McKinsey Global Institute

The Emerging Global Labor Market: The Demand for Offshore Talent in Retail

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June 2005

McKinsey&Company

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Guiding Principles

Any job that is not confined to a particular location has the potential to be globally resourced, or performed anywhere in the world. Broadly speaking, this includes any task that requires no physical or complex interaction between an employee and customers or colleagues, and little or no local knowledge.

Such jobs can be performed wherever a company deems most attractive. A company may choose to have a particular location insensitive job performed in the demand market (that is, in the market in which the resulting output is sold), in a border zone (nearshore), or remotely (offshore). Therefore, not all location insensitive jobs will move offshore.

We evaluate only service sector jobs. Although manufacturing jobs may be insensitive to their location as well, this study focuses on service jobs, whether they are in service sectors or in a back-office service function (e.g., accounting) in a manufacturing sector.

We focus on the demand for low-wage employment from high-wage countries. To estimate potential demand for globally resourced labor, we treat countries as neither inherently on the supply side nor inherently on the demand side in the global labor market. However, since cost is a major determinant of companies' location decisions, developed countries are most likely to provide the bulk of demand for offshore labor, and developing countries the bulk of supply. When we evaluate the actual rate of offshoring today and how fast it will grow, we examine only the demand for low-wage labor from high-wage countries.

We assume that demand for labor for a particular activity is the same onshore and offshore. In reality, capital/labor tradeoffs and increased service levels may cause high-wage countries to seek more labor in low-wage countries than they would for performing the same activity in the demand market. Productivity differences between the original location and the new location may also influence demand for labor. Since these effects can be either positive or negative and tend to level over time, our default assumption is that the number of FTEs[1] needed for an activity is the same whether located onshore or offshore.

For the demand evaluations we do not consider any supply constraints. All evaluations are made under the assumption that global supply will be able to meet demand. Actual supply conditions are examined in the second report in this series, "The Supply of Offshore Talent in Services".

1 Full time equivalent

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SUMMARY OF FINDINGS

Retail, although rarely associated with offshoring, has a considerable amount of employment that can be globally resourced, and several players are already leveraging this potential. In general, retail is a local employer with a low theoretical maximum to globally resource jobs and an even lower pace of adoption. However, with 147 million people employed in this sector, even small percentages in global resourcing potential or degree of adoption translate into a significant number of employees.

* * *

In 2003, the retail sector employed 147 million people. Overall employment in retail is projected to grow at an annual rate of 1.2 percent, reaching 156 million people in 2008. The vast majority of employment in retail is in store operations, a function with almost no global resourcing potential. As a consequence, the theoretical maximum global resourcing potential for the sector is 3.2 percent, or 4.9 million FTEs in 2008. Currently, however, the degree of adoption of global resourcing is only a small fraction of the theoretical maximum, with an estimated 28,000 retail jobs being performed remotely.

A notable exception to this low theoretical maximum is the growing subsector of catalog and online retailers. Within this group the global resourcing potential is 32 percent, with nearly 0.4 percent of online and catalog employment in developed nations currently globally resourced. Despite the high global resourcing potential, employment in this subsector, though growing rapidly, is less than one million, limiting the impact online and catalog retailers have on the industry.

Some retailers are already leveraging global resourcing. Companies involved in this activity tend to be large players with an international presence. The functions being performed remotely include merchandising, IT, call centers, and supply chain management (SCM). As private label sales grow for discounters and vertically integrated players, the theoretical maximum to globally resource merchandising and SCM also increases. Many retailers that source their products from abroad have located portions of their vendor selection and management departments in the country where manufacturing is occurring. Some retailers have gone as far as to consolidate their entire distribution centers in locations where their goods are manufactured, saving both time and labor costs.

Global resourcing will grow in retail at a moderate rate. As the leaders prove that the cost savings outweigh the initial costs and risks, other players will likely follow. The pace of adoption is projected to be slow relative to other industries (9 percent annual growth), yet will likely have 42,000 employees, or 0.1 percent of retail employment demand in high-wage countries, offshored to low-wage countries in 2008. As retailers face increasing cost pressure, many will overcome the inhibitors of global resourcing to realize the potential savings.

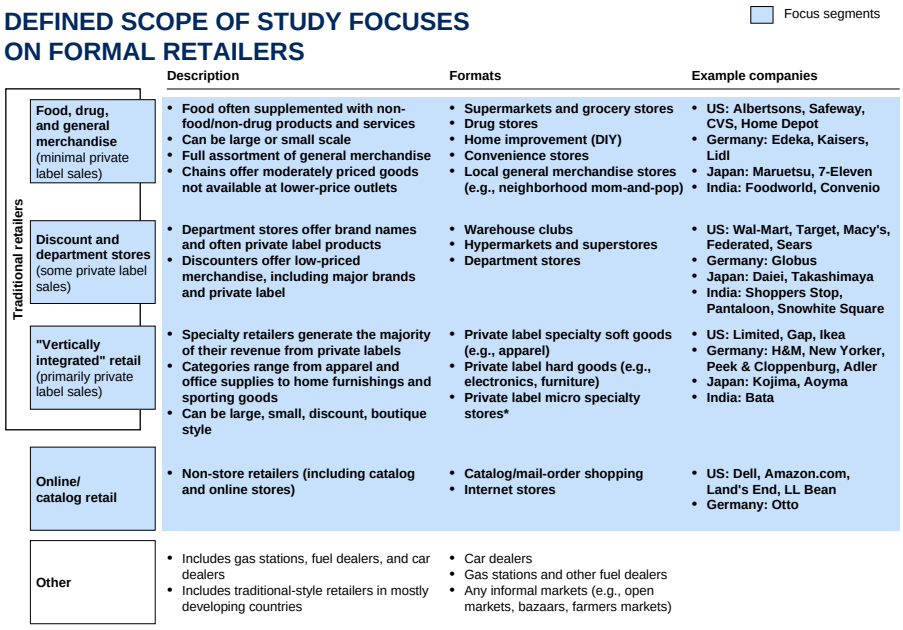
SECTOR DEFINITION AND OVERVIEW

Sector definition

The retail sector includes companies engaged in retailing merchandise and the associated services necessary to the sale of goods. Two subsectors excluded from this study are vehicle dealerships and fuel dealers (including gas stations) because of the local nature of their business. In addition, informal markets, such as bazaars or farmers' markets, were excluded given the minimal potential to globally resource these positions and the difficulty in accurately quantifying the employment in this format. As this study focuses on services, any positions associated with manufacturing (which appear in the case of a few retailers that are vertically integrated) were excluded. Restaurants, occasionally categorized as retailers, were also excluded from this analysis. The various formats included in the definition used in this study and select example retailers are illustrated in Exhibit 1.

Exhibit 1

DEFINED SCOPE OF STUDY FOCUSES ON FORMAL RETAILERS



* Specialize in one item within an already narrow category.
Source: S&P Retail Industry Survey; US Bureau of Census Retail Trade report; McKinsey Global Institute analysis

Sector segmentation

Within the defined sector, four major subsectors were used to group retailers. This breakdown addresses the peculiarities of different types of retailers, and groups together retailers with similar employment breakdowns and global resourcing potentials. The subsectors are defined as follows (see Exhibit 1):

- **Food, drug, and general merchandise.** This group includes supermarkets, grocery stores, drug stores, convenience stores, and home improvement stores. The percentage of employment in this group is diminishing as smaller stores and traditional grocery stores are being replaced by big-box discounters. While home improvement stores are growing, their employment growth has not been enough to outweigh the decline in employment of the other members in this subsector.

- **Discount and department stores.** This group includes warehouse clubs, hypermarkets, superstores, and department stores. Discount and mass merchandise stores are growing globally, but department stores are in decline. These opposing drivers leave the percent of employment in this subsector relatively stable.

- **"Vertically integrated" retailers**. Members of this group specialize in either private label soft goods (e.g., apparel) or private label hard goods (e.g., electronics, furniture). These retailers are typically involved in the design, production, and sale of their goods.

- **Online and catalog retailers.** This group includes traditional mail-order companies as well as Internet stores. While catalog companies are relatively mature in most countries, advances in package delivery and national credit cards in developing countries are expanding the percentage of employment in this format. In India, for example, the increasing use of national credit cards allows mail-order companies to accept payments electronically from all regions in India (previously limited to cash-on-delivery payments). Advances in the timeliness and reliability of mail service have boosted confidence in and reliance on delivered goods. Major online retailers are primarily based in the United States, Western Europe, and Japan, yet this category is growing rapidly as Internet is becoming widely used for shopping in both developed and developing nations.

Sector overview

Although there have been several recent trends in retail, the overarching characteristics of the industry remain constant. Both the supply and demand for labor remain very localized. While online and catalog retailers extend their reach to consumers beyond local cities or towns, few of these players have an international presence. Informal markets, primarily in developing countries, are generally remaining informal. In countries such as Brazil, informal employment has actually increased in recent years as retailers are able to reduce costs by avoiding value-added taxes placed on formal employers. It is estimated that informal retailers in developing countries account for 80 percent of the value added to GDP from the retail sector[1]. The main changes to the retail sector affecting all formats over the last five years are a shift to value, format convergence, and consolidation:

- **Shift to value.** Mass merchants and discounters have a unique business model built on low cost, efficiency, and speed. The impact of these players

1 McKinsey Global Institute analysis; International Labor Organization; World Bank

has extended to all subsectors and most regions of the world, primarily affecting prices. Drastic price drops over recent years of common products illustrate this trend: in Tesco, the price of a basket of 40 common grocery items fell by 33 percent from 1993 to 2003; the price of men's dress shirts in Asda's George declined by 62 percent from 2000 to 2003. The effect of value players has had a pronounced impact on department stores, which are struggling to remain competitive.

