

NEARSHORING

The New IT Services Frontier

Lessons Learned from Successful Nearshoring Projects

Executive Summary:

There is a common belief that businesses are better off if they turn over all of their non-core competency work to third parties. This idea has driven to the growth of the multi-billion dollar information technology outsourcing business. However, an alarming number of failed attempts at a “one size fits all” approach have shaken corporate faith in the traditional outsourcing model.

A new trend has returned control of core processes to IT leadership. This has resulted in the abolishment of the monolithic, one-vendor fits all outsourcing model of the 90’s and has contributed to the emergence of a multi-sourcing strategy where the enterprise contracts with multiple outsourcing vendors for their respective expertise in a given space.

Organizations have also realized that there is value in keeping the outsourced work close to where the business generally is. This has led to revisiting the typical Indian outsourcing model with offerings that are “close to home”. This close proximity, called “nearshoring,” has opened the door to providers that offer a combination of geographic and time zone closeness and improved cultural affinity, at an overall effective cost proposition.

Nearshoring is becoming a key component of the multi-sourcing model allowing businesses to take advantage of the benefits of a true global delivery model.

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For the last few years the common understanding in the marketplace has been that businesses are better off if they turn all of the internal work that is not directly related to running the business, over to a third party. This trend drove the growth of the information technology outsourcing business and has been the engine behind multibillion dollar contracts awarded to huge vendors.

The concept of outsourcing was perceived as a solution to dealing with ingrained process and technology issues where vendors came in as the ones who would take over the non-performing pieces of IT and run them more effectively for a fee. Over the years, the concept of “your mess for less” proved not being a panacea. The issues that plagued the IT organization for years became more complex and risky when taken over by a third party. Well negotiated deals at a 25/30% discount of internal cost ended up not being such good deals, due to additional cost invoiced outside of the original contractual agreement. Unexpected situations drove additional cost; many of them coming from geographies, time zones and cultural issues.

A few years later, a new class of providers emerged from the Far East. This new trend was primarily fueled by the race to comply with Y2K adjustments, and drove the emergence of software development and application maintenance companies. These new companies, based primarily in India, offered a similar business proposition to large enterprises: we will take over your software development nightmares for a fraction of the cost you are paying today internally or to your current outsourcer. The Indian phenomenon became commonplace and allowed a new industry segment to emerge. In the end, this was no more than the original outsourcing promise but delivered thousands of miles away potentially at a fraction of the cost.

However, new challenges appeared as a result of structuring support services from a remote location and various time zones away. While Indian providers were cost effective once the production line was in motion, the difficulties emerged when trying to deal with the well known ambiguity of software development. On line interactions became almost impossible while culture and in some cases language barriers significantly impacted productivity. The promise of 1/3 cost reduction overall never materialized due to significant hidden nuances associated with dealing with the complexities mentioned above.

With enough failed attempts to resolve issues in a single “one model fits all” strategy, the industry has now realized that it is unrealistic to think that one can hand over all of one’s challenges to a third party, and expect that automatically all of the problems will go away. In fact, the experiences mentioned above serves as proof that not only issues do not go away, but new challenges are incubated as part of the new delivery mechanism.

As such, the last 18 to 24 months have brought a new and refreshing trend in the marketplace by which IT leadership has realized that they have to take ownership of the delivery process and contract out those pieces that lend themselves better to third party services while retaining control of the strategy and overall execution plan. This trend is today accepted and recognized in the marketplace as multi-sourcing, depicting the model in which an enterprise contracts with a collection of third parties that provide the best service in each given space. As such, in 2005, 84%ⁱ of all major outsourcing contracts where under the multi-sourcing model, while several multibillion dollar agreements closed in the earlier part of the new millennium were cancelled or renegotiated under the multi-sourcing model.

As a result, specialized outsourcers in spaces such as infrastructure, telecommunications, business process, call center and software development and maintenance, were now given the opportunity to bid for portions of the business. Furthermore, the monolithic outsourcers were required to reinvent themselves to be able to fit within the new model. This trend helped bring a new approach to structuring the delivery of services, especially those related to software development and support. Large organizations realized the value of establishing the development and support capabilities close to where their business centers were, creating a network of suppliers in different geographies and with different technical expertise, supporting the needs of the business in different locations and groups. This approach, now widely known as the global delivery model, opened the door to the emergence of providers in different geographies competing with the established offshore Indian and traditional onshore providers. Providers in Latin America and Eastern Europe proved to be as well trained and cost effective as the Indian, Filipino and Chinese providers but offered a closer to home delivery mechanism that bridged the issues identified earlier.

