

Initiating an EU-Asia Corporate Responsibility Research Agenda, Conference 8 November 2006

By Bo Jonsson, member of the Administrative Board

Willem van der Geest, Director of EIAS, welcoming the participants to this joint EIAS, FES and ETUI conference conveyed also the greetings from the Director of the FES office in Brussels, Dr Ernst Stetter.

The conference would address the pertinent questions :

- 1) Which strategies are to be followed with respect to outsourcing and relocation with a view to enhancing sustainable development in support of national development targets, including Millenium Development Goals?
- 2) In which directions will the current position of trade unions and business on the controversial issues of relocation and outsourcing evolve?
- 3) What are the research needs of business with respect to outsourcing and relocation? What are the perspective of their stakeholders (including employees, consumers and shareholders)

These questions were raised against the background of an ETUI study on relocation and recent studies in Sweden by mangement schools at universities published under the title ‘Alternatives to outsourcing’ and a similar study in 2005 by McKinsey called ‘One million jobs at risk’. Both latter studies concluded that management decisions on the benefits of offshoring/outsourcing were “often mis-calculated and overestimated profits”.

The McKinsey research

Wim Ilsbroux, from the Brussels office of McKinsey, defined “*Outsourcing* as “unbundling vertically integrated processes and purchasing them back as services to leverage superior capabilities and/or lower costs” and *offshoring* as locating IT-services and other business processes offshore to leverage differences in wage levels and the availability of skilled labour across borders”

Current status

For the US approximately \$300 billion – 400 billion worth of services could be moved offshore:

40-50 percent of jobs in Packaged software and IT services can go, 1/4 of Retail banking, 1/5 of Insurance, 13 percent of Pharma and

10 percent of Auto, but less than 10 percent of Health care and only a few percent of jobs in Retail industry.

Offshoring may be inhibited if Physical presence or Local knowledge is required and if Complex interactions are required (compare Berggren's presentation). The quality of management's cost benefit analysis matters. In Europe the UK is a major exporter of jobs, by 2005 nearly 100000 are gone offshore and in Europe as a whole about 140000. By 2010 half a million jobs might have been offshored or outsourced from Europe and by 2015 more than a million, of which from the UK alone 700000.

Macro economic impact

Wim Ilsbroux stressed that though like in other forms of trade there are job losses, in the same time some jobs are created in the home country. The value created in the supply (host) country can be substantial.

Offshoring decision process

Focus was then put on the necessity of management adhering to a structured process when deciding on offshoring:

- 1) To assess whether there is value in offshoring and what opportunities there are at home to increase labour productivity, and to evaluate other efficiency levers;
- 2) Assess the feasibility, i.e. **if** the activity can be performed offshore, depending upon process characteristics, degree of integration , process risk and regulatory risk;
- 3) Assess offshore potential, i.e. can the organisation capture the benefit from offshoring,
- 4) Define the operational model, i.e. can the activity be outsourced and within what partnership model?
- 5) Define the location strategy, how many hubs and in which location, depending upon talents required, local regulations, political stability, concentration risk. Of all these aspects too often only the location is considered fully.

Wim Ilsbroux presented a framework to map trade-offs: e.g. whether certain aspects of customer service capability were important, such as Lead time, Demand volatility, Obsolescence, Product lifecycle or mobility or customization, Labour experience, Sensitivity to supply interruption, Cost fluctuation, Marketing benefits/national identity and IP sensitivity/national security (defence, raw materials locally based)

He concluded by providing an outline to quantitatively assess the net benefits from outsourcing.

Wim Ilsbroux pointed out that Corporate Social Responsibility aspects were added after this decision making procedure. The chair, Willem van der Geest concluded that in the final session of the conference these aspects would be considered so as to map a future research agenda.

Scandinavia and outsourcing – the importance of continual high investments in both R&D and manufacturing

Christian Berggren, professor in Industrial Management at Linköping University, presented his studies and those of some colleagues’.

Worrying developments

Though Scandinavian countries were ranked among the highest by the World Economic Forum in respect of competitiveness - strong economic growth, trade surplus and solid public finances - there were reasons for worries.

He referred to the “supply chock” when 100s of millions of new workers are entering the world market.