- **Format convergence**. Retailers are broadening their offerings and encroaching on each other's formats. Grocery stores are increasing their product range beyond food items to include hard and soft goods. Likewise, many discounters have expanded their traditional offerings to include groceries. The lines between store and catalog/online retailers are also blurring as many traditional retailers are offering their products online.

- **Consolidation**. Following several large mergers and acquisitions in recent years, retailers are leveraging consolidation to improve their economies of scale, increase share of a channel, expand geographically, achieve new capabilities, and introduce new formats. This trend is illustrated in the M&A of Sears-Kmart, Albertson's-Shaws-American Stores, Giant Food-Stop & Shop, Carrefour-Promodes, Wal-Mart-Asda, and May-Marshall Fields. Another major consolidation of department stores is being finalized as Federated completes an $11 billion acquisition of May Department Stores.

SECTOR EMPLOYMENT

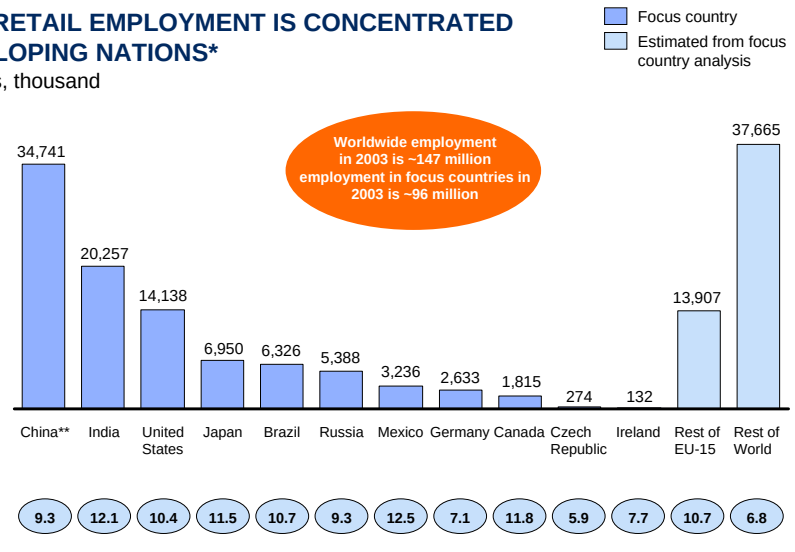
Sector employment overview

In 2003, the retail sector employed 147 million full-time-equivalent employees. This value was determined by a detailed analysis of the employment in 11 focus countries and extrapolations to the rest of the world (Exhibit 2). The global employment value slightly understates the total number of employees in retail, as this study's definition excludes some subsectors and aggregates part-time workers into full-time equivalents.

Exhibit 2

73% OF RETAIL EMPLOYMENT IS CONCENTRATED IN DEVELOPING NATIONS*

2003; FTEs, thousand



* Includes all retail employment except motor vehicle dealers and gas stations, incorporates self-employed, and reflects only formal employment.

** China data includes only companies with over $600,000 in revenue.

Source: Euromonitor; Bureau of Labor Statistics; Japan Census of Commerce; Statistical Office of Czech Republic;RAIS (Brazil); Manpower profile (India); Central Statistical Office of Ireland; Stats Canada; McKinsey Global Institute analysis

- **Country-specific factors**. The relative amount of employment in retail and the types of retailers vary slightly between developed and developing countries:

  - *Developed versus developing.* As retail is present in all regions of the world, the majority of retail employment is in developing nations (73 percent). Unlike high technology service sectors such as software or IT services (where greater than 70 percent of employment is located in developed countries), the bulk of retail employment is tied to the location of the consumer.

  - *Relative percentage of country employment.* Developing nations have a smaller percentage of the workforce employed in retail (retail represents 10.4 percent of nonagricultural employment in developed countries, but only about 8.7 percent in developing countries). The percent of service employment that retail represents in developing nations would increase if informal markets were included in this study's definition of retail. Contributing to informal retail employment are countries such as Brazil, where companies are given incentives (in terms of tax savings) to remain informal.

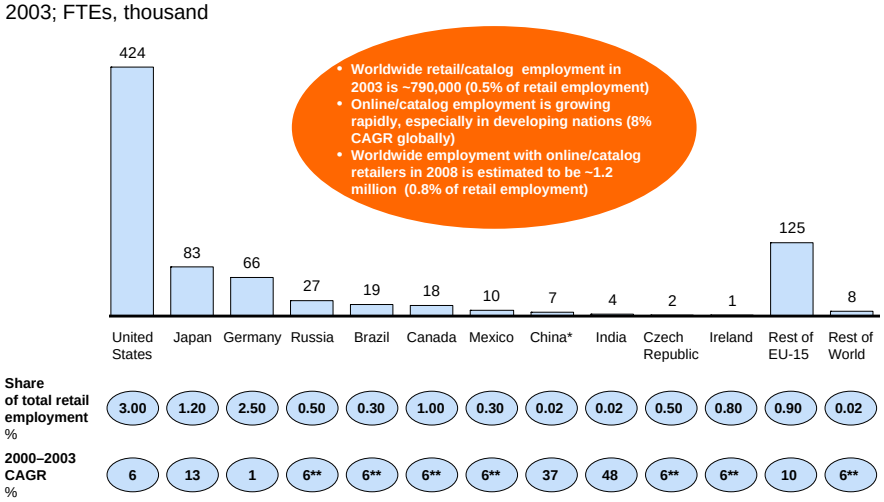
- *Subsector exceptions*. The percent of employment in each subsector also varies by country. Whereas employment in online and catalog retailers represents 3 percent of employment in the United States, hardly any employment in this subsector is found in most developing nations (0.02 percent). Discount and department stores are also much less common in developing nations.

- **Subsector employment breakdown.** Food, drug, and general merchandise is the largest employer within retail, representing 63 percent of total employment, followed by discount and department stores, which are responsible for 30 percent of total employment. Vertically integrated retailers account for 6 percent of employment. Finally, online and catalog retailers account for 0.5 percent of global retail employment. It should be noted, however, that employment in this subsector fluctuates widely by country (see Exhibit 3). For example, online and catalog retailers represents 3 percent of retail employment in the United States compared to 0.02 percent in India.

Exhibit 3

THE UNITED STATES CONSTITUTES 54% OF ONLINE AND CATALOG EMPLOYMENT

2003; FTEs, thousand

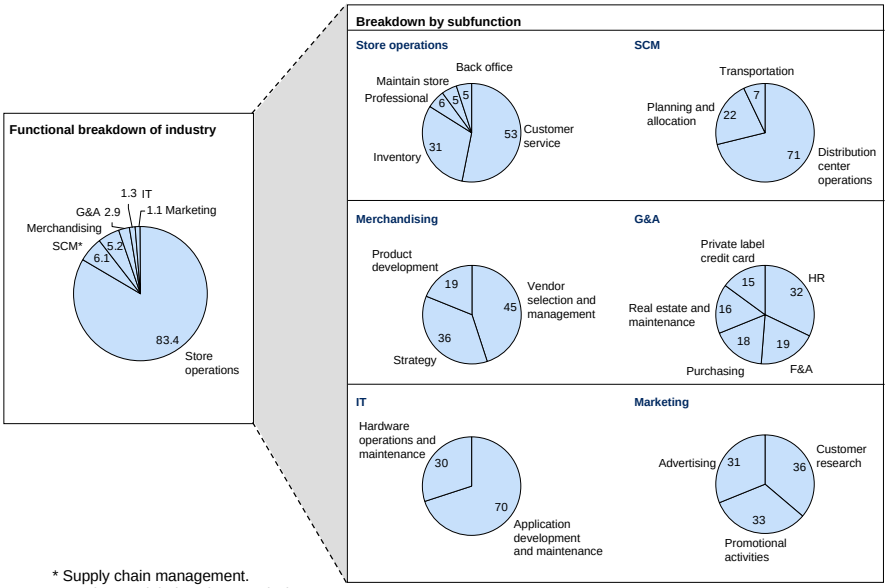


* China data only includes companies with over $ 600,000 in revenue.
** Growth rate based on that of the United States.
Source: Euromonitor; US Bureau of Labor Statistics; Japan Census of Commerce; Statistical Office of Czech Republic; ABEVD; RAIS (Brazil); Manpower profile (India); Central Statistical Office of Ireland; Stats Canada; U.S. Department of Commerce; Gartner; Global Insight; interviews

- **Employment share by function.** In the aggregated format the vast majority of employment in retail is dedicated to store operations (83 percent), with the majority of employment in this function dedicated to customer service (Exhibit 4). Additional retail-specific functions such as SCM and merchandising capture 11 percent of employment. Human resources functions constitute almost one-third of the employment within G&A, which has an overall employment share of 3 percent:

