

Development of offshore outsourcing industry and its influences on training and development- Exploring China and Malaysia's experience

Chong, Soon Meng

Sunway University, Malaysia

It cannot be denied that for the past 3 years since China made its first foray to invite FDI in 1979, the country's economy has been progressing at a rapid pace. Technical and education advancement have contributed to the nation's ability to position itself as an important offshore outsourcing destination for the world. At the same time, this industry also contributes to the nation's economic growth. As at June 2009, China has close to 7000 enterprises focusing on offshore industry. Data shows that this particular sector has provided employment to at least 1.2 million Chinese people. This seems to be similar in Malaysia's situation where Malaysia too, has begun to offer and further develop this service as it is a key contributor to the country's GDP. In fact, according to the A. T. Kearney Global Services Location Index of March 2011, China and Malaysia were ranked in the top three offshoring/outsourcing countries in the world. Despite China's success in the outsourcing industry, many global companies are still experiencing challenges to attract and retain talent in China. The paper examines the skill shortage in China's offshoring and outsourcing industry and provides insight into Malaysia's experience with the Human Resources Development Fund on developing its workforce. The paper will also provide some suggestions on the various institutional and policies levers that could address the skills shortage challenges in China.

Keywords: offshoring, outsourcing, Human Resource Development

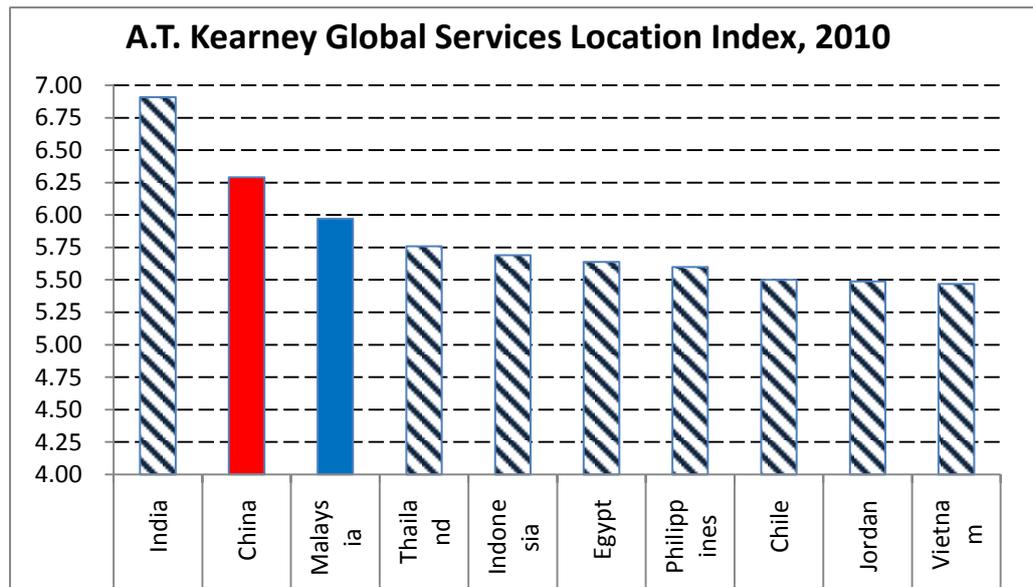
Introduction

In the increasing competitive business environment, companies are adopting the strategy of outsourcing the non-core activities or functions to specialized third parties while the companies only focus on core activities and improve overall performance (Kim and Won, 2007). Offshore outsourcing has been a growing impressive rate in recent years. It is common for companies, ranges from large multinationals to small and medium companies to adopt outsourcing strategies to cope with competitive challenges in their market

As of June 2009, China had more than 6,600 enterprises focusing on overseas service outsourcing, employing 1.2 million people. And within the first half of 2009, the country recorded US\$2.56 billion of service outsourcing business from the international market, surging 32.5 per cent year on year. (*AsiaPulse News*, 2009) In recent years, China has

developed itself into one of most preferred outsourcing hotspots in the world. China and Malaysia were ranked number two and three, respectively in the A.t. Kearney’s Global Services Location Index 2010. The index, which ranks 50 countries based on financial attractiveness, people skills and availability, and business environment, has been released annually since 2003.