He cautioned against outsourcing manufacturing and believing it would be sufficient to upgrade to more “advanced” activities, media, design, R&D. That would never support an inclusive (reducing exclusion) and differentiated labour market and an ageing population.

The low investment level in Swedish industries is worrying. The short term (e.g. by equity funds’) demands for dividends from profits, i.e. shareholder value, stand in sharp contrast to trade unions’ demands for ploughing back the currently high profits into new investments instead.

Integration of R&D and manufacturing is a must

Berggren stressed also, like Wim Ilsbroux had done, that key operational functions in companies are closely linked to each other. Relocation of manufacturing leads to outsourcing of product adaptation, then to engineering and so to R&D in a sequence.

To forestall that operations be wiped out of Sweden, management will have to ensure “collaboration in cross-functional clusters, for continual development of advanced industrial competences.” The integration of key competencies seems to be crucial for innovation capabilities. Further, his studies and those of some colleagues’ have pointed at hidden price-tags of relocation decisions. This has attracted a lot of interest and contributed to a more nuanced debate on outsourcing and relocation. Yet

there are few systematic studies about the effects of outsourcing manufacturing on overall firm performance. Further research is certainly needed in businesses and industrial sectors. Because of constantly increasing pressure to bring new products to market and ever more rapidly the importance of locating R&D next to manufacturing is well understood by management and employees.

These findings are in line with what Swedish trade union representatives on company boards have repeatedly stated when restructuring have been on the agenda of the company board meetings. Their objections have often been treated as irrelevant. It has been suggested that union influence over pension fund investments should be actively used to put pressure on management decision to invest and promote innovations.

Case studies

Christian Berggren presented three case studies:

- 1). SSAB Oxelösund, going from Bulk production and Bulk sales of steel in the 1980s to specialization and mass customisation of quenched heavy plates. Collaboration between research, engineering, manufacturing and marketing has produced abrasive resistant steel for earth moving equipment. These developments required massive investments and foresight by management. It has taken decades and still requires cultivation every day.
- 2). Micronic Laser Systems. 50 percent of its employees are in R&D. The company is now a world leader in laser-based pattern generators for photomasks, used to producing flat screens. A machine can be worth Euro 10 million. Suppliers are in the EU and the US and all customers are Korean, Japanese or Taiwanese. It takes several 1000 hours to build and test each machine assembled in the plant north of Stockholm, and transported with an installation team to Taiwan or Korea. Because machines are so technologically complex and constantly improved each of them is specific for a particular customer. Constant interaction between R&D and assembly is necessary.
- 3) This is the case of a mature products:
SCANIA heavy trucks. Consistently, over business cycles, Scania has been the most profitable heavy truck producer in the world. Few American companies are still active in that sector. Quite the opposite at Scania, which develops and manufactures all key components (except injection systems). 10 years ago the decision was taken NOT to move the final chassis assembly, the reason being the need for extended and intensive interaction between development and manufacturing. Though communication systems may have improved, but at the same time also

the pressure on Lead time, Quality and Delivery precision when customer designed production starts has increased ever more.

Other studies and considerations

Some see e.g. the telecom story as different. Both Nortel and Ericsson have been able to completely outsource manufacturing. However, Ericsson never fully implemented that policy, keeping industrialization (innovation combined with manufacturing) in-house, now insourcing instead to the surprise of competitors.

Christian Berggren's presentation added to the model of McKinsey to guide managerial decision making. He presented a number of reasons for re-evaluation of manufacturing.

In contrast he referred to Siemens assessment of "Expectations in 2000 compared with the outcome in 2003" The comparison showed that: Lower costs were a disappointment; Capital costs were not different, and though wage costs were lower the total costs were similar after e.g. transfer costs; The Shorter time to market could not replace interaction of R&D and manufacturing; Reduced capital investments – Yes; Global manufacturing and supply system would give lower material costs - BUT 60-70% of material is Siemens-specific and prices were better locally.

Berggren's suggestion was that companies needed to do their homework better. That was understood as a challenge also to organized labour.

The discussant, Sylvain Plasschaert, Professor Emeritus, University of Leuven commented to the first presentation that it was important to differentiate between investments abroad made by companies in order to exploit natural resources or to capture markets outlets rather than primarily invest in offshoring or outsourcing (with a view to re-export to the home or to the world market).