Exhibit 4

STORE OPERATIONS REPRESENTS 83% OF SECTOR EMPLOYMENT
%



* Supply chain management.
Source: McKinsey Global Institute analysis

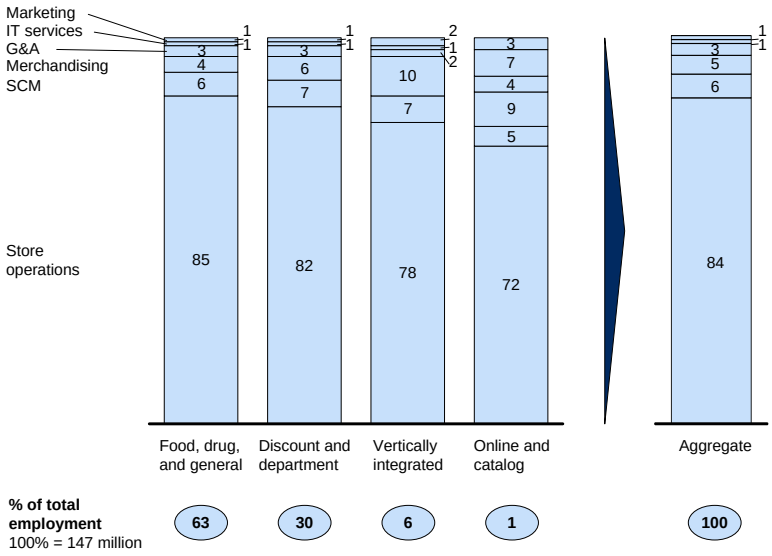
- As the majority of employment is in the food, drug, and general merchandise category, the aggregated numbers closely reflect this format. However, each of the four subsectors has a unique employment breakdown (Exhibit 5).

- While the functional breakdown among traditional retailers is similar (with the notable exception that vertically integrated retailers have significantly more employment in merchandising functions such as product development and vendor selection), online and catalog retailers differ significantly. Relative to traditional retailers, online and catalog retailers have substantially more employment dedicated to IT (7 percent versus 3 percent) and call centers (30 percent versus 1 percent).

Exhibit 5

EMPLOYMENT BREAKDOWN VARIES AMONG SUBSECTOR FORMATS

%



Source: McKinsey Global Institute analysis

- **Employment share by occupation**. Retail employs similar occupations across the various functional employment categories. Support staff, corresponding to secretaries in all functional areas, cashiers, baggers, and data entry positions, constitute the majority of retail employment (53 percent). Generalists, working on merchandising, supply chain management, marketing, and G&A, account for an additional 36 percent of employment (Exhibit 6). Analysts—accounting for 5 percent of employment—work in quantitatively demanding positions, predominantly merchandising, SCM, and marketing functions (Exhibit 7).

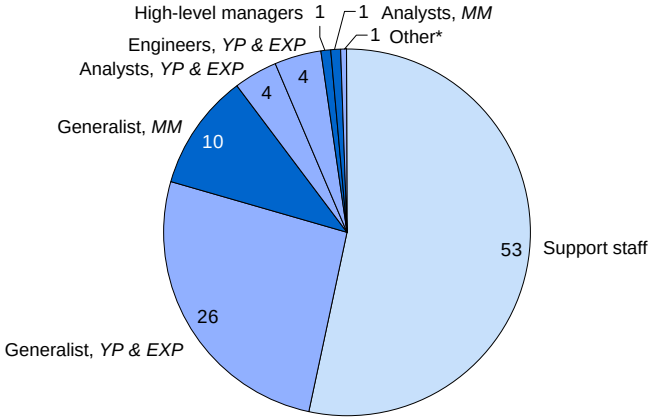
Exhibit 6

WITH A TOTAL SHARE OF ~53%, SUPPORT STAFF CONSTITUTE THE LARGEST OCCUPATIONAL GROUP IN THE RETAIL SECTOR

YP Young professional
EXP Experienced
MM Middle manager
Professional staff
Management staff
Support staff

Occupational breakdown of retail sector

100% = 156 million



* Category includes finance and accounting YP & EXP (0.4%), engineering MM (0.1%), finance and accounting MM (0.1%).
Source: Interviews; McKinsey Global Institute analysis

Exhibit 7

THIS IS DRIVEN BY A LARGE SHARE OF SUPPORT STAFF IN STORE OPERATIONS, THE LARGEST RETAIL FUNCTION

YP Young professional
EXP Experienced
MM Middle manager

Share of occupational categories per function

%

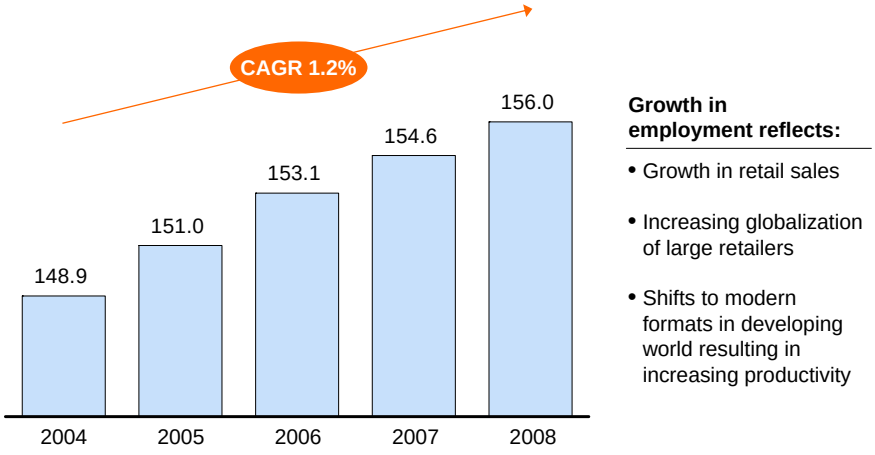
Occupational categories	Function: Merchandising	SCM	Marketing	Store ops	IT	G&A	Total in sector
• **Professional staff**							
– Generalist, *YP*	13	14	14	22	4	16	21
– Generalist, *EXP*	33	13	42	2		34	6
– Analyst, *YP*	4	9	3				1
– Analyst, *EXP*	18	37	10				3
– Finance/Accounting, *YP*						3	0
– Finance/Accounting, *EXP*						10	0
– Engineer, *YP*					13		0
– Engineer, *EXP*					61		1
• **Management staff**							
– Generalist, *MM*	7	3	7	11		9	10
– Analyst, *MM*	4	7	3				1
– Finance/Accounting, *MM*						3	0
– Engineer, *MM*					12		0
– High-level manager	5	4	5	4	5	5	4
• **Support staff**	**16**	**13**	**16**	**61**	**5**	**20**	**53**
	100	100	100	100	100	100	100

Source: Interviews; McKinsey Global Institute analysis

- **Sector employment projections, 2004–2008.** Overall employment in retail is projected to grow at an annual rate of 1.2 percent, reaching 156 million employees in 2008 (Exhibit 8). This value is the output of each country's individual projections when aggregated.

Exhibit 8

EMPLOYMENT DEMAND IS FORECASTED TO GROW AT 1.2% ANNUALLY
FTEs, million



Source: Global Insight; McKinsey Global Institute analysis

- **Overall external factors that drive employment growth**. The projection incorporates the following drivers and inhibitors:

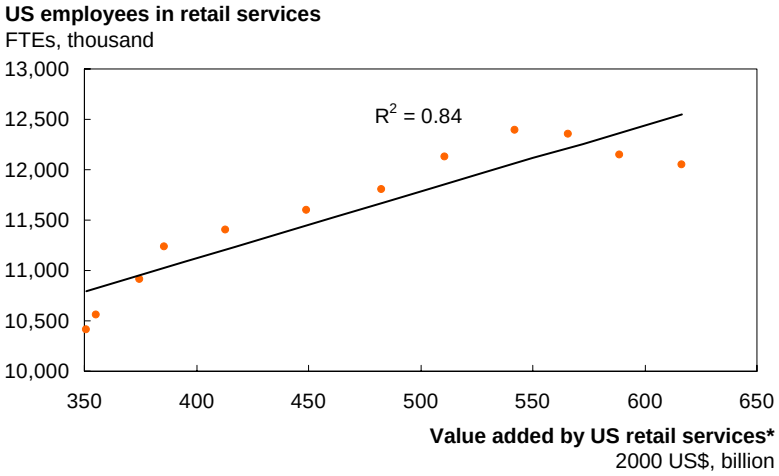
  - Growth in retail sales is raising the demand for jobs. Historically, the demand for retail employment is strongly correlated to retail sales (Exhibit 9).

  - The shift to modern formats in developing countries that results in increasing productivity (and thus reduced employment) is inhibiting growth in this sector. Although increasing globalization of large retailers is driving demand for retail goods through lower prices and increased product offerings, increased productivity is offsetting employment growth.

Exhibit 9

HISTORICAL EMPLOYMENT IN THE RETAIL SECTOR SHOWS A STRONG CORRELATION WITH SERVICE DEMAND

United States demand for retail vs. employment – 1992–2003



* Excludes automobile dealerships and gas stations.
Source: U.S. BLS; Economy.com; McKinsey Global Institute analysis

- **Country-specific factors**. Retail employment projections for each country generally reflect overall country employment growth rates. As retail is such a large employer (7–10 percent of nonagricultural employment), retail employment is correlated to changes in total employment. Retail employment in Germany, for example, is decreasing annually at 1.1 percent, while overall employment in the country is decreasing at 0.7 percent (2001–2004 CAGR). In contrast, retail employment in China is increasing at 1.1 percent, while total employment is increasing at 1.0 percent (1999–2003 CAGR).