Figure 1: A.T. Kearney Global Services Location Index, 2010



Source: A.T. Kearney Global, 2010

One of the key features of China’s job market is the abundant supply of graduates from its huge population. Despite China’s abundant pool of graduates, many global companies are still experiencing significant challenges to attract and retain talent in China (Li and Sheldon, 2010). Based on a study conducted by McKinsey, it is estimated that China will need about 75,000 globally capable executives to satisfy the demand for talent required by both China’s corporation and multinationals (Farrell and Grant, 2005). The McKinsey report also highlighted that only 60 percent of college graduates find jobs in fields in which they earned their degree and less than 10 percent of candidates are prepared for work in multinational or even local companies.

The objective of the paper is therefore to address the skills shortages and mismatches in the Chinese offshoring and outsourcing industry as identified by the McKinsey Report in 2005. The paper presents some suggestions on the various institutional and policy levers that could address the skills shortage problem in the China offshoring and outsourcing industry by

making reference to the Human Resource Development policy adopted by Malaysia. Malaysia's Human Resource Development Scheme have successfully encouraged companies to develop their workforce, thereby addressed similar skills shortage in its offshoring and outsourcing industry.

Literature review

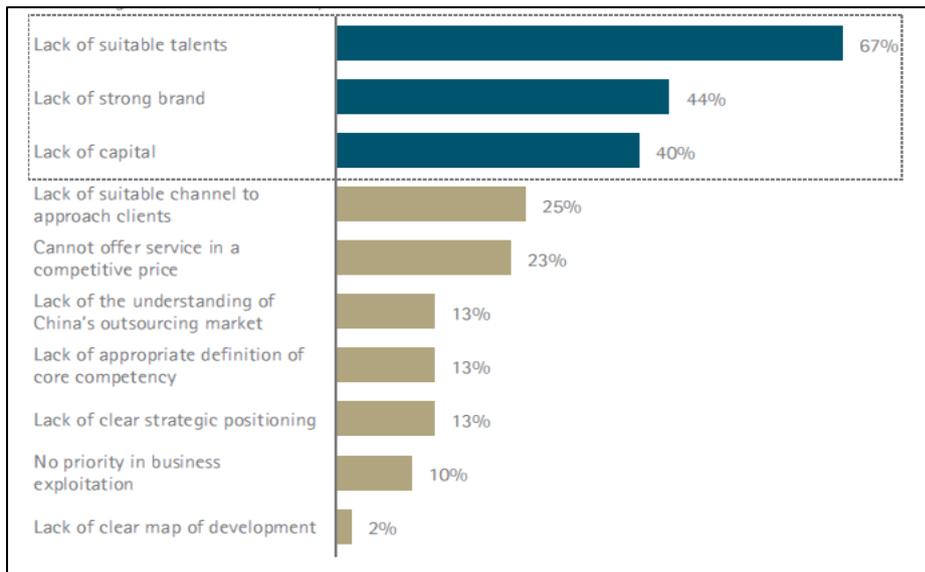
Outsourcing means subcontracting of service or activity to a third party for strategic use of company's resources, to generate company's values and gain competitive edge (Harland et al, 2005, Hanson et al, 2008). Offshore outsourcing refers to the process by which companies undertake some activities at offshore locations instead of in their home countries (Kumar et al 2009; Murtha et al., 2006) Offshoring outsourcing of administrative and technical tasks has become a mainstream business practice (Doh, 2005).

