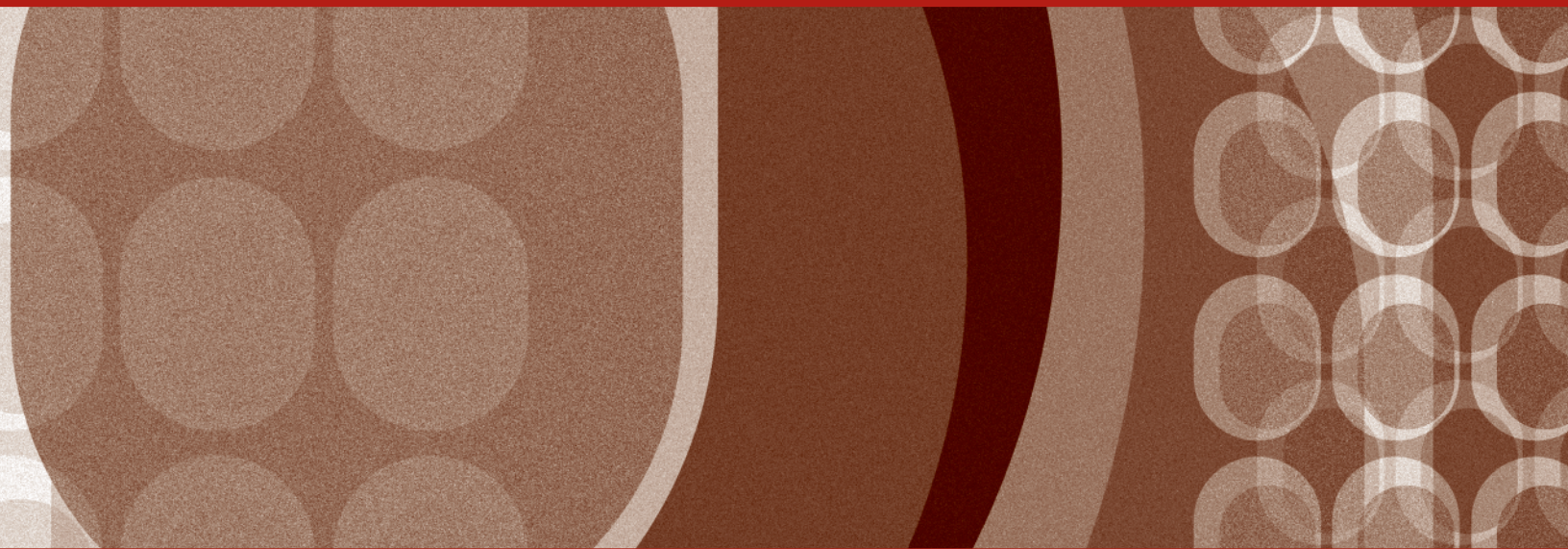


Time Zones Do Matter: Rediscovering the Americas and Nearshore Delivery

by Dana Stiffler



Though India dominates global delivery discussions today, nearshore and even domestic delivery centers are growing rapidly in importance. Numerous nearshore and onshore delivery center options are emerging for the U.S. market as global services players move to a delivery model that gives them locations across all three major time-zone windows: the Americas, EMEA, and Asia. This Report focuses on the current momentum in the Americas.

Acronyms and Initialisms

BPO Business process outsourcing

KPO Knowledge process outsourcing

EMEA Europe, Middle East, and Africa

M&A Merger and acquisition

ERP Enterprise resource planning

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As the outsourced service economy continues to grow, nearshore and even domestic delivery centers will dominate higher value technology and business processes.

The
Bottom
Line

Executive Summary

Though India dominates global delivery discussions today, nearshore and even domestic delivery centers are growing rapidly in importance. Nearshore dramatically reduces the risks associated with offshore. Dispatching and managing tasks in the same time zone is more forgiving for clients with less process maturity or for tasks that require more constant communication. Further benefits are conferred by onshore, i.e., domestic service-center-based delivery. These include cultural affinity, legal and security considerations, and handling of sensitive data.