- **Change in assumptions that could alter projected employment.** An unanticipated adoption of technological innovations could reduce projected employment. Innovative tools such as automated cleaning robots used by Billa (in Vienna) replace employees previously engaged in store operations. Developments such as automated checkout stations, bar code scanners, and electronic price tags increase worker productivity and therefore reduce total employment. Advances such as radio frequency identification could also reduce the number of FTEs engaged in supply chain management. On a

functional level, these advances will reduce the number of employees in store operations and supply chain management. As computer systems become increasingly complex, however, a small increase in the total number of IT employees will be needed to maintain these systems.

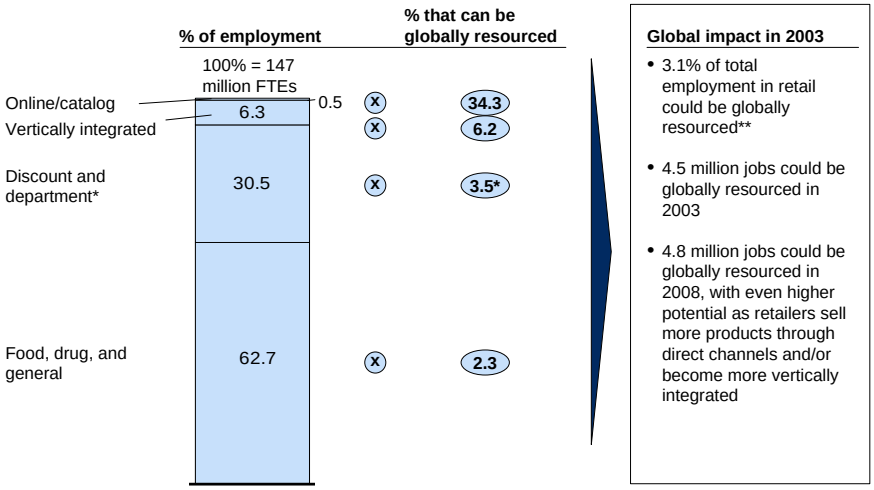
GLOBAL RESOURCING IN RETAIL

Theoretical maximum

The theoretical maximum percent of global resourcing of jobs in the retail sector is 3.1 percent, or 4.5 million FTEs in 2003. This number reflects an aggregate of the four subsectors, each of which has a unique potential to globally resource jobs (Exhibit 10):

Exhibit 10

APPROXIMATELY 3.1% OF TOTAL RETAIL JOBS COULD BE GLOBALLY RESOURCED



* Percent of employment in this category that can be globally resourced depends on percent that is dedicated to private labels. Current portion of employment dedicated to private label sales in this group is 30%.
** Not considering any supply constraints.
Source: U.S. Department of Commerce; NPD Fashion World; McKinsey Global Institute analysis

- **Factors that affect theoretical maximum**. The low theoretical maximum potential in retail is a reflection of the high requirements for physical presence and local knowledge within the sector:

- *Physical presence required*. With the exception of online and catalog retailers, the majority of employment must stay local as it is required to run the store. Cashiering, restocking, and assisting customers are examples of roles that require physical contact with either the products being sold or with customers. As the vast majority of retail employment is in store operations, physical presence is the primary inhibitor limiting the theoretical maximum in this sector.

- *Local knowledge required*. Local knowledge is required for many functions in retail, such as product offerings, store appearance, marketing, and accounting. The contrasting characteristics of stores in different countries operated by the same company illustrate the necessity for local knowledge:

  · Product offerings often are changed to appeal to local customers. In China, for example, Wal-Mart offers pools with live fish for customers to net, an effort to cater to a local custom of cooking live fish. The packaging of standard commodities also varies by country. Milk, for example, is sold in refrigerated jugs in the United States, in unrefrigerated cartons in Germany, and in plastic bags in Hungary.

  · The appearance of stores, both externally and internally, is often altered to create an appeal with local consumers. Carrefour, for example, has a bright green façade on its stores in Sao Paulo compared to their traditional blue and white storefronts in France. The format of stores is also often adjusted to local markets, as illustrated by the smaller convenience stores Tesco has opened in Japan. Wal-Mart had to develop a multistory facility in Korea to accommodate local real estate premiums.

  · Marketing also requires a deep knowledge of local consumers. Although there are some exceptions, such as Wal-Mart's global "everyday low price" campaign, most retailers adapt their marketing strategies to appeal to local consumers. Tesco's sales flyers, for example, vary widely in appearance between the UK and Poland.

  · Other functions, such as accounting and administrative work, require knowledge of local tax laws and regulatory issues.

- *Complex interactions required.* This is the least important of the limiting factors; however, some interactions between functions limit the global resourcing potential. One US apparel retailer commented that it would be difficult to separate sales agents from those involved in merchandising. In this case, the merchandising team trains the sales agents on new products and features to improve overall sales as well as the agents' ability to up-sell and cross-sell. While this interaction could technically be done remotely, the value added by physical presence prevents the global resourcing of the merchandising team.

- **Subsector peculiarities**. Our study shows that the percent of jobs that can be globally resourced within each subsector depends largely on the percentage of private label sales. As a consequence, vertically integrated retailers have the highest potential within the traditional format (6.2 percent), followed by discount and department stores (3.5 percent) and food, drug, and general merchandise stores (2.3 percent) (Exhibits 11 and 12). Exceptions to this private label rule are catalog and online retailers, which have a significantly higher global resourcing potential of 34.3 percent. The variations among the subsectors are detailed below:

Exhibit 11

THE PERCENTAGE OF JOBS THAT CAN BE GLOBALLY RESOURCED DEPENDS LARGELY ON THE EXTENT OF PRIVATE LABEL SALES

% of employment that can be globally resourced by level of service

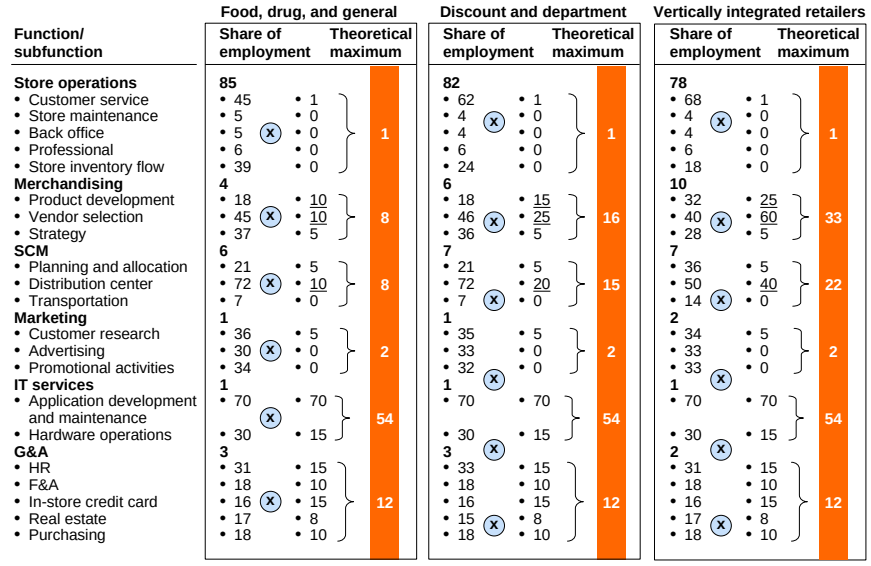
Function/ subfunction	Food, drug, and general	Discount and department	Vertically integrated retailers
	(% of total x % resourceable)	(% of total x % resourceable)	(% of total x % resourceable)
Store operations	85 x 1 = **0.38%**	82 x 1 = **0.51%**	78 x 1 = **0.53%**
Merchandising	4 x 8 = **0.35%**	6 x 16 = **0.96%**	10 x 33 = **3.34%**
SCM	6 x 8 = **0.46%**	7 x 15 = **1.08%**	7 x 22 = **1.53%**
Marketing	1 x 2 = **0.02%**	1 x 2 = **0.02%**	2 x 2 = **0.03%**
IT services	1 x 54 = **0.70%**	1 x 54 = **0.59%**	1 x 54 = **0.54%**
G&A	3 x 12 = **0.36%**	3 x 12 = **0.36%**	2 x 12 = **0.23%**
Total	**2.3%**	**3.5%**	**6.2%**

- Major differences in employment breakdown among sectors include the level of direct service provided to clients in store and number of positions dedicated to merchandising
- In-store functions, however, cannot be globally resourced, and the allocation of resources within store operations has little impact on potential to globally resource
- Retailers selling private label merchandise have the unique ability to globally resource a greater percentage of merchandising and supply chain jobs if the majority of their goods are produced in the same location

Source: McKinsey Global Institute analysis

Exhibit 12

MAIN VARIATIONS AMONG FORMATS ARE IN PRODUCT DEVELOPMENT, VENDOR SELECTION, AND DISTRIBUTION FUNCTIONS



Source: McKinsey Global Institute analysis

- *Food, drug, and general merchandise*. This subsector has the least potential to globally resource jobs because of its local nature. The majority of the products sold in this format are sourced locally, reducing the potential for supply chain management and merchandising functions to go abroad. While private label sales may exceed 20 percent in some cases, the sources of production on these products are generally limited. In addition to products tying job functions to one area, companies in this category typically create a unique local appeal. Even large multinational players such as Carrefour must cater to local tastes. The need for local knowledge and products in this subsector reduces the potential to globally resource jobs to 2.3 percent. The high concentration of employment in this sector, however, translates that into 2.2 million FTEs in 2008.