Manufacturing firms outsourced their internal manufacturing and operations to lower cost countries. Outsourcing activities include relocating non-core activities to suppliers for the purpose of securing specialized expertise, access low-cost labour (Farrel, 2004) as well as proximity to foreign markets. In the past, manufacturing companies to outsource simple business activities and operations, however until recently, knowledge-intensive and highly skilled operations have been off-shored to lower labour cost countries as well. (Lacity *et al.*, 2008)

Talent Shortage in the China's Offshore Outsourcing

China's rapid growth for the past two decades in the offshoring and outsourcing industry have generated a demand for higher-skilled workforce to fit for employment for world-class companies. China's population is expected reached 1.341 billion by end of 2010, (Chinadaily, 2011). In 2003, China had more than 9.5 million young professional graduates with up to seven years' work experience. (Farrell and Grant, 2005) Despite the abundant supply of workforce, many multinational companies operating in China are still experiencing difficulties to attract and retain talent. (Li and Sheldon, 2010) A study by McKinsey (Farrell, 2005) estimated that China will need about 75,000 globally capable executives to satisfy the demand for talent required by both China's corporation and multinationals. This situation has post a challenge to China as the outsourcing industry is a talent-intensive industry.

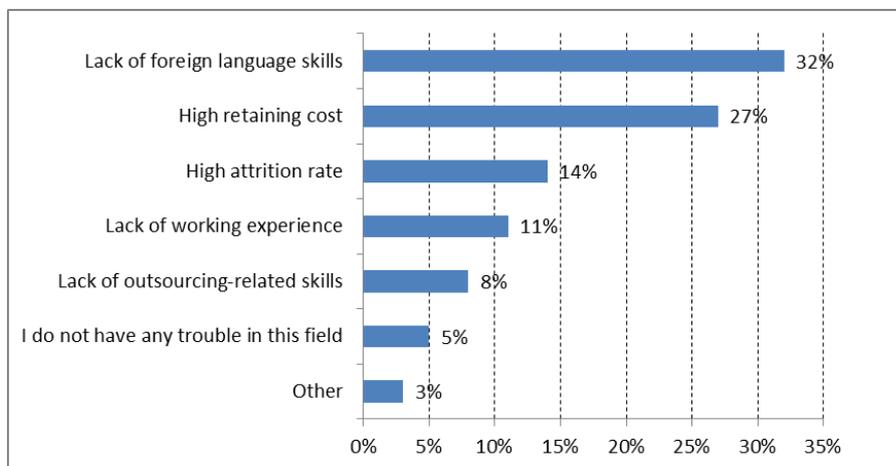
Figure 2: Main barriers to the development of service providers in the Outsourcing industry in China



Source: Accenture and CIIP (2008)

As highlighted by Hunting (2008), the talent crunch has affected many sectors of China's economy, particularly in the emerging outsourcing sector. As per Figure 2, the lack of suitable talents was ranked as the main barrier in the outsourcing industry. The lack of suitable talents has generated a bottleneck in the supply of talent in China. The survey also highlighted that in terms of talent management (Figure 3), 32 per cent of the respondents indicated that the lack of foreign language skills in the workforce as the major challenge in the outsourcing industry.

Figure 3: Talent Management Challenges



Source: Accenture and CIIP (2008)

However as highlighted in McKinsey report, only 60 percent of college graduates find jobs in fields in which they earned their degree and fewer than 10 percent of candidates are prepared for work in multinational or even local companies. Studies by Blunch and Castro (2005) and Booth (1993) highlighted that in order to continuously improve and maintain the quality of the workforce, it is essential to invest in human capital development through education and training. However due to the rapid economic growth in the recent years, many Chinese firms do not have enough resources and time to implement systematic training (Verburg, 1999). Many employees in China report that they do not think they are given sufficient opportunities for training and development. (Mercer HR 2005) A study conducted by Boston Consulting Group and Wharton School (2004) again indicated that China is still lack of competent managers. According to Wilhelm and Xia (1993) and Child (1994) and most Chinese companies typically give priority to technical issues rather than management skills as the role of managerial has shifted gradually from being bureaucratic administrators to becoming strategic decision makers. A project conducted by the United Nation Development Programme (UNDP) (Branine, 1996) stressed that there is a urgent need for the development of adequate training programmes to meet the increasing demand for skilled and efficient managers.

Lessons learned from Malaysia

Malaysia is a country in South-East Asia with a population of 27 million people with 11 million working population. Malaysia gained independence in 1957 and has transformed itself from a raw materials producer in the 1970's into an emerging multi-sector economy. According to A.T. Kearney's latest *Global Services Location Index 2010*, Malaysia is one of the most preferred locations for offshore manufacturing and service based operation since it was ranked third after India and China.

