim expansion into new markets are committed to maximize their profits. Apart from other approaches they recognize that outsourcing, joint ventures and merging are also approaches that can lead to their profit maximization. To make such decisions, it is vital that the industry can evaluate the attractiveness of different industries in terms of their potential to yield profit in the future. The primary objective of senior managers (decision-makers) is to analyze the determinants of industry profitability. Once the determinants of industry profitability are understood, it will then be possible to forecast the future profitability of the industry. It is very important to be identified the opportunities available to the company. This is in order to influence the industry structure, so that to moderate the intensity of competition and improve industry profitability in the globalized economy.

The Creation of Global Economy

The tendencies regarding the creation of a global economy have existed since the beginning of capitalism as a world system, however though, they have been stronger in certain periods than others. It is evident that the period since the collapse of Bretton Woods system in 1971 has seen the balance between transnational economic forces and national governments to move in favor of the former. Kenichi Ohmae[2] argued that the nation-state is no longer an appropriate factor to go forward with the creation of a global economy because economic activity in the global economy no longer coincides with political or cultural boundary lines. And often he argues that the nation-state is also seen as obstructing the development of global economy. This because it uses its centralized powers to raise taxes and

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[2] On his book: Ohmae, Kenichi. The End of the Nation-State: the Rise of Regional Economies. New York: Simon and Schuster Inc., 1995.

redistribute resources according to the pressures of special interest, often motivated politically. And as a consequence this leads to an inefficient bureaucracy that makes national government an obstacle of the public interest. Competiveness is determined at the level of sectors and firms, and the creation of a global economy is becoming a world trend in function of competiveness. The goal is a global cosmopolitan society that is coordinated and managed without the excessive need for politics and governments and in which national attachments become insignificant.

Indeed the globalization of the economy has become apparent since the international production of goods has become a structural characteristic of the world economy. Multinationals want to be present where: (1) demand and supply can be met in the most efficient and profitable circumstances, and (2) the production factors such as labor, capital, and technology can be obtained and used at the lowest possible cost.

There are a number of economic factors that influence the decision whether or not to expand into new markets. According to the research that I have done with the Belgian Chamber of Commerce, namely, Brussels Young Exporters Program (BYEP)[3], I came to realize that most of the Belgian companies expand to new markets due to the global production strategies whereby their international branches are functionally integrated in order to answer to world demand and its competition. This is made a lot easier today due to advances in transport and communication, which has become bigger, quicker and cheaper. They do not only take advantage of the globally spread out comparative and competitive advantages, but also of the international research opportunities and knowledge. Such a strategy offers the opportunity to achieve maximum market penetration by being on the spot and be able to meet the demand and supply in an efficient and profitable way in the globalized economy.

According to the research that I have done with the Belgian Chamber of Commerce, namely, Brussels Young Exporters Program (BYEP), I came to realize that most of the Multinational Companies expand to new markets due to the determinants which are linked with the motives for locating in a specific area, and they are the following:

1. proximity of natural resources and/or energy;
2. advantages linked to locating in that specific guest country;
3. more relaxed legislation in the guest country than at home;
4. out of necessity to gain access to local know-how;
5. import restrictions necessitating production on the spot (instead of trade).

There are many reasons why a company chooses to expand outside the boundaries of its home country. Foreign investment provide opportunities for the acquisition of technology, and it is motivated by the wish to take advantage of lower production costs, such as estate prices, lower wage rate, cheaper primary or intermediate inputs, etc.. In this line of analysis Spulberg (2012a) has stated as follows: " The firm is more likely to prefer Greenfield FDI to M&A the more productive it is, the bigger is the foreign market, the lower is foreign wage rate, the weaker is the host country's market for corporate control, and the smaller is the cost of investments." (Spulberg, 2012a, p. 854) Indeed these are important elements that need to be considered by the decision makers with regard to firm productivity and foreign market entry. Furthermore, it is important to note that foreign investors may be also attracted by tax and other incentives of firm productivity and foreign market entry.

[3] The "Brussels Exporters Young Program" (BYEP) exists since 2005 and meets a real demand for SMEs, which need specialists to develop their exports to new markets. http://www.invest-export.irisnet.be/brussels-young-exporters-program

The decision to invest will be motivated by more than one factor. They are likely to differ according to the sector, the size and nature of the company. A large multinational company will often base its investment plans on the basis of complex global production strategies. On the other hand, a smaller firm will decide to invest abroad for more direct reasons related to consumer proximity or perhaps, cost considerations.