- *Discount and department stores.* Retailers in this group generate a significant portion of their revenue from private label sales (private label sales generate 30 percent of annual US revenue in this category). Selling private label products that can be produced in low-wage countries allows retailers to globally resource a greater percentage of employment. Merchandising and SCM functions that were traditionally domestic

positions can actually be performed where the products are produced. As a result, global resourcing potential in this subsector is 3.5 percent, or 1.7 million FTEs in 2008.

- *Vertically integrated retailers*. Retailers in this group have the potential to globally resource many of their merchandising and SCM functions. In the case of one major US apparel company, its regional distribution centers were consolidated in China, where most of its clothing is produced. This retailer's goods could then be produced, sorted, tagged, folded, and organized into containers to be shipped directly to individual retail stores in the United States. While this example is at the forefront of global resourcing in this subsector, the theoretical maximum in this category is 6.2 percent, or 600 thousand FTEs in 2008.

- *Online and catalog retailers*. This group has a unique global resourcing potential due to the increased percentage of employment in categories that can be globally resourced. Larger call centers, which take orders either electronically or over phone lines, and IT departments allow retailers in this category to globally resource a greater percentage of their employment (Exhibit 13). Some retailers have already outsourced the operation of their

Exhibit 13

ONLINE AND CATALOG RETAILERS HAVE A UNIQUE GLOBAL RESOURCING OPPORTUNITY

% of employment that can be globally resourced by level of service

Function/ subfunction	Aggregate of traditional retailers	Online/catalog retailer
	(% total x % resourceable)	(% total x % resourceable)
Operations		
• Customer service/sales	45 x 1 = **0.5%**	**30 x 95 = 28.7%**
• Fulfillment and other operations*	39 x 0 = **0%****	42 x 0 **= 0%****
Merchandising	5 x 12 = **0.6%**	9 x 7 = **0.6%**
SCM	6 x 12 = **0.7%**	5 x 12 = **0.6%**
Marketing	1 x 2 = **0.02%**	3 x 2 = **0.06%**
IT services	1 x 54 = **0.7%**	**7 x 54 = 3.8%**
G&A	3 x 12 = **0.4%**	4 x 12 = **0.5%**
Total	**2.8%**	**34.3%**

Reasons catalog/online retailers have a greater potential

- Greater portion of employment dedicated to call centers
- Higher percentage of employees in IT services

Impact on retail sector

- Increase in online/catalog retailers will increase total employment that can be globally resourced
- Currently:
  - Online/catalog retailers represent 0.5% of worldwide retail employment
  - Online/catalog retailers represent 3% of retail employment in the United States

* Includes maintenance of store environment, store inventory flow, management staff, and back-office personnel.
** Nearshoring not considered.
Source: McKinsey Global Institute analysis

online stores (including Web site design, order fulfillment, customer service, and online marketing) to firms such as GSI Commerce. The global resourcing potential of each function, however, is similar to food, drug, and general merchandise retailers. Global resourcing potential in this subsector is 34.3 percent, or 400 thousand FTEs in 2008.

- **Functions amenable to global resourcing.** The functions with the greatest global resourcing potential are IT services, G&A, SCM, and merchandising (Exhibit 14). When considering employment share, the high-priority opportunities for global resourcing are IT, distribution center operations, vendor selection and management, private label credit cards, and other G&A functions (Exhibit 15). The following list delineates the aggregate global resourcing potential of each functional employment group:

  - *Store operations.* The low global resourcing potential of this function, 0.8 percent, limits the sector's theoretical maximum. Positions that can be

Exhibit 14

IT SERVICES HAS THE GREATEST POTENTIAL TO BE RESOURCED

%

Incorporated barriers for global resourcing of functions/subfunctions

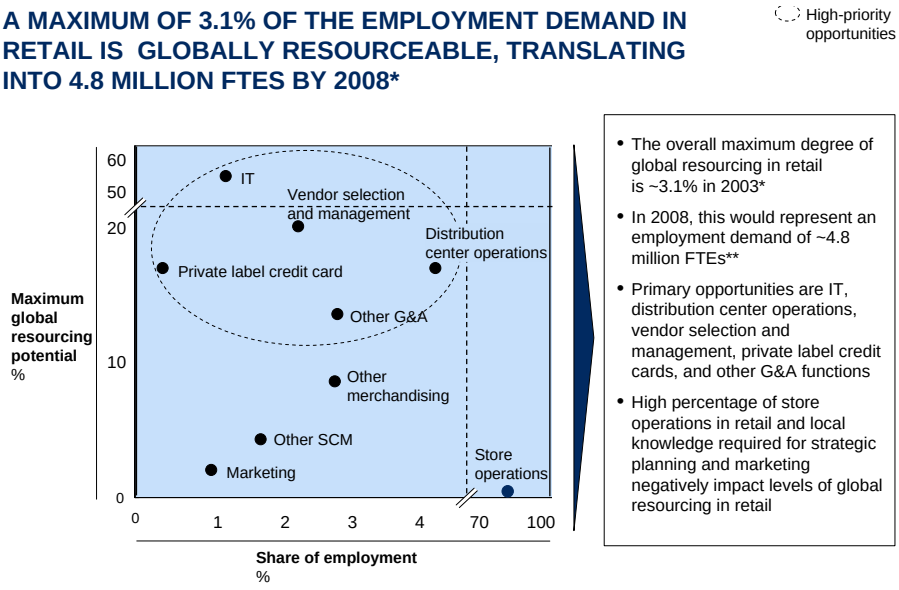
- Physical presence required
- Local knowledge required
- Complex interactions required

Function/subfunction	Share of employment %	Incorporated barriers for global resourcing of functions/subfunctions	Theoretic maximum share of function globally resourceable	
Store operations	**84**			
• Customer service	• 53		• 2	
• Store maintenance	• 5		• 0	
• Back office	• 5	x	• 0	1
• Professional	• 6		• 0	
• Store inventory flow	• 31		• 0	
Merchandising	**5**			
• Product development	• 19		• 12	
• Vendor selection/management	• 45	x	• 18	12
• Strategy	• 36		• 5	
SCM	**6**			
• Planning and allocation	• 22		• 5	
• Distribution center operations	• 71	x	• 15	12
• Transportation	• 7		• 0	
Marketing	**1**			
• Customer research	• 36		• 5	
• Advertising	• 31	x	• 0	2
• Promotional activities	• 33		• 0	
IT services	**1**			
• Application development and maintenance	• 70	x	• 70	54
• Hardware operations	• 30		• 15	
G&A	**3**			
• HR	• 32		• 15	
• F&A	• 19		• 10	
• Private label credit card	• 15	x	• 15	12
• Real estate and maintenance	• 16		• 8	
• Purchasing	• 18		• 10	

Source: Interviews; McKinsey Global Institute analysis

Exhibit 15

A MAXIMUM OF 3.1% OF THE EMPLOYMENT DEMAND IN RETAIL IS GLOBALLY RESOURCEABLE, TRANSLATING INTO 4.8 MILLION FTES BY 2008*



* Not including any markup to acknowledge increase in formats more amenable to global resourcing.
** Theoretical maximum not considering supply constraints.
Source: Interviews; McKinsey Global Institute analysis

globally resourced are generally limited to call centers. In traditional formats, these call centers answer basic customer questions, while in online and catalog formats, call centers also take orders, either electronically or over the telephone.

- *Supply chain management.* For retailers who have their goods produced abroad, a surprising amount of distribution center operations can be done at the location of production. These tasks include folding, sorting, boxing, tagging, and even sending products directly to stores. Apparel companies that have most of their products manufactured in one location have a unique ability to locate many of their supply chain management positions near the manufacturing facility. The supply chain for private label dress shirts for a US department store is entirely managed from Asia. Data is collected and analyzed remotely to manage store inventory and forecast demand. The shirts are then produced in Asia and shipped directly to stores in the US and Europe, thus by-passing regional distribution centers.

Transportation and most planning jobs, however, must remain local. In aggregate, 12 percent of SCM functions could be globally resourced. The global resourcing potential of this function for vertically integrated retailers, however, is 22 percent.

- *Merchandising.* Jobs that can be globally resourced in this function include vendor selection and management in geographies where the retailer is producing or purchasing its goods. In cases where a retailer is producing its own goods, product development can be performed where the goods will be manufactured. A Chilean department store recently relocated its vendor selection group from Chile to China to reduce costs and time from concept to finished product. In this example, the merchandising team previously traveled from Chile to Paris to understand the latest fashion trends, then to China to have the goods produced, eventually returning to Chile. Subsequent trips to China were necessary to monitor the manufacturing process. Relocating the merchandising team to China saved this retailer time and helped to reduce costs. Merchandising strategy and product development for local goods generally cannot be globally resourced. Overall, 12 percent of merchandising functions could be globally resourced. Vertically integrated retailers have the unique opportunity to globally resource 33 percent of the employment in this function.