Currently the services sector is one of the major contributors to the growth of the Malaysian economy. This sector includes IT services, shared services and business process outsourcing (BPO) and regional headquarters for multinational companies. Malaysia started to lay the foundation for the knowledge-based economy in the mid-1990s by launching the Multimedia Super Corridor (MSC) and invested heavily in IT infrastructure. This has made Malaysia a

prominent destination in the outsourcing industry. Its multi-cultural and multi-lingual strengths have also attracted more than 5000 corporations from over 40 countries to set up their offshoring and outsourcing activities in Malaysia. (mida, 2010) The Malaysian outsourcing industry is predicted to be worth \$1.9 billion by 2013 (outsourcingmalaysia, 2011) and Malaysia's total technology and technology-enabled services market, which include shared services, outsourcing, joint ventures and partially-owned subsidiaries, is estimated to be US\$3 billion with a projected compounded annual growth rate of 17 percent.

Employee Development in Malaysia

In the 1970s, Malaysia was one of the manufacturing hubs for labour-intensive and lower-end manufactured products. However, Malaysia faced a stiff competition for its labour-intensive industry from lower-wage and resource-rich economies such as China, Indonesia and Thailand. To maintain its competitive edge, Malaysia undertake employee development programmes to enhance the productivity in the traditional industries and at the same time enhance its workforce's skill-set, such as technological and knowledge capabilities to move into the mid-range and higher-end sector.

In term of training, a study by Yong (1996), (cited by Chew, 2005) indicated that due to the high training cost, most Malaysian firms provide only fundamental skills training to its employee. This is again confirmed by another study (Rowley and Abdul Rahman, 2007) that most companies provide training and development technical knowledge and skill training with little emphasis given to social intercultural skills and competence development. The reluctance of Malaysian firms in human development led the Malaysian government to intervene to promote education and skill development in the private sector. Hence, the Malaysian government established the Human Resource Development Fund in 1993, a levy grant system with the purpose of providing financial assistance and to defray all or a major portion of the "allowable costs", all retraining and skills upgrading programmes undertaken by employers. Manufacturing firms are now required to contribute one per cent of payroll to this training fund.

Human Resources Development Fund (HRDF)

Malaysia operates a scheme of training cost-reimbursement through its Human Resources Development Fund. The Human Resource Development Fund was established by the

Ministry of Human Resource Development of Malaysian government in 1993. The main objective of this scheme is the imposition and collection of a human resources development levy from the employers for the purpose of facilitating and encouraging employers in the private sector to systematically retrain and upgrade the skills of the workforce in line with their business plans and national development and administration of the Human Resources Development Fund (HRDF). Under the HRDF scheme, a central council was created with representatives from both private sectors and government agencies to administer the Human Resource Development scheme. Employers within the scope of Human Resource Development Fund Act are required to pay a levy of 1 percent of the total company payroll into HRDF on a monthly basis. Those who have contributed a minimum of six months are then eligible to access their levy payments by claiming training reimbursements through various training. Depending on their training needs, firms can select the various programmes in the HRDF scheme.

- Graduate Training Scheme
- Industrial Training Scheme
- English Language Training Programmes for Workers
- Purchase of Training Equipment & Setting Up of Training Room Scheme
- Information Technology & Computer-Based Training Scheme
- Computer-Based Training Scheme (Software Development)

Between 1992 and 2006, the HRDF reimbursed firms over 70 percent of the RM 2.0 billion collected and approved training for 5.3 million workers. Ho (2003) indicated that a successful HRDF scheme depends on 1) active employer involvement in the governance and operating committees, 2) reduced bureaucracy; and 3) dissemination of information about the importance of human resource development for raising productivity and competitiveness.

In addition, the HRDF provides firms with grants for developing training plans, organizes regional courses on training needs assessments, and administers a variety of programs targeting small enterprises.

