**The trouble with outsourcing**

**Outsourcing is sometimes more hassle than it is worth**

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WHEN Ford's River Rouge Plant was completed in 1928 it boasted everything it needed to turn raw materials into finished cars: 100,000 workers, 16m square feet of factory floor, 100 miles of railway track and its own docks and furnaces. Today it is still Ford's largest plant, but only a shadow of its former glory. Most of the parts are made by sub-contractors and merely fitted together by the plant's 6,000 workers. The local steel mill is run by a Russian company, Severstal.

Outsourcing has transformed global business. Over the past few decades companies have contracted out everything from mopping the floors to spotting the flaws in their internet security. TPI, a company that specialises in the sector, estimates that $100 billion-worth of new contracts are signed every year. Oxford Economics reckons that in Britain, one of the world's most mature economies, 10% of workers toil away in “outsourced” jobs and companies spend $200 billion a year on outsourcing. Even war is being outsourced: America employs more contract workers in Afghanistan than regular troops.

Can the outsourcing boom go on indefinitely? And is the practice as useful as its advocates claim, or is the popular suspicion that it leads to cut corners and dismal service correct? There are signs that outsourcing often goes wrong, and that companies are rethinking their approach to it.

The latest TPI quarterly index of outsourcing (which measures commercial contracts of $25m or more) suggests that the total value of such contracts for the second quarter of 2011 fell by 18% compared with the second quarter of 2010. Dismal figures in the Americas (ie, mostly the United States) dragged down the average: the value of contracts there was 50% lower in the second quarter of 2011 than in the first half of 2010. This is partly explained by America's gloomy economy, but even more by the maturity of the market: TPI suspects that much of what can sensibly be outsourced already has been.

Miles Robinson of Mayer Brown, a law firm, notes that there has also been an uptick in legal disputes over outsourcing. In one case EDS, an IT company, had to pay BSkyB, a media company, £318m ($469m) in damages. The two firms spent an estimated £70m on legal fees and were tied up in court for five months. Such nightmares are worse in India, where the courts move with Dickensian speed, or in China, where the legal system is patchy. And since many disputes stay out of court, the well of discontent with outsourcing is surely deeper than the legal record shows.

Some of the worst business disasters of recent years have been caused or aggravated by outsourcing. Eight years ago Boeing, America's biggest aeroplane-maker, decided to follow the example of car firms and hire contractors to do most of the grunt work on its new 787 Dreamliner. The result was a nightmare. Some of the parts did not fit together. Some of the dozens of sub-contractors failed to deliver their components on time, despite having sub-contracted their work to sub-sub-contractors. Boeing had to take over some of the sub-contractors to prevent them from collapsing. If the Dreamliner starts rolling off the production line towards the end of this year, as Boeing promises, it will be billions over budget and three years behind schedule.

Outsourcing can go wrong in a colourful variety of ways. Sometimes companies squeeze their contractors so hard that they are forced to cut corners. (This is a big problem in the car industry, where a handful of global firms can bully the 80,000 parts-makers.) Sometimes vendors overpromise in order to win a contract and then fail to deliver. Sometimes both parties write sloppy contracts. And some companies undermine their overall strategies with injudicious outsourcing. Service companies, for example, contract out customer complaints to foreign call centres and then wonder why their customers hate them.

When outsourcing goes wrong, it is the devil to put right. When companies outsource a job, they typically eliminate the department that used to do it. They become entwined with their contractors, handing over sensitive material and inviting contractors to work alongside their own staff. Extricating themselves from this tangle can be tough. It is much easier to close a department than to rebuild it. Sacking a contractor can mean that factories grind to a halt, bills languish unpaid and chaos mounts.

**So far and no further**

None of this means that companies are going to re-embrace the River Rouge model any time soon. Some companies, such as Boeing, are bringing more work back in-house, in the jargon. But the business logic behind outsourcing remains compelling, so long as it is done right. Many tasks are peripheral to a firm's core business and can be done better and more cheaply by specialists. Cleaning is an obvious example; many back-office jobs also fit the bill. Outsourcing firms offer labour arbitrage, using cheap Indians to enter data rather than expensive Swedes. They can offer economies of scale, too. TPI points out that, for all the problems in America, outsourcing is continuing to grow in emerging markets and, more surprisingly, in Europe, where Germany and France are late converts to the idea.

Companies are rethinking outsourcing, rather than jettisoning it. They are dumping huge long-term deals in favour of smaller, less rigid ones. The annualised value of “mega-relationships” worth $100m or more a year fell by 62% this year compared with last. Companies are forming relationships with several outsourcers, rather than putting all their eggs in few baskets. They are signing shorter contracts, too. But still, they need to think harder about what is their core business, and what is peripheral. And above all, newspaper editors need to say no to the temptation to outsource business columns to cheaper, hungrier writers.