- *General and administrative (G&A).* While training and recruiting are difficult to do remotely, other HR functions such as timesheets and payroll can be globally resourced. General accounting can be done remotely, yet some functions such as counting cash and high-level accounting must be done locally. Some corporate purchasing and real estate functions can also be done remotely. Finally, the billing and collection associated with private label credit cards do not need to be based locally. Aggregating these subfunctions yields a global resourcing potential of 12 percent.

- *Information and technology.* Despite a small amount of employment in this function, a significant portion can be globally resourced (54 percent). Positions that could be done remotely are generally limited to application development and maintenance. The majority of hardware support, however, must remain local.

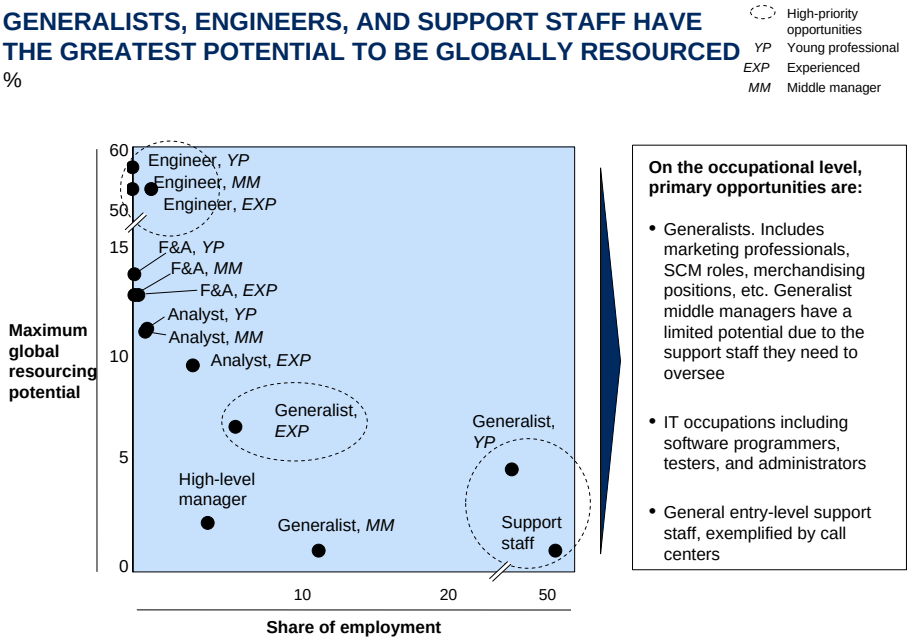
- *Marketing*. This function requires a high degree of local knowledge, and as a consequence, its global resourcing potential is only 2 percent. Positions that do not require specific local interaction or knowledge are customer research functions that involve survey analysis or data mining.

- **Occupations amenable to global resourcing.** Engineers have the highest global resourcing potential in retail (54 percent). Most engineers specializing in hardware operations must remain local, but the majority of software engineers at all levels (young professional, experienced, and middle managers) can perform their jobs remotely (Exhibit 16). Generalists represent the largest occupation that can be located remotely, with a potential of 2.3 million. While the support staff for many functions must remain local, the support staff associated with call centers can be located remotely (Exhibit 17).

Exhibit 16

GENERALISTS, ENGINEERS, AND SUPPORT STAFF HAVE THE GREATEST POTENTIAL TO BE GLOBALLY RESOURCED

%



Source: Interviews; McKinsey Global Institute analysis

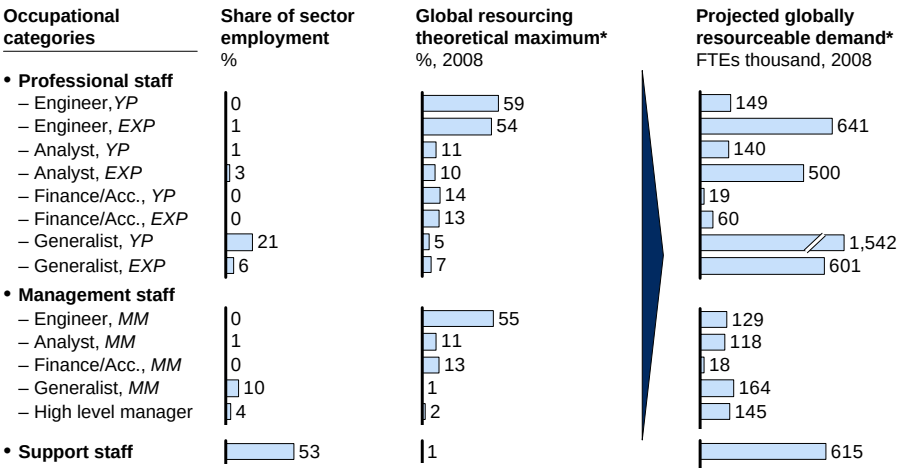
Exhibit 17

DESPITE THE LOW THEORETICAL MAXIMUM, 2.3 MILLION GENERALISTS COULD BE GLOBALLY RESOURCED

YP Young professional
EXP Experienced
MM Middle manager

Globally resourced demand by occupational group

%/FTEs



* Not considering potential supply constraints that would limit the clearing of the projected demand, including additional management overhead.

Source: McKinsey Global Institute analysis

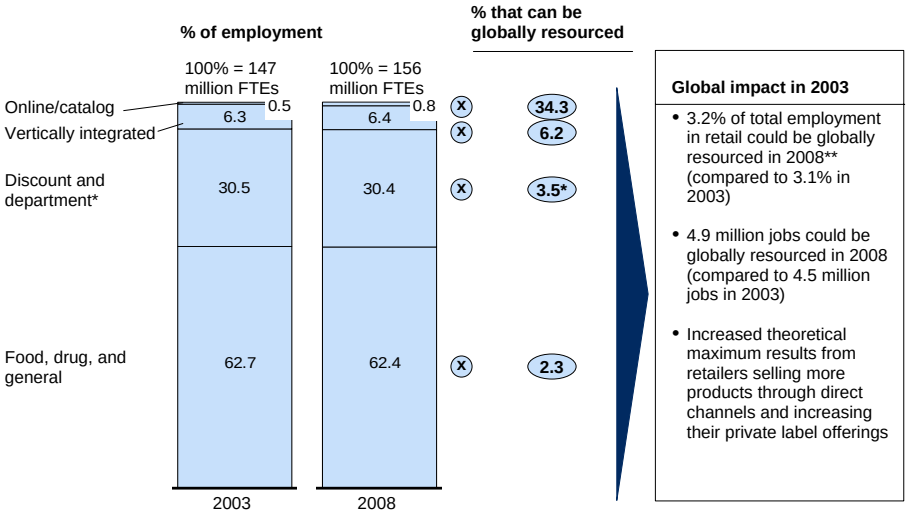
Changes in assumptions that could alter projected theoretical maximum

The theoretical maximum potential of jobs that can be globally resourced will increase from 3.1 percent to 3.2 percent by 2008 as formats shift. As employment in online/catalog and vertically integrated retailers increases, the overall maximum potential to globally resource jobs increases (Exhibit 18). The following changes in assumptions, however, could change the projected level of demand:

- **An unanticipated change in formats.** Although it is clear that the online and catalog subsector will grow in size, an accelerated growth in this area or an unanticipated change in the subsector breakdown will impact the theoretical maximum. However, even if employment in online and catalog retailers is to grow 20 percent annually (compared to our projected 10 percent compounded annual growth rate), our projected global resourcing potential for the industry would only increase from 3.2 percent in 2008 to 3.3 percent. Similarly, an accelerated growth in private label sales could increase the theoretical maximum for the industry. As discounters and department stores

Exhibit 18

THE PERCENTAGE OF GLOBALLY RESOURCEABLE JOBS WILL INCREASE AS FORMATS CHANGE



* Percent of employment in this category that can be globally resourced depends on percent that is vertically integrated or dedicated to private labels. Current portion of employment dedicated to private label sales in this group is 30%.

** Not considering any potential supply constraints.

Source: U.S. Department of Commerce; NPD Fashion World; McKinsey Global Institute analysis

increase the percentage of revenue generated from private label sales, the global resourcing potential in product development, vendor selection, and distribution centers will increase. However, doubling our projected growth of vertically integrated retailers will only increase global resourcing potential for the industry in 2008 by one-hundredth of a percentage point.

- **Technology**. In addition to reducing total employment, advances in this field could increase the globally resourceable potential. Innovations such as radio frequency identification could allow supply chains to be monitored and managed remotely, as this technology removes the necessity to physically count inventory. As computer systems become increasingly complex, more employment will be needed in IT to develop, maintain, and repair these systems. Because IT has the highest global resourcing potential, an increase in employment in this function increases the global resourcing potential for the industry. The net impact technology could have is somewhat unclear and depends entirely on the extent to which retailers adopt this new technology.

Impact on retail subsectors not covered

It is apparent that gas stations and, to a lesser extent, vehicle dealerships could leverage the benefits of global resourcing. Whereas the majority of the employment in these retailers will have to remain local, a portion of IT positions and some G&A jobs could be done remotely. As other retailers are able to demonstrate the potential cost savings available from globally resourcing standardized tasks, vehicle dealerships and gas stations will be more likely to adopt this strategy.

