OUTSOURCING AND OFFSHORING: IMPLICATIONS FOR PRODUCTIVITY OF BUSINESS SERVICES

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This paper reviews the implications of outsourcing and offshoring for the productivity of business services in the UK. Official statistics indicate that business-service productivity has grown by over 20 per cent in the last 7 years at the same time as employment grew by 20 per cent. The paper considers possible factors that account for the simultaneous growth of employment and productivity. First, we discuss outsourcing and offshoring, and their role in enhancing productivity through greater specialization, standardization, and consolidation of business processes, and a shift to higher value-added services. Outsourcing of business services is interpreted as part of corporate restructuring, namely as the unbundling of corporate functions as well as vertical dis-integration. Second, as some services become more like products, both low-skilled and high-skilled jobs are subjected to productivity growth through standardization and digitization. It is argued, however, that the future of business-service productivity is on a knife-edge, depending on the mix of two sources of productivity enhancement—namely greater standardization and capturing value from customized solutions.

I. INTRODUCTION

Services have become a dominant part of the UK economy, accounting for 66 per cent of GDP, as compared to 20 per cent for manufacturing. Two-thirds of the UK economy is therefore engaged in a diverse set of service activities, in wholesale and retail distribution, hotels and restaurants, transport and communication, financial intermediation, and 'real estate renting and business activities'. A sub-sector of growing importance, the focus of this paper, is business services, which are services provided by businesses for businesses. They include computer services, professional services,
research and development, as well as other services provided by labour placement agencies and call centres.

Business services account for 11 per cent of GDP, employing 4m, or one in every seven, workers in the UK. During 1998–2004, business-service productivity grew 23.6 per cent while employment grew 20.2 per cent (compared to 28.8 per cent growth in productivity and 22.8 per cent reduction in employment in manufacturing). Thus, in contrast to manufacturing, in which productivity growth has been accompanied by employment contraction, productivity in business services increased at a time of employment expansion. Moreover, the UK has sustained a trade surplus in business services, in contrast to a persistent trade deficit in manufacturing (Abramovsky et al., 2004).

This paper provides explanations for this phenomenon of business-service productivity and employment growth from two perspectives. The first perspective is grounded in theories of the firm and organization design (see the discussion in section III). Here, we spell out the reasons for the expansion in the demand for, and supply of, business services by focusing on a novel way of restructuring corporations, in which the make-or-buy decision concerns not only inputs into the firm’s final output, but also business processes which reside in corporate functions. It is argued that corporate-function unbundling provides a different base for the supplier to enhance value-adding activities from vertical dis-integration.

The other perspective is grounded in a social-science understanding of the contrast between services and products. The traditional distinction between services and products is becoming blurred, as services are ‘productized’ and products are ‘servicized’, in part owing to the use of information and communication technology (ICT) (see the discussion in section IV). The paper considers what the implications of this blurred distinction are for understanding the sources of productivity growth in UK business services.

The key contributions of the paper are as follows. First, it provides evidence of simultaneous growth of productivity and employment in UK business services at disaggregated levels. Second, such growth in productivity and employment is explained not merely by the use of ICT, but also by a specific type of corporate strategy for restructuring. Outsourcing enhances productivity through standardization and consolidation of business processes, as well as through greater specialization with built-in supplier incentives for high performance. Third, it is argued that the future of business-service productivity is on a knife-edge, depending on the mix of two sources of productivity enhancement—namely greater specialization through offshoring and capturing value from customized solutions.

II. BUSINESS-SERVICE EMPLOYMENT AND PRODUCTIVITY IN THE UK

This section presents evidence of productivity growth in UK business services, notwithstanding numerous difficulties in measuring the output, inputs, prices, and quality of services (see Crespi et al., 2006; Clayton, 2006).

As shown in Table 1, business services consist of a number of broad categories of activities: (a) computer services; (b) professional services; and (c) a heterogeneous set of other activities. Category (a) includes maintenance and repair, data processing, and consulting of computer hardware and software, but excludes the production of computers, which is categorized as manufacturing. In (b), professional services include legal services, accounting, market research, and business and management consulting. The rest of business services in (c) is diverse, including the renting of machinery and equipment, R&D, architectural and engineering services, advertising, labour recruitment, industrial cleaning, and call centres.

