



Nearshoring: Outsourcing to India without the Pain

In recent years, three offshoring models have emerged – outsourcing to distant locations, homeshoring (that is, keeping the work at home) and nearshoring (a compromise solution) – with the later model increasingly offering a more competitive and attractive alternative to the other two offshoring models.

1. The Rise of Nearshoring

[Nearshoring](#) is simply “outsourcing” or offshoring to an offshore location that is much closer to home. In other words, rather than a USA based company outsourcing work to a provider or shared services operation located in India or the Philippines, nearshoring would be the same company outsourcing the work to a provider or shared services operation located somewhere in Latin America or Canada.

In recent years, companies have learned the hard way that outsourcing to a distant location on the other side of the globe has many pitfalls while homeshoring often fails to generate significant or meaningful cost savings. Hence, the lessons learned from the mistakes made from outsourcing and homeshoring have increasingly made the case for nearshoring.

In fact and as early as 2005, IT Today had an article arguing that nearshoring was the [smart alternative to offshoring](#) far offshore while both [Computer Weekly](#) and [CIO Magazine](#) had articles making the case for looking closer to home. Moreover, Forbes even had an article back in 2008 that went so far as to predict [the death of Indian outsourcing](#) largely due to the nearshoring and homeshoring trends. Meanwhile, Industry Week also noted a related trend as early as 2006 where some manufacturers were also discovering benefits of [keeping production closer to home](#) (or even at home for that matter).

2. The Benefits of Proximity

The key benefits provided by nearshoring are all related to the proximity of the nearshore destination to the home country and these potential benefits may include:

2.1. Cultural

Proximity inevitably brings cultural and linguistic similarities. The USA for example, has a huge Spanish speaking community and many Latin Americans have relatives in the USA. Hence, it makes sense to nearshore work, especially contact center work for the Spanish speaking community, to a location south of the border.

2.2. Historical

Cultural and linguistic similarities are often the result of historical ties. Confucian Japan and Korea have had close historical ties to China for thousands of years while the USA and Mexico have ties that date back hundreds of years.

2.3. Economic

Proximity and historical ties also lead to close economic ties. The rise of free trade agreements such as NAFTA, which was originally created to benefit the agricultural and manufacturing sectors, inevitably bring the same benefits to companies who decide to nearshore a portion of their work to countries covered by such agreements. Furthermore, nearshoring inevitably leads to an indirect increase in trade and business in general between the source and destination countries; thus, a win-win situation for all.

2.4. Political

Close economic ties may also be followed by close political ties. The European Union (EU) is both an economic and a political union and hence, companies in Western European countries who nearshore to locations in Central or Eastern Europe will find familiar regulatory regimes along with friendly political environments in which to operate in. Moreover, both the EU and NAFTA offer flexible visa and other arrangements for professionals from member countries to move across borders for long periods of time. Furthermore, with intellectual property (IP) protection increasingly a critical concern, nearshoring to an EU or NAFTA member country is generally less risky as these countries have strong IP protection measures in place and these measures are generally enforced.

2.5. Geographic

Proximity will likely mean being only a few time zones away. Hence, this will make the critical interaction necessary between all the parties involved all the more easier. In other words, no 3 am meeting.

2.6. Cost

Furthermore, less distance means that face to face interaction is less expensive and time consuming as time is not wasted traveling from the home country to the offshore location. This inevitably leads to more face to face interaction between all critical parties necessary to make an outsourcing arrangement viable. Likewise, the inevitably additional costs (sometimes, as in the case of the Philippines, mandated by law) associated with hiring workers to work night shifts or odd hours is largely eliminated.

2.7. Risk

Finally, the further the distance and the more “out of site” the offshore location is, the more risks there are. Furthermore, the risk of failure may not just come in the form IP protection issues or country political risks but also in the form of cultural misunderstandings and language barriers.