In this new world in which the CIO has regained the responsibility to manage the sourcing strategy within the enterprise, and has already experienced the risks and rewards of both single stop outsourcing and the promised land solution of India, a new set of nearshore providers are offering an attractive alternative to assist with software development and maintenance when while keeping the business close to home.

Nearshoring

Information technology services provided from locations in Latin America and Eastern Europe are generally known as nearshoring services. A number of providers built software development, maintenance and support capabilities from these locations. Neoris has been a pioneer in the field and one of the few to offer comprehensive services seamlessly across different locations in Latin America and Eastern Europe.

Although it is difficult to argue against the massive availability of talent at low labor costs in India and other locations in the Far East, there are a number of reasons that make nearshoring a more attractive alternative for many large organizations:

Time Zone

Nearshoring offers the alternative of having the developer, support organization and user community working in the same time zone or close. Good examples are traditional nearshore locations such as Mexico (central time), Argentina (one/two hours ahead of eastern time) and Hungary and Poland (one hour ahead of GMT). This is a critical element in most engagements and could be a defining component in those cases where online interaction is a must. This interaction is helpful where there is a challenge in defining scope of the development or eventually of the required support. The more ambiguous the definition, the more valuable the time zone proximity is. Nobody needs to wake up early or stay awake at night to complete the task. When working in early morning or late night is an exception, there is no major disruption. However, when it becomes the norm, it has a significant impact in overall productivity in both ends.

Geographic Proximity

Further to the mentioned benefit of time zones helping online interaction, there is an added benefit in geographic proximity. If we agree that tasks cannot just be handed over to an entity several thousands of miles away and expect world class delivery, then we also have to recognize the need for periodic face to face interaction. This is true at the Project Manager level as it is at the power user level.

Taking an hour and thirty-minute flight from Dallas to Monterey to attend a project review session is very different from taking a 40-hour trip across the globe and fighting jet lag in the process. Costs are not the same either.

Immigration Advantages

When nearshoring is performed from Mexico for the benefit of a US based organization, there is an additional advantage that needs to be considered. As a result of the North American Free Trade Agreement between Canada, Mexico and the US (NAFTA), there are special VISA benefits granted to individuals from the NAFTA countries entering the US. Flexible work VISA arrangements allow for Mexican professionals to travel to the US to work for extended periods of time.

For projects that require a mix of onshore, nearshore combination and rotational assignments for individuals in the nearshore platform, the immigration advantages built into the NAFTA agreement are critical.

Intellectual Property Protection

In addition to the mentioned advantages of immigration rules, NAFTA also provides for increased protection of intellectual property rights. This is a critical component when sensitive proprietary information needs to cross borders as a result of the nearshore engagement.

Cultural Affinity

Although one could think that a country that speaks the same language has more affinity than one that does not, you need to consider that there is more to affinity than language. When a country shares an extensive border with another and has a common history spanning more than 300 years, like the US and Mexico, there are culture affinities that are strong.

When it comes to building the necessary empathy to collaborate in a complex project, this affinity plays a critical role.

Cost Advantage

Finally, everything ends up being a cost equation. Proximity leads to more interaction at a lower cost allowing for Project Management to be more present in the project, thus cultural affinity reduces the need to spend many cycles to reach a conclusion. Time Zone proximity eliminates the need to work extra hours. As a result of all this, the apparent hourly rate differential between nearshore service and traditional Far East based service is eliminated and true cost converges.

This is the ultimate compelling reason to move forward with the nearshore model. Only those organizations that have experienced traditional Far East-based outsourcing know the impact of some of the issues outlined above. In fact, it is actual veterans of these wars that coined the concept of nearshoring being “India without the pain”.

Successful Nearshoring Strategy – Lessons Learned

The above drivers of the nearshore promise are real and should be grant enough ammunition to consider it a valuable proposition. However, whatever program you decide to implement as part of your global delivery model, there are a number of items that you need to make sure that are addressed in a coherent manner to secure a successful return on the program.