The distribution of employment is shown in Table 1. By far the largest sub-sector is professional services, employing 918,000, followed by labour placement agencies (734,000) and computer services (573,000). Employment growth during 1998–2004 has been faster in what are conventionally considered to be relatively high-skilled sub-sectors (notably computer services (36 per cent) and professional services (30 per cent)) than in other sub-sectors (e.g. labour recruitment (18 per cent) and industrial cleaning (2 per cent)). Within professional
Table 1

| Business Services in the UK: Gross Value Added (GVA) and Employment |
|----------------------|-----------------------|------------------|------------------|------------------|
|                      | £’000       | £’000       | £’000          | ’000         | ’000         |                      |
| Renting of machinery | 8,810       | 11,811      | 13.5           | 149         | 176         | 18.1                   |
| Computer services    | 19,595      | 34,022      | 27.3           | 420         | 573         | 36.4                   |
| R&D                  | 2,315       | 4,200       | 56.3           | 87          | 101         | 16.1                   |
| Professional services | 28,880   | 40,888      | 8.7            | 705         | 918         | 30.2                   |
| Legal services       | (9,138)     | (15,173)    | (38.3)         | (254)       | (305)       | (20.1)                 |
| Accounting           | (7,587)     | (10,366)    | (16.9)         | (196)       | (229)       | (16.8)                 |
| Market research      | (812)       | (1,464)     | (64.3)         | (41)        | (45)        | (9.8)                  |
| Management consulting| (8,541)     | (12,106)    | (–13.7)        | (173)       | (284)       | (64.2)                 |
| Architectural and engineering | 12,925 | 15,985      | 14.2           | 327         | 354         | 8.3                    |
| Advertising          | 3,536       | 5,613       |                 | 90          | 95          | 5.6                    |
| Labour recruitment   | 10,969      | 17,477      | 35.5           | 624         | 734         | 17.6                   |
| Industrial cleaning  | 2,510       | 4,152       | 61.9           | 417         | 426         | 2.2                    |
| Call-centre activities | n.a.     | 1,651       |                 | n.a.        | 39          |                      |
| Total business services | approx. 23.6 | 3,344       | 20.2           | 4,020       |                      |                        |

Note: a The four rows below represent the main categories of professional services, but there are other minor categories not listed. b Call-centre activities have been separately categorized since 2003. c Certain categories are not listed above, such as ‘management of activities of holding companies’, ‘technical testing and analysis’, ‘investigation and security activities’, ‘photographic activities’, ‘packaging activities’, etc.

Source: UK Annual Business Inquiry.

services, ‘business and management consulting’ saw the fastest growth, at 64 per cent.

Business services contain a diverse set of activities, and one measure of productivity, gross value added per worker, demonstrates this heterogeneity. As shown in Figure 1, labour productivity in 2004 ranges from £59,000 in computer services and £44,500 in professional services, down to £42,000 for call-centre activities, £23,800 in labour recruitment, and £9,700 in industrial cleaning.

Over the period 1998–2004, productivity for the whole business-services sector, as measured by gross value added per worker, increased by 23.6 per cent. Disaggregating by sub-sector, computer services experienced a clearly strong growth, 27 per cent over the period (see Table 1). The average growth of 8.7 per cent for the professional services sub-sector disguises a mixed story, with market research and legal services experiencing very high growth (38 per cent and 64 per cent, respectively), while management consulting had a negative growth of minus 13 per cent (the next section provides an explanation of this). Both labour recruitment and industrial cleaning achieved strong productivity growth, at 35 per cent and 62 per cent, respectively, while R&D also experienced a strong growth of 56 per cent.

Thus, labour productivity is rising in nearly all segments of business services, while employment is also rising in all segments. But the dispersion in labour productivity growth rates is difficult to explain merely by reference to the skill requirement or the degree of digitization in each sub-sector. For

3 This echoes Blinder’s insight that ‘the dividing line between the jobs that produce services that are suitable for electronic delivery (and are thus threatened by offshoring) and those that do not does not correspond to traditional distinctions between high-end and low-end work’ (Blinder, 2006).
example, computer service workers are six times as productive as industrial cleaners. But the latter experienced one of the fastest growths in productivity, alongside more professional sectors such as market research and R&D.