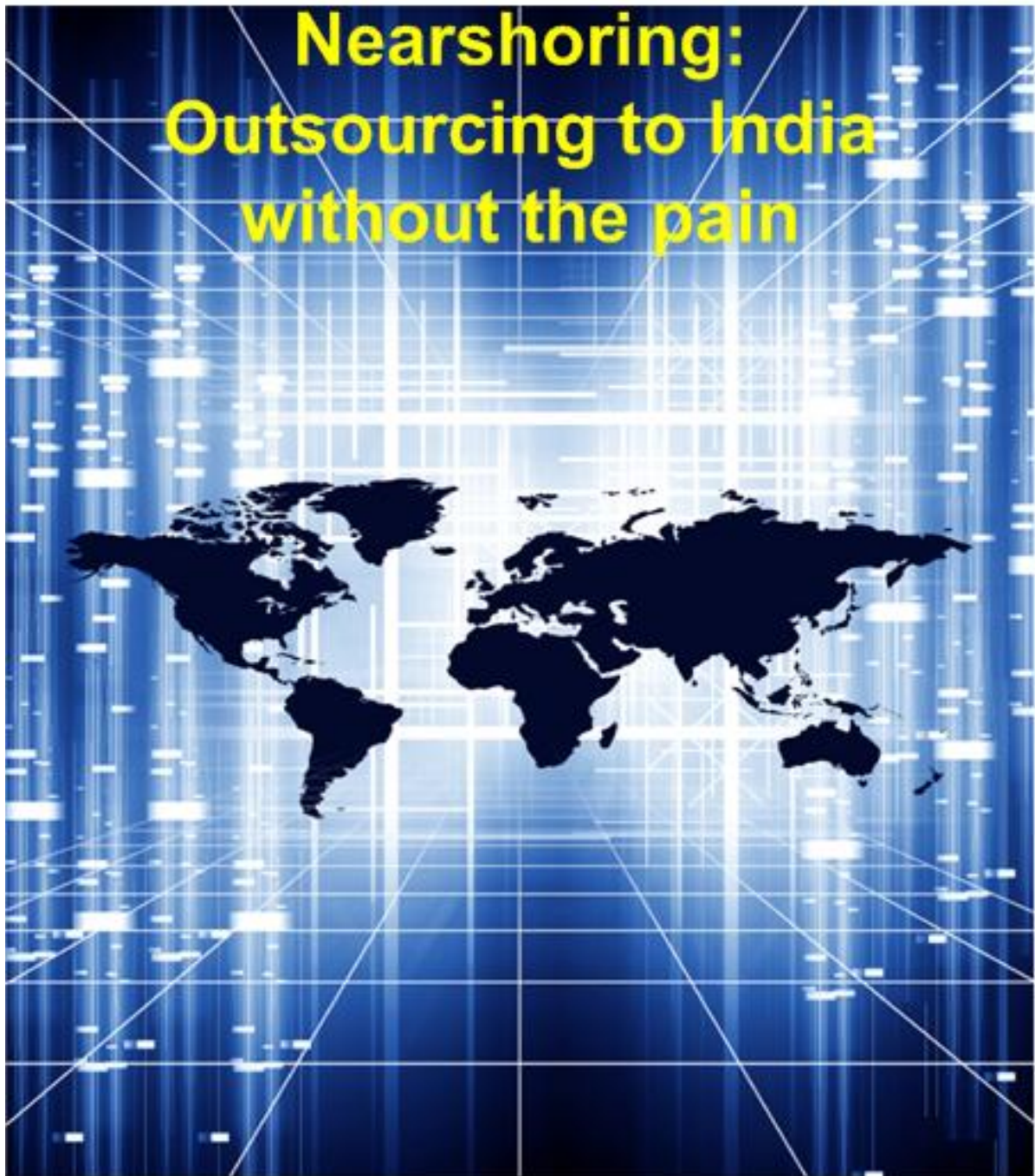
Hence, given all of the above potential benefits to a nearshore location, nearshoring has often been described as “outsourcing to India without the pain.”

3. Key Nearshoring Hubs

In recent years, three major nearshoring hubs have emerged to challenge the traditional offshore outsourcing destinations such as India and the Philippines for business from key markets. These hubs include:

- The USA market to Canada and Latin America
- The Western Europe market to Central and Eastern Europe
- The Japanese and Korean markets to China

Each of the above nearshore destination hubs have their own unique set of advantages to effectively compete with traditional outsourcing destinations.



3.1. The USA to Canada and Latin America

Latin America and Mexico in particular to the south and even Canada to the north are natural nearshoring destinations for companies based in the USA. In addition to the obvious time zone advantages, Latin American currencies are more closely tied to the US dollar and hence, tend to have less dramatic fluctuations, which can significantly raise outsourcing costs. Also, there is a huge pool of untapped labor and many professionals in the region are bilingual and can easily adjust to working in a North American type of business environment. In addition, a [2008 Industry Week article](#) noted that Latin American countries tend to have a high level of technological sophistication while another 2008 VatorNews article pointed out that the open source revolution that has taken hold in Latin America is fast turning the region into a software engineering powerhouse. Furthermore, a recent [Cap Gemini nearshoring whitepaper](#) cited the fact that six of the 55 most competitive countries according to the [2008 World Competitiveness Yearbook from IMD](#) in Switzerland are Latin American countries.