From our extensive experience in helping large North American and European organizations adopt nearshoring programs, we have learned that the following areas require attention from decision makers and participants:

Productivity Improvement

Although labor cost reduction is at the heart of most of the nearshore initiatives, there is no doubt that the program will rapidly run out of steam if it is not well rooted in productivity improvement actions. Organizations should embark in a nearshoring program when they are capable of identifying sustainable enhancements in the way the tasks are being performed. If everything you are going to get is the same service at a lower cost throughout the life of the contract, you will certainly realize some savings but with no productivity improvements over time there is no real progress and your competitiveness will be severely hurt.

On the other hand, if your nearshore provider has a hard time segmenting the work and applying a production line scheme, you have gained very little by outsourcing. If work is performed by dedicated individuals in silos, it is no more than staff augmentation across country borders. There are some benefits behind this model, especially the fact that dedicated individuals develop unique expertise on your systems over time, thus reducing errors and rework. However, it is difficult to keep the same individual working on the same task for 3 to 5 years. If agreed to, at least you have to recognize the seniority and in most cases this would trigger salary increases. Salary increases lead to rate hikes and in the end very little productivity improvement.

As a starter you would expect your nearshore provider to be able to segment and structure the work so as to take advantage of standardized production lines with measurable productivity. Normalization allows for continuous improvement through the application of defacto industry standards such as CMMIⁱⁱ. Standards have imbedded the models required for continuous improvement. You can expect that over time the same work will be performed with less effort, eventually in less time and with fewer errors. This is the promise behind rigid models such as CMMI.

However, this is not enough. You should plan up front for a process of discovery, piloting an implementation of improvement initiatives that allow for step-sized enhancements in the way the work is done overtime. This is an area where your best technical talent should focus and work closely with the key subject matter experts within the outsourcer.

You need to make sure this approach is adequately built into the contract and monitor its execution throughout. This is a key item that people have struggled with, including in the legacy outsourcing and offshoring contracts. Two or three years into the contract, the lack of clear, identifiable productivity improvements was one of the key drivers for people to cancel the contracts and question the validity of the model.

Plan before you move

Although the concept of outsourcing software development or support seems to be pretty straight forward, lack of a well thought-out plan is in many cases the reason for failure. Adequate planning starts with a well defined strategy. You should review the proposed nearshoring program in light of the overall IT and sourcing strategy of the company. You may need to embark in a detailed review of the current strategic definition and make sure that there is no inconsistency with the plan.

One key item in this process is reviewing the overall company strategy to confirm that the program that you are planning to deploy is in no way inconsistent with the definitions of the strategy. Furthermore, in many cases, anticipated moves regarding geographies, acquisitions, or business divestitures could be in conflict with the program you are trying to implement. You do not want to sign a 5-year contract with a provider in Mexico while your company is performing due diligence on an acquisition that owns captive software development assets in the country. To avoid this trap the recommended approach is to make sure you involve the appropriate participants from the executive team at the time of defining the key concepts of the program. By doing that you will not only confirm that the initiative is well rooted within company strategy but you will also secure valuable support for the program upfront.

Strategizing is only the first step in planning. Once the strategic foundation is secured, it is time to put detail behind each step that needs to take place from now until the contract is actually complete 3 to 5 years down the road. Make sure you map every activity that needs to take place: definition of scope, detailed inventory of components, current cost, risk strategy, project management, contracting approach, transition in, deployment, measurements, improvement plan, vendor relationship, conflict negotiation, transition out, and so on.

The industry has improved considerably in the understanding and managing of some of the aspects mentioned above. In the last few years a cadre of outsourcing advisory firms has emerged as valid providers of support in the process of deploying an outsourcing program. For complex multiyear contracts, we encourage you to consider the support of leading firms. A word of advice: make sure the firm you choose to work with does not have ties with vendors and does not provide any outsourcing services themselves. Independent, vendor agnostic view is critical to secure solid, trusted advice.

Build a true TCO analysis

A common mistake is to have a narrow view of cost for the nearshore initiative. You have a good understanding of the cost of the new service as specified in the vendor's proposal. You also have a good understanding of the cost of the service you are replacing. It can be performed by a third party or it could be the internal cost of staff that needs to be displaced. These are costs that you are generally familiar with. However, there are a number of other costs that are not so transparent that need to be considered before moving forward with the plan.