In general, little is known about what drives productivity in business services, and many issues over the quality of the data have deterred serious investigation. There is a small chance that the growth in productivity in the above business-service sectors is spurious, reflecting measurement difficulties. For example, the growth of value added per head in legal services might be due to lawyers charging higher prices for their work, which may not be reflected in improved quality of legal services. It may simply reflect the increasing monopoly position of those services that are not open to international or interregional competition. Alternatively, the increased burden of regulation and changes in legislation leading to a rise in personal injury claims services might have led to a rise in both the volume of work (‘billable hours’) and legal fees in a tight market. Despite the difficulty in separating out the price effect and the quantity effect, this paper proceeds on the assumption that official statistics reflect real growth in business-service productivity. With this assumption, it is worthwhile considering what factors might account for productivity growth in this sector.

Taking the services sector as a whole, the main focus of the policy and academic debate so far has been on the retail industry, where the UK and EU lag behind the USA. This has been attributed in part to the slow uptake of ICT. In manufacturing, also, economists have focused on ICT, and complementarities between ICT and management practices in explaining performance differences (Bloom et al., 2005). In the United States, ICT and work reorganization were found to be complementary in enhancing performance in both manufacturing and service firms (Bresnahan et al., 2002). Also, recent work has shown that ICT investment has been relatively high in business services in the UK (Oulton, 2001).

This paper builds on, but also goes beyond, explanations of productivity growth that concentrate on the role of ICT investment and complementary practices in management and work organization. In particular, we focus on outsourcing and offshoring as corporate strategy for restructuring, and sources of productivity that derive from standardization of processes on the one hand and customized services and solutions on the other.
III. OUTSOURCING AND OFFSHORING AS DRIVERS OF PRODUCTIVITY GROWTH IN BUSINESS SERVICES

This section focuses on the phenomenon of outsourcing and offshoring to account for the simultaneous growth of productivity and employment in UK business services. Employment growth is in part due to domestic outsourcing—sometimes involving the transfer of employees from user to provider firms—and in part due to general growth in demand for business services.

Outsourcing occurs when firms opt to ‘buy’ rather than ‘make’ things in-house. Outsourcing therefore involves greater specialization as firms switch from sourcing goods and services internally to sourcing them from separately owned suppliers. Offshoring occurs when firms move productive activities overseas, whether they are conducted by separately owned suppliers or by fully owned (captive) subsidiaries.

There are three separate trajectories towards offshoring, as shown in Figure 2. First, companies may already be outsourcing (arrow 1), but decide to switch from a domestic supplier to a foreign supplier (arrow 2). Second, companies may be making the decisions to outsource and to offshore to a foreign supplier simultaneously (arrow 3). Third, companies may source from overseas locations by establishing foreign affiliates (arrow 4). Switching the source from an overseas affiliate to a foreign-owned supplier (arrow 5) may also occur. Abramovsky et al. (2004) established that domestic outsourcing—greater specialization within the UK national boundaries—is significantly bigger in size, relative to offshoring.

Outsourcing and offshoring have been part of the staple diet of corporate restructuring activities for a long time (Gerrefi et al., 2004). What is new is that they are occurring increasingly in business services. The rest of this section describes why more firms are outsourcing business services—the demand side of the story—before analysing the ways in which suppliers of business services are improving their labour productivity—the supply side of the story.