He also made a few other points :

- foreign direct investments remain overwhelmingly aimed at the market potential of the host countries, and not at lower-cost production in the host country, or offshoring proper
- offshoring is not a novel phenomenon, but today, the entry of such giants as China and India is susceptible of creating big waves of outsourcing
- outsourcing result in lower prices for consumers, even if dispersed in small doses over a large number of customers, whereas the loss of jobs and of incomes of laid-off workers, because of relocation, are concentrated and highly visible.

- Yet, protection of jobs in sectors/enterprises with a dim future , is costly and not efficient. This does not mean that laid off persons should be left in the cold. Government policies should aim at retraining them, helping them to find a new job, and at providing assistance to those severely affected.
- Even if wages are unavoidably much lower in countries that receive outsourcing , there is a need for securing acceptably decent working conditions , according to internationally accepted norms.

The chair, Willem van der Geest noted that precisely these aspects also should be addressed in the next session and added that EIAS was extending its Corporate Research Network to serve an exchange of information about Best Practices in CSR activities.

Relocation and outsourcing: The trade union point of view

In the second session Bela Galgoczi from the European Trade Union Institute for Research, Education and Health and Safety, ETUI-REHS, said there were problems of measuring the effect of managerial decision making on relocation. especially for the purpose of formulating an adequate response from trade unions.

The issue is complex. Relocation depends upon branch, business strategies and models, as well as upon technological change and increasingly due to the fact that more technologies are tradable. He also emphasized the trend of commercialization of manufacturing, i.e. the financialisation of production. There is a pressure on management (even their pay system, e.g. options favors) decisions that in the short term deliver shareholder value, but do not take sustainability and effects on society as a whole properly sufficiently into account. This issue merits more research and exposure.

Relocation in the EU protects the New Member States under globalization.

Against the background of the challenges of globalization and difficulties in measuring relocation and its consequences, Bela Galgoczi clarified that within the EU the New Member States (NMS) are in head-on competition with e.g. the BRIC countries. Relocation from the EU 15 may offset global comparative disadvantages for those countries and the EU integration is a protecting shield in globalization.

Apart from explicit cases of closures, the substitution effect on domestic operations are implicit, e.g. from opening in new markets, making new

investments, shift in focus of production. The most important effect is job transfers.

A macro economic perspectives

A driving force of relocation is labour costs. Though wages in Germany are 6 times those in Estonia, wage increases in the Baltics are speeding up mostly due to migration. The wage gap is getting smaller

The FDI from e.g. the US to the EU in 2005 was US\$ 422 Billion of which only a small fraction went to the NMS, the EU 10, namely US\$ 33 billion, and there is a fierce location competition for new investment and reinvestment of profits. There is a changing pattern – less horizontal and more vertical FDI- market exploration is mostly over.

Changing pattern in relocation

Bela Galgoczi described the changing patterns in relocation, from buyer driven to supply chain driven networks. Though there are different supply chain management strategies in automobile and ICT manufacturing sectors, there is a clear Win-win situation: both horizontal and vertical integration of production chains had a “stabilising and positive employment effect on source countries also, in case of ICT sector it contributed to world market expansion of Europe”. Pure’ relocation with negative employment effects is taking place in sectors with shrinking markets in EU 15, e.g. household appliances.

Don’t dramatize !

He stated that though “the challenge of relocation is serious, (but) the situation should not be dramatized”. But the pattern of FDI changed, to be less market driven, and more related to cost cutting and upgrading in CEE Still the overall impact on the EU25 is positive. The employment balance for EU15 is still positive, but more job losses will appear

What are the employment effects?

- “there are quantitative (net employment loss) and qualitative (from the structural pressures on the labour markets)
- there is no positive employment impact of FDI in the NMS and in South Eastern Europe (SEE)
- Jobless growth in CEE even if FDI is picking up (migration from Poland and the Baltics had more labour market impact)
- Evidence of two-tier labour markets in EU-15, growing income gaps
- Negative impact first of all on low skilled workers in EU15

Are fears justified ?

Though evidence is patchy and incomplete it seems to “suggest that on aggregate level the relocation is a smaller phenomenon than the public debate supposes”, answering and agreeing to Sylvains Plasschaert’s comments. However, there are examples of relocations and serious effects. And we do not know if relocation will speed up in the future, Wim Ilsbroux had suggested that would be the development in Europe. Many employers now threaten with relocation and demand downward adjustments of wages and working conditions. That is a major challenge for trade unions

He questioned the approach just to cope with local adjustment needs and simply promoting acceptance of structural change and warned that the structural problems would become lasting unemployment!