Of all the potential nearshoring destinations in Latin America, Mexico in particular is well positioned as a nearshoring hub for the USA. In fact, the [National Chamber of Electronics, Telecommunications and Information Technologies \(CANIETI\)](#), the industry association for IT companies in Mexico, has set up [MexicoIT](#) – a website initiative to aggressively market the country as an outsourcing destination of choice. And with [around 400,000 students](#) studying IT-related subjects and roughly 60,000 of these students graduating annually, Mexico has a substantial and attractive labor pool to draw from. Furthermore, the Christian Science Monitor [recently pointed out](#) that rising costs in China has also made Mexico a more attractive location for nearshoring manufacturing operations in the same manner that rising costs in India has made the country more competitive for offshoring other services to.

Meanwhile, Canada to the north has quietly positioned itself as a nearshore destination for the USA IT market in particular. In a [whitepaper by Nearshoring.ca](#), it was noted that Canada spends 8.4% of its GDP on education (while India spends just 2.8%) and the curriculum is the same as that taught in the USA. Furthermore, it was noted that government and legal frameworks in Canada function on a common and transparent standard while accounting standards are the same, infrastructure is excellent and labor costs in many locations across the country tends to be lower than in the USA.

3.2. Western to Central or Eastern Europe

In the same manner that Latin America and Canada have emerged as nearshoring destinations for the USA, Central and Eastern Europe have emerged as highly competitive offshoring destinations for Western Europe. In fact, the Economist noted the trend in an [extensive article](#) back in 2005 while the [McKinsey Quarterly](#) noted back in 2006 that less than 1% of the world's US\$30 billion market for offshore IT and business process outsourcing (BPO) went to Eastern Europe and that the region has many “undiscovered” locations for offshoring. Meanwhile, [Computer Weekly](#) noted that the creative thinking and linguistic abilities of the local population along with the fact that visiting managers can “drink the water” and “don't need injections” prior to a visit gives the region an advantage over more distant locations like India. On a similar note, a comprehensive [Deutsche Bank Research](#) whitepaper also toted the diverse language skills found

throughout the region (which is extremely beneficial for companies located in non-English speaking Western European countries) and noted the region's particular strength in performing complex back-office processes.

In fact, it is Central and Eastern Europe's diversity in general, whether it's in language capabilities or in niche skill sets or the ability to perform highly complex tasks that gives the region a tremendous advantage over more distant offshoring locales. For example:

[The Banker](#) notes that Russia, with its strong scientific education system, is a particularly attractive location when a financial services type of organization needs a small team of highly qualified individuals to carry out a complex technology project at a lower cost.

On a similar note, a comprehensive article by [Wall Street & Technology](#) noted in a [sidebar](#) that quant programming work is increasing going to Russia and the Ukraine while the concentration of PhDs and economist types in Hungary and Romania make these countries popular destinations for analytics and modeling type work.

Furthermore, according to the [Economist](#), Romania (which like Russia also has a long tradition of scientific education) has more engineers per capita than India, the USA or Russia – a fact that has been noticed by Indian outsourcers Genpact and Wipro.

Meanwhile, Silicon.com has observed the general trend of [Indian IT firms setting up nearshoring bases](#) in Central and Eastern Europe with Hungary and the Czech Republic being favored destinations.

Nevertheless, the [Times Online](#) quoted the head of outsourcing at Accenture back in 2007 as saying that although companies were turning to Central and Eastern Europe for work that requires extensive collaboration between suppliers and customers, the bulk of offshore IT work from Europe was still being sent to India.

3.2. Japan and Korea to China

Meanwhile in the Far East, China is increasingly emerging as a potential outsourcing powerhouse and the nearshoring destination of choice for the region and for Japan and Korea in particular. In fact, the [McKinsey Quarterly](#) noted that China has two million Korean and Japanese speakers and this was predicted to help sustain and increase its lead as a nearshore destination for IT application development and BPO type work. Moreover, the [Economist Intelligence Unit \(EIU\)](#) noted that the common Confucian culture shared by both China and Japan means that the Japanese find it easier to work with their Chinese counterparts than they do with Indians. Hence, nearly half of China's total exports of IT services already go to Japan.

Nevertheless, the [Economist](#) has pointed out that Japanese companies are increasingly seeking to diversify away from China where they have already set up extensive manufacturing operations while it is also Japanese government policy to promote India as the economic and political counterweight to China. Hence, out of all three major nearshoring hubs, China's potential may be the one most weighted down by political and other risk considerations.

4. Conclusions

In many instances, nearshoring is increasingly becoming a much more potentially beneficial alternative to offshoring to distant and more traditional offshore destinations such as India. In other words, nearshoring is fast living up to its motto of “outsourcing to India without the pain.”

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