On the demand side, this paper makes a useful distinction between two types of value-chain disaggregation, namely vertical dis-integration of inputs and the unbundling of corporate functions. Business-service outsourcing is as much about the unbundling of corporate functions as vertical dis-integration. The decision to outsource business services is typically taken at the top management level, aimed at reducing costs and improving return on assets as part of a wider corporate restructuring or renewal programme (Pettigrew et al., 2003). Thus, the extent of business-service outsourcing depends on the nature of corporate strategy and structure, not merely on ICT investment to improve operational efficiency.
On the supply side, outsourcing by client firms results in employment growth for business-service providers, through general growth in demand due to vertical dis-integration and corporate function unbundling. Productivity is enhanced due to a combination of three factors, namely (a) the standardization and consolidation of business processes, (b) greater specialization through outsourcing and offshoring with built-in supplier incentives for high performance, and (c) moving into higher-value-added segments in the business-services value chain, such as expert advice and customized solutions.

(i) Vertical Dis-integration

Vertical dis-integration happens when a firm decides to buy rather than make, when it is cheaper to source inputs that go into the firm’s final product or service in the market than make them in-house. Vertical dis-integration in manufacturing gathered pace in the 1980s, in part in response to the rise of ‘lean production’ and ‘lean supply’, a paradigm developed by looking at the Japanese example of ‘just-in-time’ production and delivery (Womack et al., 1990). For example, General Motors used to make many car components in-house at their parts divisions. But by spinning out the parts divisions as Delphi Corporation, GM now sources major chunks of the car such as seats and front-end modules from independent suppliers.

Through international trade and foreign direct investment (FDI), transnational corporations have come to build complex global networks of geographically dispersed production activities (Berger, 2006). The resulting global value chains may be producer-driven, as in the case of capital-intensive automobile manufacturing, or buyer-driven, as in the case of brand-owning retailers (such as Gap) and ‘manufacturers without factories’ (e.g. Nike). The 1990s saw the rise of contract manufacturing in US electronics, with companies such as Dell and Cisco Systems outsourcing the entire manufacturing and assembly processes to contract manufacturers. Solectron is one such contractor, employing 80,000 employees in 50 locations, with $20 billion sales revenue in 2000, to offer electronic manufacturing services (EMS) (Gereffi et al., 2004).
A similar process of vertical dis-integration is happening in non-manufacturing settings, such as financial services. For example, an insurance company may outsource its claims-handling process to a third-party provider that operates contact centres and the associated back-office infrastructure. What such a supplier provides is an input into the final service that the insurance company sells, and can be analysed in the same way as a component supplier (see Figure 3). So-called BPO (business process outsourcing) may therefore involve the vertical disaggregation of the value chain. Through such vertical dis-integration, fewer employees work at internal contact centres in the financial services sector, while demand for contact-centre employees in the business-services sector increases.

(ii) Unbundling of Corporate Functions

However, there is also a different sort of BPO which is not at all ‘vertical’. This other type concerns the outsourcing of business processes within corporate functions, rather than of inputs that go into the final product or service of a company. Such ‘corporate function unbundling’ potentially affects modern corporations and organizations in any part of the economy, in manufacturing and services, and in private and public sectors.

Every modern corporation has corporate functions, such as finance and accounting (F&A), human resources (HR), information technology (IT), sales and marketing, purchasing and supply, and research and development (R&D). Many processes in these departments are potentially outsourceable. In 2005, it was estimated that $90 billion was spent globally on purchasing IT, $179 billion in logistics and procurement, $27 billion on engineering, $14 billion on F&A, and $13 billion on HR (IDC estimates quoted in Business Week, 30 January 2006). In the last decade, outsourcing of business processes within these corporate functions has become just as important as outsourcing of inputs. This distinction is often not made, at the risk of overlooking some of the important causes and consequences of the current phase of outsourcing.

The Chandlerian modern corporation is a good starting point to identify what is new. In the twentieth century, single-product corporations with a functional organization structure (known as U-Form) came to develop specialized corporate functions staffed by professional managers (Chandler, 1962). These functions had been regarded as ‘overhead’, hitherto untouched in previous rounds of cost-cutting efforts including through vertical dis-integration. However, at the same time as retrenching blue-collar workers, firms began to peel away at the administrative structure of professional administrators and managers through the outsourcing of business processes.

