

The Case for Nearshoring: Why and How the New Normal will shift Sourcing Dynamics



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Over the last decade, organizations have realized that outsourcing delivers more than cost savings –it enables agile and competitive businesses that can take on new market challenges. Many have used outsourcing effectively and created significant long term value for themselves. But as Dr Howard Rubin, who coined the term Technology Economy, famously states –“the only thing about the future is that it’s not what it used to be”. Times have changed and with the economy still plodding along on half throttle, it is clear that the fluctuating business and market conditions will become the new normal. Businesses that survive will leverage outsourcing to provide the operational flexibility that constantly changing market conditions demand. Businesses that thrive will be the ones that master the Technology Economy by spending wisely in solutions that further multiply the impact of outsourcing.

The supplier landscape has also undergone significant shifts, with the rise of new

Shifting Dynamics	Advantage Nearshore
Balancing the portfolio: Adding Nearshore to the Sourcing Mix	Near shore destinations are becoming an integral part of the balanced portfolio in addition to already existing offshore locations. These nearshore geographies offer not just cost savings and quality of service but also address some of the gaps of mature offshore locations such as language availability, time zone proximity and cultural affinity.
Consolidation and Expansion of the Nearshore Market	Consolidation of service providers and increasing foray of mature service providers are making the nearshore market very attractive. Vendors are not only bringing their specialized practices and service delivery maturity to this region, but also acting as a reservoir of talent for other companies to offer more value-added services to their global clients.
Increasing adoption of Cloud based Business Services	Many Telecom and Infrastructure providers are already setting up large Data and Cloud computing centers across the Caribbean, Central and Latin America to serve regional and North American markets. Firms are expanding their nearshore footprint to offset their farshore "disadvantage".
Offshore Fatigue, Nearshore Fascination	The proximity of a Nearshore location also has the benefit of making vendor management and governance easier. It is simpler to manage providers in similar time zones, reducing governance costs and resulting in better managed engagements.
The Rise of the MultiLatinas – Why its not just about Costs anymore	Increasing FDI and growth of the middle class in Latin America are leading to a new aggressive breed of companies known as the MultiLatinas. Multilatinas are eagerly embracing outsourcing and in many cases structuring strategic ventures to capture these opportunities. This is driving domain expertise based outsourcing opportunities to the nearshore region.

destinations, rapid vendor consolidation, evolution of cloud based services and proliferation of more transformative sourcing models. As executives grapple with a myriad of priorities and a complex web of options, finding the sourcing equilibrium is becoming increasingly important. In this piece we take a look at how changed Sourcing Dynamics will impact the case for Nearshoring.

BALANCING THE PORTFOLIO: ADDING NEARSHORE TO THE SOURCING MIX

Services Globalization has been in a constant state of evolution, resulting in ever changing opportunities and challenges for organizations. The elements of a sourcing strategy created few years ago may continue to be valid but the order of importance of each element may no longer be as pertinent. Companies have to recalibrate their sourcing strategy to adapt to these operating conditions and market changes. This is having a major impact on

how different sourcing destinations are developing. For instance, recently Philippines overtook India as the largest provider nation of voice based services. Despite being a later entrant in the call center market, Philippines has grown faster in the last 5 years due to superior quality of

service and competitive costs. While India faced labor tightening and rising salaries, the Philippines strengthened its position due to an inherent affinity towards voice based services and more stable workforce. But another important factor played a key role – companies began diversifying their sourcing portfolio, allocating their outsourcing assets between different geographies to match the right skills to the right location. Philippines offered a great option to clients seeking locations that could offer the scale of India at similar costs.

In recent years many new Nearshore options have emerged that are now following the maturity curve of India and the Philippines. These nearshore geographies offer not just cost savings and quality of service but also address some of the gaps of mature offshore locations such as language availability, time zone proximity and cultural affinity. Nearshore locations like Colombia, Dominican Republic, Jamaica, Costa Rica and further south such

as Chile, Argentina and Uruguay present viable alternatives for a balanced sourcing portfolio. Mature services buyers are expanding their presence in this region to diversify their resource base and reduce outsourcing risks.