Nearshore and remote domestic delivery are best suited for serving the broadest possible array of corporate functions. Successful remote management or execution of a process has more to do with process maturity and independence than with core competency. This research outlines three different scenarios that show how most processes are better candidates for nearshore and remote domestic delivery than they are for 100% onsite or 100% offshore.

Combining offshore with nearshore and remote domestic delivery gives service providers the chance to create more value-added services for existing and new clients as well as onboard new clients with less mature processes and/or lower tolerance for risk.

By 2015, India will be just one node in the network from which companies source IT and business skills. Numerous nearshore and onshore delivery center options are emerging for the U.S. market. Global players are moving to a delivery model where they have locations across all three major time-zone families: the Americas, EMEA, and Asia. This Report focuses on the current momentum in the Americas.

Offshore: high hopes, steep learning curves

One inquiry we field several times a month is the disappointment-in-offshoring inquiry. Some clients are so disillusioned that all they want are reports and data to bolster the case for taking everything back onshore and in house. We tell them we don't have what they're looking for because this isn't what's happening in the market, apart from a few heavily publicized cases. Their frustration is palpable.

What we say after that they may like even less: embrace this now because there's no getting around it. More aggressive use of third-party service providers and outright outsourcing of IT and business processes are here to stay, remote delivery included. The market forces driving it are too strong:

- Pressure to move into emerging markets and get new products to market faster
- Relentless M&A and private equity activity
- The continued drive toward standardization and doing more with less

All are combining to turn the classic lowest-cost, core-versus-non-core construct on its head. The numbers show there simply aren't enough skilled people to do what needs to be done: since 2005, AMR Research's quantitative surveys have shown skills access trumping cost as the reason for looking to third-party service providers.

Nearshore delivers

Nearshore delivery goes a long way toward addressing the difficulties clients, and service providers themselves, face with projects delivered from India and China. On the client side, a combination of process immaturity, unreasonable expectations, and lack of executive commitment all contribute to subpar performance. On the vendor side, the culprits are weak migration and change management methodologies, attrition, and shaky project- and service-level management.

For the emerging high-value process outsourcing, or what many have tagged knowledge process outsourcing (KPO), nearshore and onshore delivery provide great counterbalances to high employee turnover in Asia. Much of the attrition problem in India, especially in higher value operations, can be attributed to professionals having to work the night shift. Business analysts don't want to work on remote campuses in the middle of the night, and with the Indian labor market as dynamic as it is, they don't have to. See "Future Value Networks: You're Going To Outsource What?" to explore managed services beyond the back office.

Nearshore dramatically reduces the risks associated with offshore outlined above. Dispatching and managing tasks in the same time zone is more forgiving for clients with less process maturity or for tasks that require more constant communication. Further benefits are conferred by onshore delivery, including cultural affinity, legal and security considerations, and handling of sensitive data.

In addition, there is some India and China fatigue, even in the global companies and service providers that continue to invest substantially in both countries for the long haul. They are seeking some relief from the attrition and wage increases that have become the norm. Geopolitical and operational risk diversification is also key.

Nearshore versus offshore determinants and scenarios

Figure 1 shows in simple terms that nearshore and remote domestic delivery are best suited for serving the broadest possible array of corporate functions. The two main dynamics we've used to frame the debate are process value/sensitivity and process independence.