A further avenue for cost saving exists if corporations had adopted a multi-divisional structure (so-called M-Form). In this semi-decentralized structure, each product division has its own set of administrative functions. Divisions have each developed their own processes and ways of doing things, duplicating some tasks that could be made more efficient if standardized and centralized. In order to cut costs and to improve the quality of service delivery, the same function in different divisions can be bundled together, in a shared services centre (see Figure 3). For example, multi-divisional firms such as Proctor & Gamble and Unilever created such centres to carry out processes in F&A (e.g. accounts payable) and HR (e.g. payroll and benefits administration). Thus, the scope for efficiency gain from standardization and consolidation of processes is likely to be greater for a multidivisional firm (M-Form) than for a single-product firm (U-Form). Corporate function unbundling involves taking away functional processes from product divisions, and is therefore an act of re-centralization at the corporate headquarters.

In some cases, such a shared services centre is kept in-house, to exploit economies of scale internal to a global corporation. In other cases, a centre is sold to an independent business-services provider, in order to further enhance the efficiency and the quality of service delivery. In still other cases, it is contracted out for a period of several years. The choice of ‘make or buy’ depends on whether asset ownership might create appropriate incentives for the supplier (Baker et al., 2002). Thus, if the supplier can be motivated via a bonus to exert effort to provide good quality services, and if there are many alternative users wanting similar services, then the centre should be owned by the supplier. By contrast, shared services centres should be owned by the user if the user wants specialized services and does
not lose much in performance owing to the absence of bonus payments.

Large landmark outsourcing deals have involved the sale of a shared services centre. Such asset sale is considered important for improving the client firm’s return on assets. Pioneering business-services outsourcing deals in the HR field, including BP’s outsourcing to Exult (a Californian start-up) (Adler, 2003), BT’s outsourcing to Accenture HR Services (Accenture, 2003), and Proctor & Gamble’s deal with IBM Global Services (Sako and Tierney, 2005), all involved such transfer of assets. The sale of assets may also be accompanied by the transfer of some employees in the HR function. In fact, BP employees were inherited by Exult, BT employees by Accenture HR Services, and P&G employees by IBM Global Services. This phenomenon explains part of the employment growth in business services.

Lest it might be thought that this phenomenon is relevant only to large global corporations, the unbundling of corporate functions is also affecting smaller firms and organizations in the public sector. Because they can treat their functions as component pieces (or modules) to be mixed and matched, small firms and start-ups face lower entry costs to become global actors quickly (Palmisano, 2006).

(iii) Mechanisms for Enhancing Suppliers’ Productivity in Business Services

From the above discussion, it is evident that employment in business services has grown due to a general growth in corporate demand for such services. Sometimes, employment growth is also due to transfer of employees from client firms to provider firms when the whole IT department or the HR department is sold in outsourcing deals. Independent providers also have incentives to enhance their performance through bonus payments built into outsourcing contracts. Moreover, suppliers can enhance productivity by moving into higher-value-adding activities over time. However, the trajectory and incentives built into upgrading their capabilities are quite different in a vertical dis-integration setting and in a corporate function unbundling setting.

As an example of a vertical supply chain, the global production network for the apparel industry underwent transformation from the 1950s to the 1990s (Abernathy et al., 1999). Not only has the epicentre of export-oriented clothing manufacturers shifted from Japan to South Korea, Taiwan, Hong Kong, and now China, but the type of tasks undertaken by Asian suppliers has also changed enormously. They were initially subcontractors, undertaking simple ‘cut, trim, and sew’ tasks based on detailed instruction and fabrics supplied by client firms. But by the 1990s, some became full-package suppliers, capable of designing clothes, making samples, sourcing the needed inputs including fabrics, and even developing retail outlets with their own brands. The upgrading of local suppliers’ capabilities by ‘insertion’ into the global value chain generates substantial backward linkages to emerging market economies.

At the same time, when suppliers in vertically dis-integrated markets develop new capabilities, they are likely to engage in an invasive strategy to go upstream and downstream, in direct competition with the client companies’ business. In electronic assembly, for instance, assembly contractors in Taiwan, such as ACER, may come to compete directly with their clients once they start selling branded electronic goods (Berger, 2006).