Market Penetration

Market penetration seems to be a normal process in a firms development cycle. Is this always the case? Suppose a Belgian firm opens an office in Northern France; if production and employment are reduced in Belgium as a result of this new office and if a share of what is produced in Northern France is exported to Belgium, can we still speak of a classic and clear cut case of market penetration?

Suppose we invest in Southern Europe as a result of the future potential market opportunities and in the meanwhile, benefit from the low wages in that region, then where lies the difference between the policy of market penetration and that of outsourcing?

The above stated suppositions result directly from expansion to new markets. If a new production facility has been set up in a host country for a different product range (and not necessarily of less/more quality) than that of the home country, or if one lets the same product be made in the host country as in the home country due to which the production at home stagnates or even is reduced in the long-run, then some analysts will not judge this as outsourcing but normal expansion to new markets.

The economic theory in support of expansion to new markets is founded on the theory of comparative advantage, leading into competitive advantage. The theory focuses on two important macro-economic factors; the flows of imports and exports, and the flow of investments. The hypotheses of immobile production factors between countries, the absence of technological differences, and the absence of product differentiation lie central to this approach. According to Michael Porters writings, on his book, The Competitive Advantage of Nations, he points out that a company has a competitive advantage if it can produce at lower cost than its competitors or if it can differentiate itself from the competition by use of unique production methods. It is clear that Porter stresses the importance of technological evolution. Due to this reason he stresses the importance of competitive advantages instead of comparative advantages.

We know the theory of comparative advantage presented by Ricardo pertaining to English cloth and Portuguese wine. In any event his conclusion was that each country should specialize in the production of the good that it can produce or supply at the most advantageous price (least cost). These ideas were expanded on in the theory of Heckscher-Ohlin-Samuelson which stated that each country should specialize in the production process that uses the production factor of which it has a comparative advantage. Leontief showed that this was not always the case when he proved by the hand of some data of 1947 that the United States imported mostly capital intensive goods while it exported mostly labor intensive goods. This was contrary to the HOS model and became known as the Leontief paradox. To explain this it was stated that the U.S. had a greater advantage in labor relative to capital due to the qualifications of the labor force. This theory and model does not clear up many of our questions or doubts but it does lie down a good foundation for further exploration.

Chung H. Lee introduces another dynamic element into the discussion. He stresses the importance of change of comparative advantages and the effect they have on investment.

He believes that companies who lose comparative advantages abroad will invest, while companies who gain comparative advantages at home will invest. Then why, one might ask himself, will companies who lose comparative advantages will invest in the same activities abroad, while not in a different sector at home? The answer to this is quite simple. It has to do with industry specific capital (for example; marketing know-how). In case of an investment in a similar activity abroad, one can now make immediate use of general capital, as well as, industry specific capital. The cost of investing in a new activity is thus greater than the investment needed in a similar sector.

Lee concludes that the change in comparative advantages modifies the value of industry specific capital, that is unless one can invest abroad. Investing in foreign countries allows the value of industry specific capital to stay intact, and, at the same time, allows for the dismantlement of the old production facility to be accomplished at a lower cost. Lee adds that, "Since in the latter case (no investment) structural adjustments (to start something new) will cost the country the industry specific capital, it follows that the country gains from foreign investment by avoiding this loss." (Van Sebroeck, p. 43)

Porter[4] stresses the importance of the changes in comparative advantages in relation to production factors and thereby, points out the link with the element of technology. Porter states that it is not so much the available amount of technology that is important but the rate at which it can be created and improved. It is obvious that the value of an advanced production factor increases as science progresses. "The most significant and sustainable competitive advantage results when a nation possesses factors needed for competing in a particular industry that are both advanced and specialized. In addition, firms gain and sustain competitive advantage in international competition through improvement, innovation and upgrading." (Van Sebroeck, p. 44) Theory teaches us the companies who want to sustain their comparative advantages must invest. If a home country loses comparative advantages at home than it must invest in a foreign country to keep the industry-specific capital intact. At the same time this would allow the dismantlement of the plant in the home country to be achieved at a lower cost.

Furthermore, with regard to production factor, technology, also plays an important role in expansion to new markets. Theory teaches us that technological innovation is an important factor in sustaining comparative advantages, and that a product will almost certainly be produced where it was invented or thought of. Theory also teaches us that the best way to sustain competitive advantages is through permanent innovation. Considering that R&D has become so important, it seems that more and more companies will want to build their production plants or at least want to be present near the most important research centers in the world.

Global Production Strategy

With regard to global production strategy we can identify the following trend regardless of the different sectors and companies which exist on the world market. With the ever increasing competition on a world scale in the last decades companies were primarily concerned with the reduction of cost prices while increasing quality. The production in lower wage countries necessitated that the mother company plays more of a coordinating role.