DEGREE OF ADOPTION OF GLOBAL RESOURCING

Current degree of global resourcing

Interviews and publicly available information indicate that the top 10 companies in each subgroup have collectively globally resourced nearly 6,000 jobs. Extrapolating from this sample to the rest of the developed world (27 percent of employment in retail), roughly 28,000 positions are currently globally resourced in the world, equivalent to 0.07 percent of retail employment in high-wage countries. However, it is difficult to accurately identify the amount of employment that is being globally resourced—most companies are reluctant to release any information relating to offshore activities as the public typically reacts negatively to such announcements:

- The primary functions that are globally resourced include vendor selection, customer service (call centers), and IT. While there are examples of retailers globally resourcing entire distribution centers and product design positions, this is not typical. Most retailers are not involved at all in global resourcing and those who are involved are only leveraging a small portion of their potential.
- The main occupations already globally resourced include support staff, young professional engineers, generalist young professionals, analyst young professionals, finance and accounting young professionals, and the middle managers associated with the aforementioned positions.
- Companies from the United States, Germany, and the UK are the leaders in leveraging global resourcing. Retailers in developing countries have little incentive to globally resource employment, and there does not appear to be any examples of such firms doing so.

Determinants of degree of adoption

While cost pressure and other factors are driving retailers to adopt global resourcing, these drivers are dwarfed by inhibitors and this imbalance is unlikely to change by 2008 (Exhibit 19):

Exhibit 19

INSUFFICIENT SCALE AND LACK OF GLOBAL PRESENCE ARE KEY INHIBITORS TO ADOPTING GLOBAL RESOURCING

+++ Strong driver
Ø Neutral
– – – Strong inhibitor

	Drivers/inhibitors	Importance for sector degree of adoption
Sector characteristics and dynamics	• **Cost pressure**	**+++**
	• **Cost differential (perceived or real)**	**+**
	• Availability (perceived or real) of quality vendors	**+**
	• Availability (perceived or real) of suitable labor	**Ø**
Organizational, operational, and technical factors	• **Global presence and experience in managing global footprint**	**– –**
	• **Scale of business processes to be globally resourced**	**– – –**
	• Suitability of process to support global resourcing	**–**
	• Intensity of paper-based processes in sector	**Ø**
	• Suitability of IT to support global resourcing	**– –**
	• Alignment of management incentives with profit maximization	**Ø**
	• Comparison of global resourcing Return On Investment (ROI) (perceived or real) with alternative profit-maximization strategies	**– –**
Legal, regulatory, political, and social factors	• Access to attractive markets	**Ø**
	• Social/political position towards global resourcing	**–**
	• Labor market regulation in the home country	**Ø**
	• Product market regulations in the home country	**Ø**
	• Intellectual Property (IP) regulation in the producing country	**Ø**

Source: Interviews; McKinsey Global Institute analysis

- **Sector characteristics and dynamics:**

  - *Cost pressure.* The razor-thin margins that most retailers are experiencing and need to cut costs will enhance pace of adoption. While all retailers are experiencing cost pressures, non-discount retailers are being pressured by big-box value players to keep costs low.

  - *Cost differential (perceived or real).* Of the positions that can be globally resourced, a large difference exists in the cost of labor between developed and developing countries; labor costs in developed countries can be reduced by as much as 80 percent. This discrepancy is driving retailers to adopt global resourcing. Call center, IT, and merchandising functions can all be performed at a fraction of the cost these functions incur in developed countries.

- *Availability of quality vendors*. The abundance of qualified vendors in Asia is facilitating the pace of adoption by retailers. Nearly 50 percent of the identified examples of global resourcing involved vendors. Vendors providing routine functions at a fraction of the cost are appealing, especially for retailers without sufficient scale or global presence to create a captive center.

- *Time to market*. The importance of accelerating the design to production cycle will drive some retailers to increase global resourcing, while preventing others from engaging in it. It is increasingly important for retailers to reduce the time from concept to consumer. Players that coordinate design and manufacturing abroad will be able to improve time to consumer by placing supply chain management and merchandising functions in the location where their goods are produced. Retailers that currently produce their goods locally, however, will be less likely to globally resource production and the associated merchandising and supply chain functions, as this will retard their time from development to consumer.

- **Organizational, operational, and technical factors:**

  - *Global presence and experience in managing global footprints.* Large, multinational players are the most involved in global resourcing. Inexperience with managing global footprints will inhibit the pace of adoption. Relative to other industries, retailers are very localized. Even multinational players tend to function at a local level. This makes it difficult for retailers to centralize their operations in a foreign country. Although globalization is limited in retail, most players involved in global resourcing have an international presence.

  - *Scale of business processes to be globally resourced*. Sufficient size of functions to be done remotely is a primary inhibitor toward pace of adoption; only companies with departments large enough to create significant savings will consider global resourcing. For most retailers, the subfunctional departments that could be globally resourced are too small to warrant moving. In addition, the complexity of moving sections of departments could outweigh potential savings from reduced labor costs.

- *Suitability of IT architecture to support global resourcing*. Proprietary IT systems common among retailers make it difficult to globally resource IT positions. For some retailers, archaic proprietary IT systems need to be updated and standardized before any IT support or development can be globally resourced. Nonstandardized IT systems also inhibit global resourcing. One large US-based department store could not perform security tagging and other cross-dock operations where its products were manufactured because its stores collectively had five different IT systems. Retailers that perform staggered IT and security system updates are limited by their fragmented systems.

- *Alignment of management incentives with profit maximization*. There is a fear among upper management that if too many job functions go abroad, the top management will have to follow. This personal resistance to relocation can translate into corporate resistance to global resourcing.

- *Comparison of global resourcing ROI (perceived or real) with alternative profit maximization strategies*. Research indicates that retailers have not yet leveraged many important opportunities to increase efficiency that could yield higher returns than global resourcing. Most retailers will not consider global resourcing until they achieve best practices in areas that will have a larger impact. These steps include the consolidation of back-office functions, improved SCM, superior buying, improved efficiency of store operations, and the improvement of archaic IT systems. The relatively small savings global resourcing can provide these players will unlikely outweigh the risks and costs incurred in moving functions abroad. This inhibitor applies to both small and large retailers.

- *Concerns with quality*. There are also concerns that quality, to a lesser extent, will retard the pace of adoption. One fear retailers have is that they will lose customers who have to interact with foreign employees in functions such as call centers. There is also a fear that internal functions will not operate as efficiently as the result of inferior quality of employees abroad. Retailers with deficient areas (such as IT or marketing) tend to carefully consider global resourcing these functions as this action could result in failure.

- **Legal, regulatory, social, and political factors:**

  - *Social/political position toward global resourcing*. Community focus among retailers could slow the pace of adoption. Although least important, there is resistance to being associated with contributing to domestic unemployment. This is still a sensitive issue in most countries and many retailers in the United States and Western Europe believe that a widespread awareness of global resourcing will have a negative impact on sales.

  - *Labor market regulation in the home country*. Labor regulation in the retail industry is minimal and does not have a significant effect on the theoretical maximum of globally resourceable positions or on the pace of adoption. Labor laws, such as those in Germany, limit the productivity and increase the cost of local employment. In applicable cases, such labor laws could increase pace of adoption, assuming that these laws do not prevent labor from going abroad.

Pattern of adoption

Offshoring of services within the retail sector lacks enough successful examples to create high interest among its players. Despite the variations in global resourcing potential between subsectors, the pattern of adoption will likely be similar for most retailers. The high fragmentation of the industry means that many retailers lack sufficient scale and global presence to consider setting up captive centers. As a consequence, these companies will turn to vendors. As the demand for globally resourced services increases, vendors will likely specialize and cater to smaller retailers. This would result in an increase in confidence in vendors and in more players adopting. As IT is a high theoretical maximum function, it will likely be one of the first targeted. Overcoming IT architectural issues will be specific to each company, but it is likely to be the primary target of several players, providing them with the confidence to pursue global resourcing in other areas. We also believe that as not only retailers but other sectors also expand the amount of employment globally resourced, the social resistance will gradually fade, allowing hesitant retailers to capture the benefits of locating labor abroad.

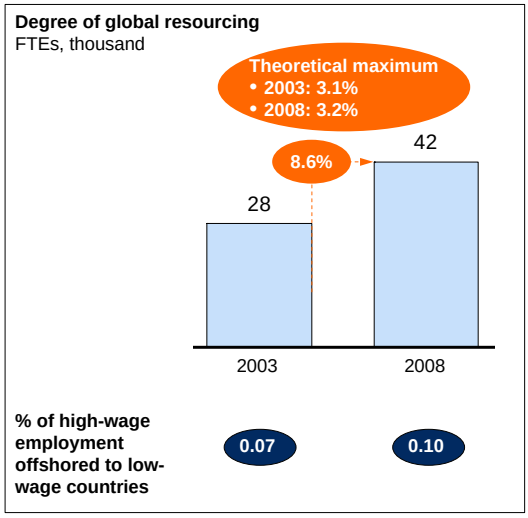
Projected growth in adoption

An estimated 42,000 jobs will be globally resourced in 2008 (equivalent to 0.1 percent of retail employment in high-wage countries), indicating an annual growth rate, in terms of FTEs, of 9 percent (Exhibit 20). Estimating the current extent of global resourcing and likely pace of adoption among the four subsectors has allowed us to project the degree of global resourcing in 2008 (Exhibit 21). While most retailers have not yet globally resourced any jobs, others are engaging at varying degrees (Exhibit 22):