By contrast, in markets for corporate function unbundling, providers of business services do not compete in the same final market as client firms. For example, IBM is in the business of providing IT and other business services, and is totally unrelated to the business of providing intermediate inputs for its client’s final products, for instance P&G’s personal care products such as soap and toothpaste. Consequently, suppliers may grow over time to occupy higher-value-added processes in markets other than the client firm’s final markets. This puts suppliers in a relatively strong position vis-à-vis buyers, which cannot exercise monopsonistic power. If Johnson Control fails to make and deliver seats on time for General Motors, GM’s assembly lines would stop. However, if IBM were to fail to process payroll or travel expenses on time, P&G’s productive activities would not be affected so directly. Table 2 provides a summary of these relationships and the distinction between vertical dis-integration and corporate function unbundling.

In vertical markets, suppliers typically attempt to create higher value added by moving from simple
assembly and testing to component manufacturing, design, and marketing. In markets for business services, suppliers also operate on the notion of climbing the value-added ladder, by moving from simple to more complex transactions. The complexity of transactions is increased by shifting, to use industry jargon, from transactional to transformational outsourcing. Transactional outsourcing is defined as outsourcing that focuses on efficiency gains through the application of standardized solutions to automate previously labour-intensive processes. Transformational outsourcing, by contrast, involves creating customized solutions, which go beyond simple standardization and centralization. Suppliers then derive higher value added by providing services which are closer to the advisory and consulting end of the spectrum.

In human resource outsourcing (HRO), transactional processes in the HR function, for example in payroll and benefits administration, are typically outsourced. At the other extreme, HR strategy formulation is never outsourced, and is the responsibility of so-called ‘business partners’, namely the Chief Human Resource Officer (CHRO) and a small number of top HR managers who can rub shoulders with board members from other functional areas. In between the low-value-adding and the high-value-adding extremes, however, is a grey middle area of professional and advisory services based on specific areas of HR expertise, such as compensation design, learning and training, performance management, and labour relations (see Figure 4 for the notion of an ‘HR curve’ which orders HR processes from low- to high-value-adding activities). HRO providers’ intent is to obtain deals containing these higher-value-adding advisory service businesses, while offshoring transactional processes to locations such as India. In reality, however, many of the existing HRO deals contain transactional processes only (Sako and Tierney, 2005).

Similarly in F&A, transactional processes such as general accounting and accounts payable are typically subjected to standardization, consolidation, and offshoring. But financial strategy and accounting policy and control are never outsourced, and are the responsibility of the client firm’s Chief Finance Officer (CFO) and ‘business partners’ in the finance function. In between, there are advisory services in specific expertise areas, such as internal auditing, budgeting and forecasting, taxation, and risk management (see Figure 5 for a schematic representation of three layers of F&A processes). While outsourceable, a considerable degree of caution exists in subjecting these processes to outsourcing, for fear of losing internal competence.

The quandary with how to increase overall productivity—by balancing the scope of standardized transactional processes and more customized solutions—is illustrated by the predicament of the management consulting sector. As we saw in section II, this is a
Figure 4
The Human Resource Curve

Figure 5
Typology for Thinking About Outsourcing in F&A

Source: www.tpi.net

Source: Everest Research Institute, August 2005.
sector in which employment grew by 64 per cent from 173,000 in 1998 to 284,000 in 2004, but labour productivity declined by 13 per cent. This decline is due to consulting firms diversifying away from providing business advice only to actually ‘doing’ what they advise—i.e. providing business services. The latter is subject to lower value-added per head than the former. Accenture evidently makes less money per employee in providing outsourced business services than in management and strategy consultancy services.

To summarize, employment in UK business services is growing due to both vertical dis-integration and the unbundling of corporate functions. Through outsourcing, employees in in-house call centres or corporate functions of manufacturing companies are reclassified into business-service employment. Labour productivity is enhanced owing to a combination of three factors, namely (a) the standardization and consolidation of business processes, (b) greater specialization through outsourcing with built-in supplier incentives for high performance, and (c) moving into a higher-value-added segment of the business-services value chain, such as expert advice and customized solutions. Evidence from HRO and F&A suggests that productivity gains from (a) and (b) are being realized, while further gains from (c) are not yet fully incorporated.