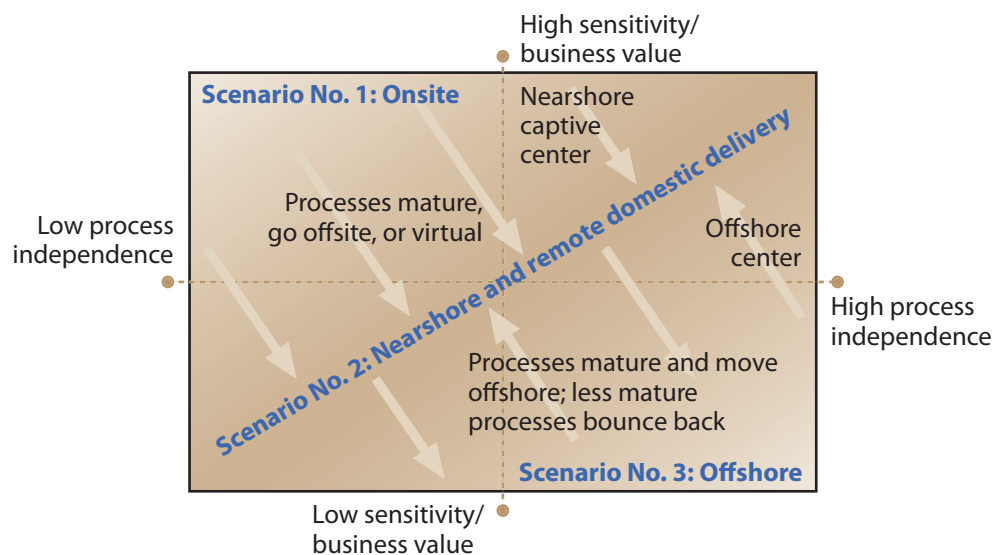
- **Process value**—This is the measure of a process's contribution to a company's competitive position in the marketplace and shareholder value it creates or potentially destroys. It's the traditional core versus non-core assessment companies have used to decide where a process should be supported, and by whom.
- **Process independence**—This is the measure of whether a process is well understood, documented, and performed in a standardized fashion. Very mature processes tend to be automated. Just as important is whether the process can stand on its own or be carved out; processes that have lots of compliance and approval gateways are difficult to separate.

Process independence is almost always undervalued during assessment exercises. Successful remote management or execution of a process has more to do with process maturity and detachability than with core competency. Three different scenarios show how the majority of processes are better candidates for nearshore and remote domestic delivery than they are for 100% onsite or 100% offshore.

- **Scenario No. 1: Onsite**—Processes with very high value and very low independence are most often effectively conducted onsite. If there is slightly less perceived value or a little more process independence, it can be conducted onshore, but from a remote location. The onsite-only requirement is quickly shrinking in developed economies as more workforces go virtual and become accustomed to conducting even complex and sensitive communications and transactions via telephone, web, and distributed applications.

- **Scenario No. 2: Remote domestic delivery and nearshore**—Whether we’re talking about high-value, high-independence processes or low-value, low-independence processes, this is the grey area where most companies will feel the skills sting and service providers will see the opportunity. Most processes fall into this area, as do most companies’ process maturity and service provider management abilities. Furthermore, for any more iterative high-value outsourcing, more mature, accomplished individuals will be needed to support processes. Nearshore and onshore delivery clearly have the edge over offshore in these situations
- **Scenario No. 3: Offshore**—High-independence, medium-to-lower-value processes are natural candidates for offshore. They’re standardized and automated. This category will expand as Scenario No. 2 processes mature and distance and time zones cease to matter. It’s already happening with big pharma and the outsourcing of many precommercialization activities to India-based firms **Cognizant**, **Tata Consultancy Services (TCS)**, and **Wipro**. In some cases, offshore activities will bounce back as companies or service providers try to take processes offshore before they are ready.

Figure 1: How process value and independence determine global sourcing options



Source: AMR Research, 2007

The recent surge in interest in nearshore and domestic delivery options as a complement or alternative to offshore is also aided by the current foreign exchange situation. In the past year, as the rupee has strengthened against an already weak U.S. dollar (see Figure 2), the cost savings associated with offshoring to India is being chipped away, especially when balanced with the overhead and oversight burden.

Latin American currencies gained little against the dollar or not at all over the same time period, making these markets even more attractive from a global delivery perspective. In addition, as growth slows and demographics shift in North America and Western Europe, Latin America looks attractive across the board: as a global delivery destination, as a node in global supply chains, and as a promising set of industrial and retail market opportunities.

Figure 2: INR appreciating against USD from 2006 to 2007



Source: Yahoo! Finance, 2007

The tougher challenge is shifting from onsite to remote service, not insourced to outsourced

Note that we haven't used the terms *insource* or *outsource* much in this Report. That's because, by all accounts, a process shift from physical co-location to remote operation is a tougher adjustment than a process shift from insourced to outsourced, which requires rebadging employees and transferring assets. Ownership or employment that corresponds to "core" corporate focus will be less and less a determinant. The pull for skillsets and capabilities will pull third parties in from all directions, whether the process is captive or outsourced, high-value add or transactional.