[4] That is on his book: Porter, Michael. The Competitive Advantage of Nations. Cambridge: Harvard Business School Publishing, 1990.

More recently the strategy has changed again. The different branches of a company are responsible to different 'competence' centers spread out all over the world. These centers are thus responsible for a given branch of production. Today there are a number of possibilities. The global production strategy can go as far as to limit the function of the firm in the home country to the keeping track of profits and expenses and quality control. Each production unit, where ever it may be in the world is thus responsible for subcontracting and sales in its region, this of course with the aim of maximizing overall profits.

Further more, with regard to global production strategy we can also identify the reallocation of resources generated by the integration process which enable the utilization of national comparative advantages. It is evident that factors of production will be allocated in sectors where the country has a comparative advantage, while production in other sectors will be reduced or even stopped. Once reallocation is completed, inter-industry trade within the region will increase. The larger market generated by integration will enable firms to increase returns. This leads to further specialization within the same sectors as competition rests both on lower costs deriving from expanded production and on product differentiation. Indeed, global production strategy aims to increase gains which will result from lower costs of production and broader quality ranges generated by the learning process following the introduction of new technologies.

As the world market increases in size it implies that supply has more opportunities to meet demand in a sufficient manner. As a result, the globalization of the economy, in a sense, forces producers to penetrate into foreign markets either by setting up sales branches or by building production plants there. This shuffling of production and services activities across the globe has become possible mainly due to:

(A) the ever decreasing transportation costs; and
(B) the improvement of communication technology.

(A) Transportation Costs

In order to illustrate the importance of the transportation costs, I will base my analysis on the following examples:

a. The transportation of a car made in Japan and sold in Cherbourg (France), costs today about 250 Euros, more or less the same price it costs to transport a vehicle by road from the south of Spain to Northern Europe.

b. The cost of maritime transport has decreased by 23% between 1985 and 1992, and still is continuing to decrease. The cost of areal transport is decreasing at a rate of 1% per year, since 1984.

(B) Communication Technology

The ever improving communication and information technology is a vital factor with regard to globalization. We are living in a period where the rapidly advancing and developing telecommunications is facilitating globalization of the economy and the strategies of expansion to new markets.

As a result of the globalization of the economy and the impact of the improvements in the communications sector, and the lowering of transport costs many multinationals strive to increase sales and production through outsourcing approach that senior managers implement in order to drive costs out of their operations as well as in order to increase sales and production with the aim of maximizing overall profits. What this means is that any given firm will extend more and more branches of its own company to foreign countries so as to be able to benefit from the competitive advantages in the host countries.

Summary of Conclusions

Following are some important conclusions that can be made:

1. The investments abroad are not the cause of unemployment at home.
2. The investments abroad are basically due to the loss of competitive advantages at home.
3. Enterprises which base their development growth on low skill and low technological production requirements are in a unfavorable situation. The only manner in which to gain some comparative advantage is to invest in R&D and knowledge-technology.
4. It is evident, for example, a certain company which faces difficulties to sustain competitive advantage has had to cut back in some of its labor force, but at the same time the amount of investments has increased. Here we are confronted with the phenomenon of initially losing competitive advantages and thus reducing employment, while the increase in investment in industry at home in a production process with great added value, is a fair attempt at regaining those or other comparative advantages.
5. It is evident that for a company aspiring to increase sales and production through outsourcing, it can be concluded that outsourcing is an approach which senior managers implement in order to drive costs out of their operations as well as in order to increase sales and production with the aim of maximizing overall profits.

In light of what I have researched and discovered it is evident that increasing sales and production through outsourcing is an approach that senior managers implement in order to drive costs out of their operations as well as in order to increase sales and production with the aim of maximizing overall profits. This is because of the Globalization of the world economy which is endowed with a high technology and skilled labor force and other factors of production. This is of great importance as it enhances the competitiveness of the enterprises, and this in turn ensures high quality and continued success.

The globalization of the world economy has relieved control over to the open-market rules and regulations, and that is of great importance for enterprises who aim to extant their activities into the new markets, because this would enable them to compete on equal footings with the other companies. Multinationals want to be present where: (1) demand and supply can be met in the most efficient and profitable circumstances, and (2) the production factors (labor, capital, and technology) can be obtained and used at the lowest possible cost, this of course with the aim of maximizing overall profits.

The success of prosperous enterprises in the decades to come will be due to the expansion into the emerging capitalist economies and due to firm commitment to deliver the best in products and services for their customers through continuous improvements in people, technology and assets.

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