CONSOLIDATION AND EXPANSION OF THE NEARSHORE LANDSCAPE

All aspects of global sourcing have witnessed rapid transformation in a span of few years. From newer engagement models to advanced technologies to more innovative service providers – recent developments have changed the game significantly. The transformation has happened at both the macro as well as micro environment level. Some geographies have saturated while newer locations have emerged. Service providers have been on a consolidation spree (Igate acquiring Patni; Xerox acquiring ACS; Dell acquiring Perot Systems, Atos Origin acquiring Siemens IT Services, Cap Gemini acquiring CPM Braxis etc.) resulting in new supplier market dynamics. Service providers from established locations are moving into the nearshore market not just to expand their portfolio but to cater to a rising demand of Spanish/Bi-lingual services as well as time-zone sensitive services such as Agile computing. Countries such as Argentina and Uruguay also have a strong affinity with Europe. They are serving Europe not just in Spanish but in Italian, German, French and other languages as

well. With the rapid rise of IT and BPO service delivery capacity in Latin America, Nearshoring has become a very viable option, blending the advantage of proximity with the maturity of more established locations. Accenture for instance has set up delivery locations both in Brazil and Argentina. Indian outsourcing giant Tata now has presence in 14 countries in Latin America, with centers in Brazil, Uruguay, Mexico and Chile to serve its clients with local and global IT resources. There were 14 M&A transactions involving Latin American targets in 2010, a substantial increase compared to just three Latin American acquisitions in all of 2009. Private equity firms are also investing aggressively in the region now, with Apax Partners last year agreeing to pay about \$1 billion for Tivit, a Brazilian IT outsourcing company. Many U.S. players, including HP, Accenture and Unisys, are increasing their presence in Brazil in particular, a growing center for BPO and IT services. These players are not only bringing their specialized practices and service delivery maturity to this region, but also acting as a reservoir of talent for other companies to offer more value-added services to their global clients.

INCREASING ADOPTION OF CLOUD BASED BUSINESS SERVICES

Organizations are starting to give cloud computing the respect it deserves. Though we do not expect that cloud will replace

traditional IT anytime soon, we strongly believe that organizations will start deploying cloud as an integral component of their service delivery mix. However, the promise of cloud based business services is like a double edged sword. It can be a ray of sunshine for cash-strapped businesses wishing to scale their infrastructure while reducing capex. Yet, if not done right or for the wrong reasons, this can literally cloud an IT organization's future. Sourcing IT services on a subscription basis requires reliable communication and security infrastructure. As organizations evaluate cloud based solutions, factors such as customer usability, security, uptime, response time (latency) and scalability will become the main determinants for decision making. While most cloud service providers pitch their utopian vision of plug-n-play and homogeneity, each organization will have to look at cloud based solutions contextually and develop an adoption roadmap to suit their technology DNA and business objectives. Nearshoring will play a key role in the growth of Cloud based Business services (or Business Process as a Service). The demand for real time support, low latency and higher security will favor nearshore locations. Locating data centers that house the application and data servers in farshore locations would not satisfy the QoS and Service Level requirements of Cloud users. Many Telecom and Infrastructure providers are already setting up large Data and Cloud computing



centers across the Caribbean, Central and Latin America to serve regional and North American markets. Cloud computing in many ways will change not only the IT operating model, but also significantly impact the service delivery market. Mature providers are already repositioning their services and embedding components of Cloud services within their delivery matrix. Its not a surprise that most of these firms are also expanding their nearshore footprint to offset their farshore "disadvantage".