We did use the word *captive* in Figure 1, acknowledging that for the highest-value, riskiest, or competitively differentiating processes, clients will tend to want ownership and direct control, even if the process can be physically separated with relative ease. A well-publicized example is **JPMorgan Chase's** offshoring of risk analytics to a captive center in Mumbai.

Latin America emerges as preferred nearshore location

For the largest service providers targeting the U.S. market, expansion into Latin America is already underway, with the most popular destinations being Brazil and, most recently, Mexico. We've also seen strong regional players emerge out of Latin America that intend to compete with U.S. and Indian firms on a global basis. **Neoris**, the IT services subsidiary of Mexican manufacturing giant **Cemex**, is taking its industry-specific story to U.S.- and Europe-based clients, while competitor **Softtek** just successfully closed its acquisition of Chinese service provider **IT United**.

As for the traditional global services players, U.S. service providers (**EDS** and **IBM**, for example) had already worked in the past to establish centers in Latin America, but these supported local operations for large global customers, not nearshore services. Today these centers are handling a mix of local and export services operations. New service centers have sprung up as well, with big investments coming from US and India-based firms. Brazil, Mexico, and the Cono Sur countries (Southern Cone, which consists of Argentina, Chile, and Uruguay) are the primary recipients (see Figures 3a and 3b):

- **Brazil**—With São Paulo as the epicenter, service providers are pouring into Brazil, with an eye on its potential as an emerging market as much as its potential strength as a nearshore location. Mexico-based Softtek has centers in São Paulo and Porto Alegre. **CSC** is in São Paulo, Accenture in São Paulo and Curitiba, TCS in Brasília, Wipro in Curitiba, and IBM in Hortolândia. **Satyam** also recently opened a center in São Paulo.
- **Mexico**—2007 has been a big year for delivery-center investment in Mexico. TCS and **Infosys** recently announced centers in Guadalajara and Monterrey, respectively. **GE** spinoff **Genpact** already runs centers out of Juárez and Caborca. It recently relaunched the Juárez location at its Latin American headquarters. Regional veterans Neoris and Softtek both have significant operations in Monterrey; Softtek is actually headquartered there. Softtek also runs centers in Mexico City, Aguascalientes, and Ensenada.
- **Argentina, Chile, and Uruguay**—The Cono Sur region of South America is getting its fair share of investment too, with an emphasis on business support services as much as IT. TCS's Uruguay operation in Montevideo was the first meaningful investment by India, Inc. in the region back in 2002. The company also has a large BPO center in Santiago, Chile. In Argentina, Neoris opened a center in 2007 in Rosario, and **EDS** expanded its operations in Córdoba.

In Central America we are also seeing some BPO activity, notably **HP's** and **Fujitsu Consulting's** call centers in San Jose, Costa Rica.

Figure 3a: Selected delivery centers in Mexico and Central America



Source: AMR Research, 2007

Figure 3b: Selected delivery centers in South America



* Launched 2002, first CMM-level V center in Latin America

Source: AMR Research, 2007

Service providers rediscover America

Just as striking as the amount of activity in Latin America in recent months is the rediscovery of the United States as a potential delivery location (see Figure 3c). Canada continues to be a strong remote delivery location, but the activity has quieted down recently, since much of the exchange rate advantage has evaporated.

On the U.S. front, there are two main veins of activity. The first is the opening or expansion of remote consulting and software service centers by traditional IT services firms like Accenture (San Antonio, Texas), **Capgemini** (Junction City, Kansas), and EDS (Tulsa, Oklahoma). **BearingPoint** had earlier opened a center in Hattiesburg, Mississippi, and **Deloitte**, although it sold off its Tulsa-based BPO business to **Convergys** a couple of years back, still maintains an ERP services capability there as well as delivery centers in Harrisburg, PA, and Crystal City, VA.

Figure 3c: Selected delivery centers and partnerships in the United States and Canada



Infosys has plans for a center in Atlanta, GA and/or Austin, TX

*Umatilla Reservation, a partnership with Cayuse IT

**Tata Consultancy Services is currently exploring Raleigh, NC, Austin, TX, and Richmond, VA and has plans for a center in Atlanta, GA

Source: AMR Research, 2007

Of course, traditional outsourcing giants like CSC, EDS, HP, and IBM already have numerous centers in the United States, but these have been dominated by infrastructure services, while application projects, maintenance, and business support were provided onsite. All of these players are now shifting their delivery models to focus more on off-site consulting and applications services.