IV. ARE SOURCES OF PRODUCTIVITY GROWTH DIFFERENT FOR DIFFERENT TYPES OF SERVICES?

Thus far, we have not explored whether or not there is a difference between outsourcing and offshoring in their impact on productivity and employment in UK business services. Much of the popular debate on offshoring is about the migration of jobs, but not the workers, from a country such as the UK to low-cost countries, such as India and China. While the UK continues to have trade surplus and employment growth in business services, it is worthwhile asking which jobs are likely to move to locations such as India and which might stay within the UK. Moreover, are the mobile jobs more or less productive than immobile jobs?

One way of addressing this question is to consider what characteristics of services jobs account for mobility/immobility, and what characteristics of services account for their tradability (i.e. transportability across long distances). In order to address this issue, this section establishes some definitions of services in contrast to products, in so far as they are useful in understanding sources of their productivity growth. We then consider the impact of outsourcing and offshoring on business-service productivity via this lens of the services versus products distinction.

(i) Defining Services versus Products

In economics, products are tangible and storable artifacts. They can be manufactured efficiently by subjecting production processes to standardization and automation. By contrast, services are traditionally conceptualized as intangible, non-storable, and co-produced with customers. Co-production makes standardization and automation of service delivery difficult.

This ideal-typical contrast between services and products may still persist today, but it does not map neatly on to differences between sectors in the economy. This is because any firm in the economy is now likely to have a combination of products and service activities. This hybrid is on the rise owing to the phenomena of ‘productizing’ services and ‘servicizing’ products.

(ii) ‘Productizing’ Services

Services used to be non-tradable (in the sense normally used in international economics, i.e. not able to enter into international trade) because consumption had to happen at the point of production, face-to-face. There are, of course, personal services that retain this essential characteristic of services, in the form of restaurant and hotel workers, hairdressers, nurses, and social workers. However, ICT has transformed a considerable proportion of services in two distinct ways. First, with the fall in telecommunications costs, geographical distance is not a barrier to the simultaneous production and consumption of some customer services, as European customers can phone contact (or call) centres in India. Second, services are becoming more like...
manufacturing as processes can be standardized and data stored for medical diagnosis, benefits administration, and legal services. “Information today can be standardized, built to order, assembled from components, picked, packed, stored and shipped, all using processes resembling manufacturing’s” (Karmarkar, 2004).

By treating contact centres as no different from factories, the key aim is to make services look more like manufacturing through process standardization, the adoption of labour-saving technology, and the use and reuse of repeatable services and solutions. The role of human skills is minimized in this perspective. Offshoring also looms large, as once standardized and automated, operating at a distance proves to be not a disadvantage. Thus, labour productivity in services has increased due to ICT and economies of scale in back-office work.

(iii) ‘Servicizing’ Products

Product-based companies, be they capital-intensive firms such as BAE systems or GE, or software firms, are increasingly turning to services when their core product markets become saturated (Sawhney et al., 2004). For example, software firms may offer maintenance, customization, and upgrading services (Cusumano et al., 2006). GE offers financial services not merely as diversification, but as complements to the products it produces. Thus, offering services which are complementary to the products firms sell, in the form of after-sales maintenance, systems integration solutions, or financial services, is a way of seeking growth. Because of the labour-intensive nature of some services as compared to products, however, services do not necessarily enhance labour productivity.

Another related phenomenon is a trend towards ‘servicizing’ manufacturing. A key driver of outsourcing in manufacturing has been to reduce costs and to increase flexibility by turning fixed costs into variable ones. One way of achieving this objective is to outsource the ownership of fixed assets tied up in manufacturing. For example, electronics manufacturers, such as Dell, do not assemble their own products but contract out to microelectronics contract assembly firms, such as Solectron and Celestica. These firms, in effect, offer brand-owning client firms a ‘manufacturing service’ on demand (Sturgeon, 2002). The rapid growth of temporary labour agencies, such as Adecco and Manpower, is due to the associated demand for labour services without employing labour directly. Thus, outsourcing of production processes turns manufacturing into a contract service.

