# Outsourcing: risks and benefits

Business

Outsourcing is when a firm designates the production of some goods, use of its brand s, or allows another company to provide some services under the same brand name to another firm in a different country. There are many benefits that result from outsourcing.

The main benefit is saving the cost of setup in another country. The firms which takes the right of the original company's brand name pays for the setup costs such as setting up of a manufacturing facility, advertisement costs and all other expenses associated with the setup of the business. For e. g. McDonald's usually outsource its operations to other companies by issuing licenses. This has resulted in quick and rapid expansion of McDonald's throughout the world, without McDonald having to pay for such massive expansion.

The other benefit as discussed above is rapid expansion of the brand-name throughout the world. Like the way McDonald's, KFC and Pizza Hut grew.

The other fringe benefit of outsourcing is that it earns profits for the original company. For e. g. McDonald's charges very high fees to firm willing to use its brand name. Similarly it helps McDonald's to earn very high revenues.

Another benefit from this is that the original firm usually do not have to pay for advertising of the firm's product. The responsibility of advertising the product to the different part of the world remains to the company obtaining the outsourcing licenses.

The main risks that firms face when investing in an emerging market is the loss in the value of their investment and the risk of frauds that are found very often in these markets. For example, Merrill-Lynch and the Government of USA outsourced many of their operations to an Indian firm " Satyam". However, recently the firm was charged for litigation and their co-founder was arrested. These risks are very common in emerging markets as government has little control of so-called " Big Businesses". (New York Tmes, 2009).

Not only this, loss of investment is another major risk in these markets due to their volatility and their dependence on other economies of the world. For example, investors lose billions of dollars of their money when Pakistan stock market crashed in 2005. (KSE. com. pk/2005)

This list of risk in not exhaustive, but there are also thousands of other risks when investing in an emerging market. Another major risk is differences in culture and religion of the host country and the company. In 2006/7, there was an issue of blasphemous cartoons being published in Norwegian newspapers. This angered the Muslims all over the world. Telenor, one company which is from Norway and operating in Muslim countries like Bangladesh and Pakistan suffered as a result. Many people stopped using their service and many governments threatened or fined the company. To make the matters worse people also protested and damaged their branches. As a result, the company suffered huge losses and at one time it looked like that whole of their investment is going to go wasted. (Grameen Phone, 2005)

Similarly, disparity of income in many countries has made matter worse for these businesses. For example, Subway initially entered as luxury brand in Pakistan. But because people in Pakistan are generally poor, they were not able to afford this expensive food and hence the business suffered huge losses until they bring their prices down which implied reduction in profits for SubWay.

References:

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