The second trend is the entrance of Indian service providers into the mix. These companies had already either built up or purchased consulting practices in selected domains, but as a group had not aggressively invested in North American remote delivery of infrastructure, software services, or BPO. This is changing rapidly as India, Inc. arrives in the heartland.

TCS's center in Atlanta will open soon and the company is also exploring Raleigh, North Carolina, Austin, Texas, and Richmond, Virginia as potential future sites. It already has centers in Windsor, Ontario, Reno, Ohio, and Milton, Florida. Wipro just acquired New Jersey-based **Infocrossing**, giving it five U.S. data center locations (in Arizona, California, Georgia, Nebraska, and New Jersey) and a public sector healthcare solutions business to boot. Infosys is looking at Atlanta and Austin.

Cognizant, Genpact, **Patni**, and Satyam already have one or several existing U.S. delivery locations (as highlighted in Figure 3c).

Findings and recommendations

Delivery of business and IT services from Latin America and the United States will not supplant what's now being done in India or China. It simply enlarges the potential pool of processes and technologies that can be addressed. Taken on its own, as Figure 1 showed, the opportunity for remote offshore is relatively small and subject to commoditization over time. Combining offshore with nearshore and remote domestic delivery gives service providers the chance to create more value-added services for existing and new clients, as well as onboard new clients with less mature processes and/or lower tolerance for risk.

For buyers

Circling back to the disgruntled offshoring and outsourcing customers looking for data on taking everything back in house, it's plain to see that business and demographic trends don't support this approach. Furthermore, remote delivery in your own hemisphere confers many offshore advantages in easier-to-swallow bites that should make it easier to be successful. Here are some observations:

- **See the big picture.** Ideally, global delivery strategy should take into account where you, your partners, and your customers source, manufacture, or go to market. Is Latin America a big part—or a future big part—of your emerging market strategy? If so, then dovetail nearshore strategy with your overall business direction.
- **Nearshore is not *Offshore for Dummies*.** Nearshore is not an excuse to slack off on building up more sophisticated remote global delivery capabilities. It's about being able to support a wider variety of processes, risk appetites, and readiness. There will also be a learning curve with remote domestic delivery, with the strain coming from running a process offsite.
- **Service industries and select manufacturing sectors should continue to beef up their offshore operations.** Where industrial-strength application development and maintenance at scale is required, Asia will continue to provide the best long-term bang for the buck. Especially in industries where a technology-enabled service is the product—financial services, telecommunications, electronic media—services companies will need to master all flavors of global delivery to remain competitive, as will manufacturers with lots of embedded technology in their products.

For service providers

In this research targeting the Americas, the leader in the move to expand is not a regional Latin American firm or a U.S. headquartered multinational. It's Mumbai-based TCS, which, in addition to its nearshore and North American operations outlined above, also has centers serving local clients in Brazil and Ecuador. TCS realized early on that if it wanted to grow and serve clients globally, it would need to diversify its delivery networks—that is, move beyond the U.S./India axis. Service providers that complement offshore delivery with nearshore as well as domestic presence have more attractive operational and risk profiles than those that don't.

Here are our recommendations for service providers looking to build up nearshore and remote delivery capabilities:

- **Nearshore is not a pit stop on the race to offshore.** Nearshore should not be viewed as simply a staging ground for the eventual migration of all processes to an offshore model. For some processes this will be the case—pure IT at scale, for example, or monitoring. But thinking about nearshore this way limits its potential. For service providers to be successful, there needs to be a standalone business case for these operations.
- **Putting all eggs in the India basket is risky.** For service providers whose only delivery location is India, it's imperative that they open robust delivery centers in or nearer to their primary export markets as well. Secondary and tertiary Indian cities are good too, but they don't get at the nearshore opportunity or the issues of economic and geopolitical risk.
- **Broader employee profiles lead to broader opportunities.** The most innovative services that emerge will require business and analysis input as well as IT skills. Hire entrepreneurs and MBAs as well as engineers.

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