(iv) Two Views of Services

To summarize, the characteristics of manufacturing products and delivering services have converged recently owing to a combination of ICT and cost-driven corporate strategy. These convergent characteristics have made services resemble products that can be put in a box and shipped. How much further can we go down this route to make more services resemble products?

There are two contrasting views. One view, grounded in computer and engineering sciences, regards services as a control system (Lyons et al., 2006). Then the aim is to make more services efficient, seeking productivity gains from better controls and predictability. The other view, grounded in economics and sociology, regards services primarily as co-produced with customers. This perspective focuses on the fact that some services will remain customized, requiring face-to-face contact, judgement, loyalty, and trust, which are the sources of creating and capturing value. In the former view, the role of human skills is minimized. In the latter, service delivery depends much on judgement-based work grounded in professional knowledge. Context is important in making such judgement, thus advantaging face-to-face rather than distant transactions.

Which of these two views is more significant in explaining productivity growth in UK business services? They appear to be of equal importance, precisely because the contrast between jobs that can be ‘standardized and controlled’, as a precursor to offshoring, and those that require workers to ‘customize and judge’, does not map neatly on to the divide between low-end and high-end jobs (Blinder, 2006). Blinder calls the former ‘impersonal service’ jobs and the latter ‘personal service’ jobs, pointing out that not all jobs in the latter category require higher education than jobs in the former category. Thus, both low-skilled jobs (e.g. typing and clerical tasks) and high-skilled jobs (e.g. accountants and computer programmers) are equally subjected to
standardization, and have contributed to UK productivity growth as well as promoted offshoring. Moreover, both low-skilled jobs (e.g. hairdressers and janitors) and high-skilled jobs (court judges and medical doctors) require face-to-face human contact and customized solutions. Consequently, it is not the case that all low-end (i.e. low-productivity) jobs are being offshored and all high-end (i.e. high-productivity) jobs are retained within the UK borders.

V. CONCLUSIONS

This paper presents evidence of employment and productivity growth in UK business services. Official statistics indicate that productivity has grown by over 20 per cent in the last 7 years at the same time as employment growing by 20 per cent. Growth has been faster in IT services and professional services than in other sectors, such as labour recruitment and industrial cleaning. However, it is difficult to explain the dispersion in rates of growth of labour productivity in different types of services by reference to their skill requirement.

The paper considers possible factors accounting for the simultaneous growth in employment and productivity. First, we focus on outsourcing and offshoring as firm-level decisions in unbundling corporate functions or vertical dis-integration. Employment growth in business services is due either to direct transfers of employees or to increase in demand for such services. Productivity of business-service providers is enhanced through (a) greater standardization and consolidation of business processes, (b) greater specialization through outsourcing and offshoring, and (c) moving up the value chain to offer customized solutions.

Second, in making a distinction between products and services, it was argued that much of the outsourced part of business-service activities is subjected to the same sort of operational efficiency improvements as in manufacturing. However, not all high-skilled jobs are immune to such ‘standardize and control’ measures, though some jobs remain those that require customization and judgement. Similarly, not all low-skilled jobs can be subjected to ‘standardize and control’ measures, since some personal services continue to require face-to-face and customized delivery. Thus, UK-based business-service providers’ productivity will depend on balancing the mix of two potential sources of productivity growth, namely the provision of customized solutions and the provision, in part through offshoring, of standardized processes.

This paper’s objective was to provide a systematic framework for thinking about outsourcing and offshoring as firm-level strategic decisions. As such, providers of business services may enhance their productivity by (a) standardizing and consolidating processes, and (b) moving into higher-value-adding activities when their client firms unbundle corporate functions or vertically dis-integrate. It has not been possible to attribute weight to the relative importance of these two factors. The paper also provided a framework for considering why some jobs are more prone to offshoring than others, based on the characteristics of services rather than on the educational or skill content of those jobs. Nevertheless, the paper does not provide empirical evidence of jobs that have been offshored, nor the skill content of those jobs. It is hoped that with better data, in both statistical and qualitative terms, further research would be able to provide a clear macro-picture and vision of outsourcing and offshoring for the UK economy.

REFERENCES

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