Lesson from Malaysia

The focus of this paper is on the shortage of the skilled labour confronting the offshoring and outsourcing industry in China and how Malaysian Ministry of Human Resource Department have tried to address these challenges. Preliminary findings on this paper indicate that the

HRDF scheme launched by Malaysian's Human Resource Ministry has made a positive contribution to the supply of skilled workers into the economy. A study conducted by Tan (2001) provides evidence that Malaysian's HRDF scheme was a main contributory in promoting enterprise training to the workforce among all firms.

Continuous training and up-skilling are crucial for workers to sustain their human capital in ever changing industrial structure. However numerous studies (Wilhelm and Xia 1993, Child 1994, Branine 1996, and Li and Sheldon 2010) have indicated that the current workplace training in China focuses mostly on technical skills and is operations-oriented. Training in most Chinese enterprises is a low in priority due to lack of financial resources as well. (Zhao, 1999, cited by Zhao and Chen)

To address such an urgent need for China to increased demand for skilled and efficient managers, China policy maker should consider establishing a scheme similar to Malaysia's Human Resource Development Fund, a levy grant system with the purpose of providing financial assistance and to defray all or a major portion of the "allowable costs" and skills upgrading programmes undertaken by employers. This scheme should assist employer to upgrade their workers and to maintain their human capital in the long-run. The scheme should include a central council with representatives from both private sectors and government agencies to administer the Human Resource Development Fund. The responsibilities of the council should coordinate and integrate the training and development system to the changing needs of the private sector.

As indicated earlier by McKinsey report, only 60 per cent of college graduates find jobs in fields in which they earned their degree and more than 90 per cent of the candidates are unprepared to work in multinational or even local companies. China policy makers should consider introducing a Graduate Training Scheme and the Industrial Training scheme for its new graduates as this programmes would benefit them before they enter the workforce.

Graduate Training Programme

The objective of the Graduate Training Scheme should assist and equip new graduates and unemployed graduates with specialised skills required in the respective industry. The Government Graduate Training Scheme implemented by the Ministry of Human Resource in Malaysia offers numerous development programmes ranges from Financial and Management programme, such Marketing, Business Accounting and Wealth Management, to Information

Technology such as Microsoft Certified System Engineer (MCSE), Cisco Certified Network and Professional, Linux System Administrator, Web Publishing and Web Application Development to Malaysian graduates. As indicated earlier (Hunting 2008), one of the key challenges is the lack of foreign language skills by the graduates in the outsourcing industry. China policy maker should therefore consider including foreign language courses in the Graduate Training Programme.

Industrial Training Scheme

The objective of this scheme is to expose the student from university, college or training institution to work experiences and to enhance the skill set of the student before they enter the workforce. The working experience would strengthen the student's resumes and provide opportunities to access their interest and abilities in the workplace. China policy maker should consider adopting these industrial training schemes to enhance the skill set of the future workforce. To encourage employers to participate in this programme, the scheme should allow employers to obtain financial assistance if they sponsor students from universities, colleges or training institutions for their industrial training programme.

Conclusion

China has experience rapid changes in its economy and if it is to sustain its position as a preferred offshore outsourcing destination, it will require a huge supply of qualified skilled workers. While China offers abundant of university graduates, only a small proportion of them have the required skills for jobs further up the value chain. China's approach to training and management development is characterised by an emphasis on quantitative rather than qualitative. (Branine, 1996) China must therefore undertake a long-term effort to raise the quality of its workforce by implementing policies to encourage private enterprise to train their workforce to meet the needs of the industry.

This paper has put forward a review on the Human Resource Development scheme adopted by the Malaysian Ministry of Human Resource. Preliminary findings on this paper indicate that the HRDF scheme launched by Malaysian's Human Resource Ministry has made a positive contribution to the supply of skilled workers into the economy. A study (Tan, 2001) provides evidence that HRDF scheme promote enterprise to increase training to the workforce. The increased in training investments by the private sector had positive impact on productivity of the workforce. The increased in training investments by the private sector had

demonstrated a positive impact on productivity growth, especially when training was conducted continuously rather than episodic. This paper therefore offered suggestions to Chinese policy makers on implementing a similar human resource development scheme to encourage Chinese private enterprise on developing its workforce, thereby increasing the supply of skilled workers to the industry.

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