You should review the communication services cost determining how the new service will impact your current infrastructure and clearly understand what services will be picked up by the provider and which will stay with you. The same is true with other expenses associated with the services such as IT equipment, disaster recovery and software. The cost of upgrades and new versions should be factored into the equation as well. Sometimes these items fall into a grey zone and pop up later well into the implementation.

Another element to be considered is the cost of training. Typically this is covered by the nearshore provider but in cases where complex proprietary software developments are part of the engagement, you may need to provide some level of training. In this case there may be significant costs associated with this activity that need to be identified.

Travel cost is also a key item to consider in respect to management time, training and other transition activities.

Special consideration is required in topics such as provisions in the contract for price adjustments, inflation/currency fluctuation, and productivity improvement. You need to equate this into the TCO analysis.

You need to plan for management time dedicated to monitoring the contract with the provider. Significant time will be required upfront and during the transition but there will be also a need to follow up on issues, metrics and overall performance. This is an item that is not considered in most of the cases. It is also the hardest to quantify but could be the line item that makes the proposition not viable.

In summary, make sure you dedicate enough attention to the TCO calculation and you get as much granularity as possible. Assistance from your outsourcing advisory firm is critical to ensure you are addressing all items.

Build a strong risk management strategy

Not all plans work out as anticipated. When undertaking a major transition to a nearshore provider you may run into a number of unexpected surprises ranging from the ability of the vendor's staff to take over the task, communication pitfalls in both sides of the equation, technology issues, and even environmental and country political issues.

You should make sure that your vendor has shared with you the risk management plan. However, you must build your own plan that thoroughly addresses each item. Your plan should be well aligned with your internal risk management policies.

If possible, test your plan and make sure all participants are versed on it and well up to speed of what are the risk mitigation actions that apply in each case. Educate the vendor on your plan and make sure you request full adherence to it.

Plan for transition

Transition is the #1 change management component of the program. It is very unlikely that you will be able to shut off your current service one day and open the next day with a “big bang” deployment. Even if this is the case, the transition plan is complex and needs to be comprehensive.

Your vendor can assist with the transition plan, in many cases it is embedded in the contract requirements, but transition does not end with the vendor. You need to address all components that deal with transition. Hidden costs typically start showing up during the transition. For example, there is a surprising amount of management time required to move processes over to the outsourcer, or employees must take several unexpected yet necessary trips to the vendor’s facility.

You cannot underestimate the complexities that you will run into as you deploy the new model. Make sure you have a thorough understanding of each of the activities that will be involved during the transition and plan for them. These activities should be clearly reflected in the TCO model and should also be a critical component of contract negotiations.

Manage vendor relationship

The contract you are about to sign with the vendor is the starting point of what will hopefully be a long term productive relationship. You are bound to work together with the vendor hand in hand to make the program a complete success. Thus, you need to recognize that establishing a healthy partnership with your vendor is not an item to disregard. In fact it should be a critical component of your strategy.

A healthy relationship must start with a contract that is win-win for both parties. It does not help to push the vendor to a corner to accept reduced pricing or unrealistic terms and conditions. You can get away with it, but you will have to live with the consequences of such an approach for the next few years.

It will be almost impossible to define upfront 100% of the requirements and situations that may arise in the life of a complex engagement. The only way to deal with the unexpected in a constructive way is to have a real partner in the vendor you are working with.

Our recommendation is that you assign appropriate value to building a strong relationship with the vendor. This requires management time and effort. You need to make sure that you have the right personalities in your team to achieve the kind of partnership that will lead the initiative to success.

Nearshoring – A new way of delivering consulting services

We hope that some of the concepts mentioned above are valuable as you outsource critical information technology services. We believe the current nearshoring trend offers a unique opportunity to capitalize on the intrinsic benefits of the model while taking advantage of the learnings of earlier models.

However, we urge you to consider the opportunity of nearshoring not only as a way of reducing cost through labor arbitrage. We are convinced that there is an emerging new way of delivering consulting services that favors specialized IT insight provided through a seamless knowledge-based global delivery model.

We believe that this is the direction that the consulting profession is taking and that we should approach this opportunity with the stakeholders in mind.

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- i Analyst Reports, Forrester Research
- ii CMMI, Capability Maturity Model Integration

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