Exhibit 20

WHILE RELATIVELY FEW EMPLOYEES ARE CURRENTLY OFFSHORED, THIS VALUE WILL LIKELY INCREASE 9% ANNUALLY
2008E

- **Current degree of global resourcing:**
  - 0.07% of industry employment in high-wage countries
  - 0.02% of worldwide industry employment
- **Drivers positively influencing pace of adoption**
  - Cost pressure
  - Move toward formats conducive to global resourcing (private labels and direct channel formats)
  - Talent availability (IT and analytic skills)
- **Drivers negatively influencing pace of adoption**
  - Scale of jobs that could be offshored
  - Other cost control levers have not been used
  - Lack of globalization
  - Concerns regarding quality
  - Political and social pressures



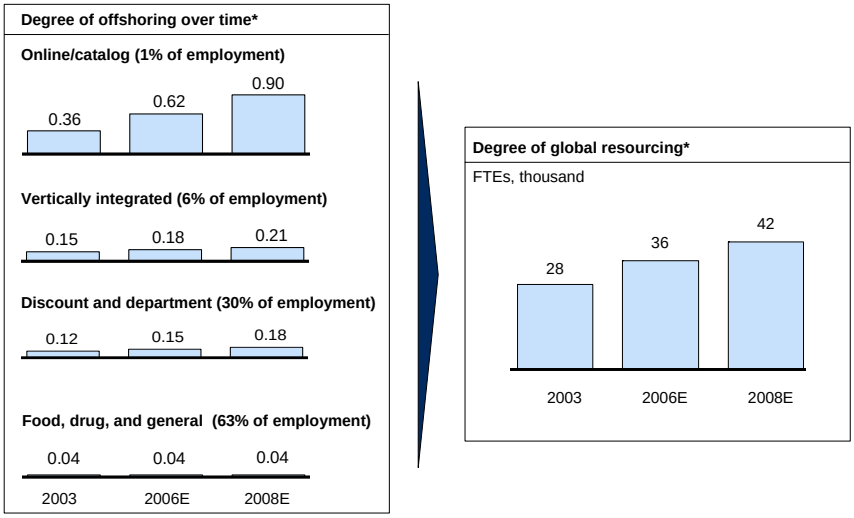
Source: Interviews; press releases; Company filings; Company Web sites; Techsunite.org; McKinsey Global Institute analysis

- **Subsector growth**. Different retail formats are likely to adopt global resourcing at varying rates. Online and catalog companies have the highest potential and are at the forefront. Amazon, Dell, and IBM have operations abroad, yet they are far from realizing the global resourcing potential of an online company. Vertically integrated retailers are likely to capitalize on their potential to globally resource merchandising and supply chain management roles. Marks & Spencer and Jones Apparel already have operations abroad,

Exhibit 21

GROWTH IN OFFSHORED ONLINE/CATALOG EMPLOYMENT WILL CONTRIBUTE TO AN ESTIMATED 42,000 FTES RESOURCED IN 2008

%

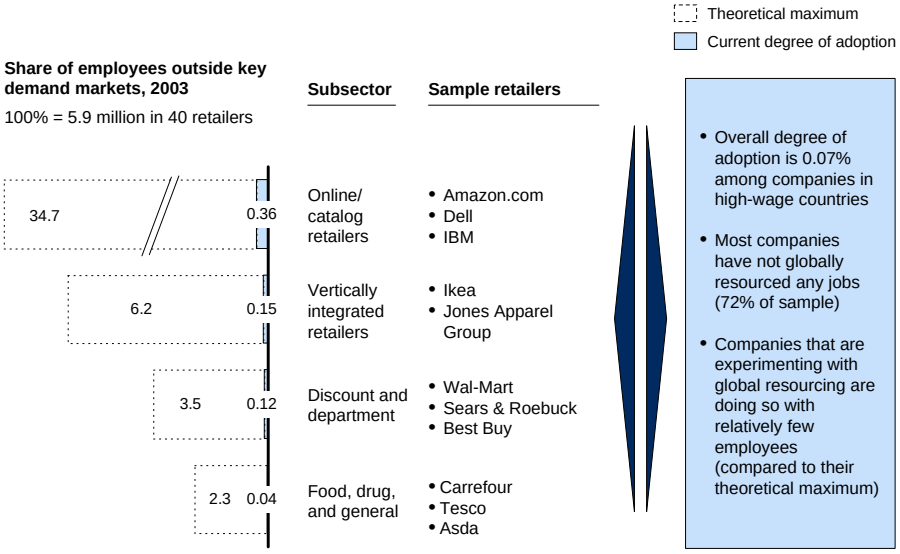


* Not considering supply constraints or potential markup to account for capital/labor substitution made by companies.

Source: Press releases on offshoring initiatives; McKinsey Global Institute analysis

Exhibit 22

EVEN THE LARGEST RETAILERS HAVE A LOW DEGREE OF ADOPTION*



* Values based on a sample of the top 10 global companies in each category.

Source: Hoovers; press releases; Techsunite.org

and others will likely adopt similar strategies. Discount and department stores and food, drug, and general merchandise retailers are unlikely to significantly increase their degree of global resourcing.

- **Main functions most likely to be adopted**. It is expected that there will be an expansion of merchandising, supply chain management, IT, and G&A functions performed abroad. While all retailers could leverage global resourcing for IT and G&A functions, only those with foreign sourcing operations will send merchandising and SCM functions abroad.

- **Main occupations likely to be required**. The primary occupations that are globally resourced will continue to be support staff, young professionals (mostly generalists and engineers), and enough middle managers to support the young professionals.

IMPLICATIONS

Company-level implications

- **Cost reduction.** Offshoring of retail services can reduce expenses in functions such as IT services and G&A as well as the costs of producing and delivering products to a home market. For those players that adopt offshoring, one would expect cost of goods sold as well as selling, general, and administrative costs as a percent of sales to decrease. As observed in other sectors, this in the short run will likely translate into greater profit margins for retailers. However, in the long run, savings will likely be passed on to consumers through lower prices in attempts to capture and increase market share.

- **Revenue enhancement.** Currently, retailers work on razor-thin margins, forcing them to not pursue opportunities that, although interesting, would force even tighter margins. The possibility of leveraging low-cost labor to pursue these opportunities are starting to be considered by several players. One of the most cited by our interviewees was the opportunity to pursue better marketing analysis and customer outreach. Data mining and analysis of point of sale purchases is becoming increasingly complex as large amounts of customer and marketing data have become available. In addition

to cost, lack of qualified domestic labor is a reason retailers are not fully leveraging marketing. The use of low-cost, talented labor (primarily through vendors), should allow retailers to better know their consumers and could result in revenue increases for these players. Another revenue-enhancing option made possible by global resourcing is additional product development and customization. With lower costs and additional capacity, companies that adopt offshoring will be able to increase the number of products developed and optimized.

- **Acceleration**. The fact that co-location of design, production, and SCM results in shorter time to market has been demonstrated by a few players who have pursued this opportunity and consequently decreased the product life cycle. This allows merchants to better match fast-changing consumer preferences and will drive demand.

Sector-level implications

Increased profitability of online sales (as a result of decreased costs associated with globally resourced call centers) will change the business model of many retailers that have unprofitable online divisions. The increased use of online retailing will then increase the theoretical maximum for the industry, as well as the pace of adoption, as retailers leverage low-cost labor to operate their call centers. Online retailers that choose not to offshore will face increasing cost pressure and will need to either consider this opportunity or find another comparative advantage to remain competitive.

Country-level implications

The current pace of adoption is too low to have significant implications on countries. Retail is and will continue to be a local business. Despite the potentially large impact movement of labor within the retail sector could cause, it is unlikely that at anytime labor markets in one country will sufficiently suffer from movements in this sector. On the other hand, the labor employed in low-wage countries is and will continue to be primarily support functions. This, in theory, could increase employment in low-wage countries and increase productivity in high-wage countries. On the short term, however, this trend will unlikely have any quantifiable effect.

Methodology

EMPLOYMENT

Functions. Sectors were broken down along their value chains, resulting in functions and subfunctions. These breakdowns are sector specific. However, several functions (e.g., R&D, sales and marketing, IT, and G&A) appear across sectors. Other functions, such as nursing, are sector specific.

Occupations. Employees in specific occupations perform tasks in the above functions and subfunctions. For the purpose of this study, nine broad occupational groups were defined based on their required educational background.

Double counting of employment was avoided by considering only the employees who are directly employed in companies in that sector. Outsourced employment is not considered within the sector being evaluated but rather in the recipient sector (e.g., outsourced IT services employees in retail banking are included in the IT services sector analysis).

GLOBAL RESOURCING POTENTIAL-THEORETICAL MAXIMUM

Theoretical maximum describes the percentage of a function or subfunction that may be globally resourced in the absence of supply constraints. To construct the theoretical maximum of each function or subfunction, we determined the percentage of the positions that could potentially be performed anywhere in the world.

Factors that affect theoretical maximum. Three factors explain why a function cannot reach a 100% theoretical maximum: physical presence, local knowledge, and complex interactions are required to some extent in each sector.

DEGREE OF ADOPTION

Degree of adoption assesses the current and projected levels of global resourcing from low-wage locations within a sector.

Determinants of pace of adoption. Three broad categories of determinants were identified: (1) sector characteristics and dynamics, (2) operational, organizational, and technical factors, and (3) legal, regulatory, social, and political factors.

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