Further: How to share benefits from globalisation with losers? That requires more solidarity and that when management in profitable enterprises set the tone and grab for themselves the largest piece of the pie?

And equally challenging: What is required of industrial policies? Are EU policies good enough? Does management understand that involvement of employees and unions is an asset in management of structural change? Can unions make their voice heard? It is difficult when employers are more reluctant to cooperate, viewing the trade unions as weakened and to be avoided even. We need also research, should there be a reduction in incentives for relocation?

What should unions themselves do?

Since there is a strong relation between relocation, restructuring, collective bargaining and worker participation, trade unions must themselves take initiatives and combine policies in several areas.

There has to be better information and consultations through e.g. EWCs the European Works Councils.

Unions need to intensify coordination of collective bargaining, and start . capacity building of TU-s in the EU, especially in NMS, and even globally and require a

strengthened social dialogue especially on branch level in CEE, as well as in the whole of EU

Trade unions want to see high quality workplaces and upgrading activities through specialisation and higher value added.

Employees are still those paying the major part of the costs for the structural adjustment and transition on the labour market.

Trade unions will have to initiate a dialogue at industry and enterprise levels and as Berggren emphasised put pressure on management to invest

in innovations, technology and training, i.e. investment in human capital and thereby increase efficiency more than by pursuing the cost cutting mantra, while as Professor Plasschaert pointed out public resources must be there for an active labour market policy, and for what is called flexicurity

Trade unions see adaptation to become much smoother through this “high road” approach than the low road through cost cutting and lower wages and longer working hours.

The great freedom management has within a free market economy also demands more corporate responsibility from management for the decisions that affect society as a whole not just the company.

Andrew Watt, also a senior researcher at the ETUI-REHS, continued the presentation of trade union views by focusing on China.

Economic trends in China since ca 1980

The growth in real terms of the economy has averaged 8-10 percent over recent decades. The active population has doubled in the same time to about 800 million and the total population has grown by a third to more than 1300 million; unemployment is high especially on the rural side and in the hinterland; while at the same time there are skill shortages in certain areas and occupations though employment has declined dramatically in the state owned industries. The urban population has more than doubled and the share is now about 40%.

Productivity has more than doubled during the last 10 years, although there are uncertainties about the data, and so have wages, almost, but certainly not evenly over the entire economy and the labour force, differences are big.

External trade had increased six fold over the last decade and Chinese foreign currency reserves amount now to a trillion US dollars, but overall trade in goods had been in balance until recently.

EU-China economic relations

Trade

Andrew Watt discussed export and import developments

Though the EU 15 export to China has increased it is still only ¼ of the trade with CEE member states but on par with the export to Japan.(2003). The EU trade with China is unbalanced as it is with the US.

The EU exports to China were in 2004 worth US\$ 50 billion and imports US\$ 125 billion; thus the EU had a trade deficit in 2004 of about US\$ 75 billion with China, which is about the same as the trade surplus with the

US. The imports from China are to 95 percent in manufactures, and of EU export that is about 80 percent

FDI

Turning to the FDI aspect Watt showed that the inflows of FDI to China was now at the level of US \$ 75 billion, up from 30 billion in the early 1990s – in comparison FDI to India was in 2005 less than US\$ 10 billion – though to China it was hardly 10 percent of the inflows of capital to the whole world while the EU took over 40 –45 percent on average the last 10 years. FDI as percentage of gross investment was about 9 percent in China, and in India only slightly above 3 percent. However, the flows to China are small in comparison to those within the EU and to North America.

Looking ahead

Looking at the near future Andrew Watt showed different forecasts for growth for the next 10 to 15 years where Deutsche Bank forecasts were lower than what the IMF had presented, concluding the growth would be rapid but slowing a bit. He thought that “growth would be sustainable”, due to the large internal market, high investment, and slow population growth though ageing population, rapid rise in human capital and still high productivity reserves, i.e. sectoral reallocation of labour.