OFFSHORE FATIGUE, NEARSHORE FASCINATION

Most Sourcing executives who have spent significant amount of time and effort on managing offshore vendors and sourcing programs will admit to offshore fatigue. While the benefits of Offshoring outweigh the costs of higher management

bandwidth required, there is an increasing fascination towards finding a comparable nearshore alternative. Not only is there erosion of offshore savings due to high travel and communication costs, but mature offshore locations are also witnessing rising wages and attrition, resulting in lower cost differential between Offshore and Nearshore providers. The business case for outsourcing closer to shore has never been stronger. Between the emergence of new nearshore service providers and expansion of global players, there is now a much wider array of options. Buyers visiting major nearshore destinations such as Colombia, Costa Rica and Chile have not only been pleasantly surprised by the capabilities available, but also enthralled by the natural beauty of these countries. When 24 hour plane journeys can be substituted by a half a day round of golf, nearshore starts looking a lot more attractive as a complete package. The proximity of a Nearshore location also has the benefit of making vendor management and governance easier. It is simpler to manage providers in similar time zones, reducing governance costs and resulting in better managed engagements. While process rigor and service delivery methods with many nearshore providers may not yet be at the same level as mature offshore providers, that is offset by the ability to manage contracts in a real time mode. Businesses are also expanding into Latin American markets to capture its growing

middle class and this provides another impetus to outsource to the region. Our final section describes this new vector that is going to make Nearshoring even more compelling

THE RISE OF THE MULTILATINAS - WHY ITS NOT JUST ABOUT COSTS ANYMORE

According to a recent study released by Inter-American Development Bank (IDB), the amount of foreign direct investment within Latin America and the growth of middle class has created a new breed of aggressive multinational companies endemic to the region. These are being classified as the "Multilatinas". These companies have borrowed a page from the Multinational companies (MNCs) and leveraged the cultural and historical familiarity within the region to create scalable business models. A combination of economic reform, advances in technology, improved education, comparatively low costs and increased management sophistication is driving these new generation of companies. Though Latin America's total population is just 43 percent of China's (560 million, compared with 1.33 billion), the region's combined Gross Domestic Product (GDP) equals China's (about \$4.2 trillion in 2008). As the American and European economies struggle to get out of recessionary pressures, the burgeoning buying power of Latin America is a counterbalance to the drop in demand in

Western markets. American and global companies are expanding into the region in larger numbers and along with that they are also outsourcing to the region. Multilatinas are embracing outsourcing aggressively and in many cases structuring strategic ventures to capture these opportunities as well. According to the COO of TCS, which has probably the largest footprint in the region, the primary reason for their growing Latin American presence is that many of these Multilatinas are expanding their global presence, resulting in an increase in IT spend. While the IT phenomenon in India that created the \$60 Billion outsourcing industry in the country was largely driven by export markets, in Latin America its the reverse. Most large Latin American outsourcing firms have started with local and regional markets and only started diversifying globally in the last decade. Hence the outsourcing culture in these providers has had to adjust to the demands of Western (North American and European) markets. However Latin American providers bring some unique attributes and expertise that their offshore brethren perhaps cannot mimic. Brazil possesses considerable expertise in the financial services industry and its banking sector is known for the sophistication of its transactional efficiency. The vast majority of bank checks in Brazil are cleared

electronically the same-day, while in the US it takes one week on average and the country also has the world's largest ATM network. This domain expertise is being leveraged by many global banks that outsource their IT to Brazil.

CONCLUSION

A perfect confluence of factors ranging from economic uncertainty to emergence of alternative sourcing models and maturing of new destinations is ushering in a new era of global sourcing. As companies re-prioritize and re-align their operating structures based on this new business reality, the importance of having a balanced sourcing portfolio becomes increasingly important. With the changing dynamics in the sourcing landscape and increasing maturity, the nearshore market will become attractive not just for businesses seeking to outsource, but also for service providers from established destinations seeking to diversify. Nearshoring may not be a complete replacement for offshoring but will become an integral part of the sourcing mix. The business model that carried many companies into the new millennium is obsolete and the only way to navigate the coming decades would be by staying lean, flexible and willing to go where you've never gone before. One of those places may just be Nearshore. **GS**