But he also saw several risks to a smooth development

e.g. political (challenge to party authority and openness);

social risks (inequalities, rural/urban, migration, accidents, working conditions); and not least

ecological (high environmental problems, energy, water)

What implications for Europe?

The export-led, mercantilist Chinese model is probably by now dysfunctional,

Wages are rising and the exchange rate also (compare with Japan and Korea) which entails reduced competitive advantages,

but there is an increasingly interesting consumer market, as it is in India and finally EU has a competitive advantages in key areas, such as large scale investments and environmental technologies

Challenges for European trade unions

The international challenges for European labour is

- to avoid a political demonisation strategy- economic growth is not a zero- sum game;

- support workers interest in China- autonomous organisations and reform wing in ACFTU;

- campaign on human rights issues
 - use multinational levers or forums such as OECD, ILO and WTO
 - strengthen links with NGOs and pressure groups and awareness campaigns on working conditions in China
- as the ETUC is doing within the EU and in close cooperation with the ITUC elsewhere in the world

Within Europe the challenges are as always to

- 1) campaign for a full employment macro economic strategy
- 2) establish a trade adjustment support
- 3) right to retraining for displaced workers
- 4) human capital development and an effective
- 5) industrial policy stressing innovation and the ‘high road’ as his colleague already had emphasised

The discussant, Joern Keck, former Deputy Director General, DG Enterprise expressed his satisfaction with the balanced view the two researchers from the ETUI had presented, He wanted first of all to draw the attention to the Lisbon strategy with the same and similar goals as presented by the speakers, e.g. the ‘high road’ to job creation.

With reference also to the speakers in the first session he stressed the need for a strong industrial policy that supports innovation, research and development of the manufacturing sector. The productivity increase in the manufacturing sector is the key component in the EU development strategy. He referred to his own experiences as trade negotiator, especially in textile, and the need for a clear insight into the consequences for the global division of labour and how to handle the social issues. He brought up as a third point the CSR activities of companies and the verification of e.g. the labour rights and even other international standards e.g. on environment.

In view of the time constraints the chair, Bo Jonsson, member of the EIAS Administrative Board, referred the open discussion to the following session, which should focus on the research aspects as a result of these four presentations and the comments by the discussants.

Proposals for future research – a first needs assessment

EIAS chairman, Ludo Cuyvers, Professor at the University of Antwerp Management School, who chaired this third session stressed the great need for both macro economic and micro enterprise related research.

His own research had looked into the effects of trade on jobs and incomes and found there was no general depression of wages from trade developments, though labour in unskilled occupations were experiencing lower relative wages and wage increases.

He also stressed, as Sylvain Plasschaert and Joern Keck had done that decision making should be looked into at both company and industry levels for comparative reasons.

In the following discussion several issues were discussed and some areas for continued research were identified, e.g.

- Macro economic and social developments in Asia and EU and how business strategies and investments relate to national or regional development strategies, integrating issues of migration and aging populations, flexicurity etc.
- Bilateral FTAs could relate better to national development strategies of Asian countries and investments could be more efficient if bilateral and/or regional FTAs addressed intra regional trade as well
- How involvement of employees and trade unions at industry and company level effect the decisions regarding relocation, outsourcing, offshoring, innovation, integration of R&D and manufacturing, sustainable developments and Corporate Responsibility. (ETUI has in the past conducted a research programme on the experiences of involvement of employees and unions in a social dialogue, called “Innovation, Participation and Corporate Culture”.
- Benchmarking enterprises CSR activities and reporting, e.g. from SRI point of view, based on better verification possibilities involving stakeholders, review of best practices from point of view of e.g. consumer, environmental, community, labour and shareholder (including pension funds) and development of public services capability
- How labour market reforms relate to international standards, improve the functioning of the labour market e.g. in order to cope with structural changes and ensure labour rights, good labour relations as well as initiate capacity building for labour and other stakeholders on CSR issues.

- Extending EU based companies CSR activities beyond Europe, especially since these multinational companies have world wide operations which implies that their CSR activities and reporting are not just related to operations within Europe but as much to their operations in Asia and other continents.
- EU and other databases need constant updating and upgrading and could include CR/CSR issues, in particular stakeholder analysis.

It was mentioned in this respect that several DGs, such as Enterprise, Employment and Research have interest in research and development e.g. of the EU CSR policy.