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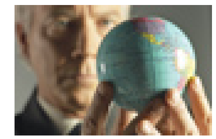
Offshoring to New Markets

Rising costs in India and China are prompting companies to seek alternative countries for offshoring opportunities.

By Barbara Worthington



The outsourcing focus continues to shift, and the thriving economies of many offshore markets beckon U.S. companies with promises of cheaper labor and production. Although India and China continue to lead the offshoring pack, attention is turning from these familiar hot spots to some newcomers -- Vietnam, Indonesia, Mexico, Costa Rica, the Czech Republic, Hungary and Russia.

"India is getting more expensive by the day," says Manish Chowdhary, president of Bridgeport, Conn.-based MachroTech, an IT consulting and outsourcing firm. He adds that Indian businesses also suffer from a high rate of employee turnover.

"The market is extremely vibrant right now, which is adding to the chaos," he says, noting that India's "rapidly rising wages" are impacting strategy, resulting in increasing interest in China. Subsequently, he says, there's more outsourcing to countries "lower on the value chain."

China will be "by far" the most attractive low-cost country in 2011, according to the 2006 study, The Asian Sourcing Boom: How Long Will it Last, conducted by the Wellesley, Mass.-based Boston Logistics Group. Though it remains the hottest market, particularly for manufacturing, automotive, banking, pharmaceutical and engineering capabilities, other countries -- namely Vietnam, Indonesia and Mexico -- will see significant growth over the next few years, according to David Jacoby, president of BLG.

"There are a lot of places to go in the world to accomplish objectives," he says.

Among BLG's key findings: 20 percent of outsourcing companies currently have offshoring operations in low-cost countries, with a typical savings of 18 percent. This has set a new threshold of cost-efficiency that competing outsourcers must equal, whether through similar offshoring or alternative means of reducing conventional costs.

Within five years, the study says, the percentage of work done in low-cost countries will increase to 34 percent. Companies that currently offshore 20 percent or more of their work in low-cost countries are likely to invest 2.3 times their annual cost savings as they expand their operations.

"In general, global sourcing companies save 13 percent, on average," says Jacoby. "[Currently,] we're looking at a very, very exciting period."

Competition within this arena is fierce. As a result, employers planning to offshore to these new destinations, or that have successfully navigated the challenges of doing so, are unwilling to share their strategies. All the HR leaders contacted for this story declined to comment.

Market Roundup

Outsourcing experts, however, say that each emerging offshoring location has its own unique set of pluses and minuses.

With inexpensive IT labor and relatively low attrition rates, Vietnam provides programmers and help-desk staff at a fraction of the cost companies would pay stateside. However, Vietnam's current infrastructure doesn't come close to India's.

Vietnam is recognized for its talented programmers and high-quality work stemming from well-grounded IT education. In addition, the population possesses advanced English skills. Though it has not always been friendly, the workforce's relationship with the United States is a long and familiar one. The result is a large, highly-skilled talent pool available at very low cost.

Negative aspects include potential political instability and a culture that tolerates corruption. For example, the Washington-based Business Software Association, in its most recent Global Software Piracy study, places Vietnam at the top of its ranking of countries where software piracy is rampant.

Vietnam's strongest burgeoning markets are in apparel manufacturing, software development and integrated circuit production. In March, Intel announced plans to construct a $300 million chip plant in Ho Chi Minh City.

Indonesia is an up-and-coming player, too. However, an unsophisticated business environment, language barriers and limited education opportunities present some obstacles. Pluses include very competitive wages and a substantial population.

Indonesia has positioned itself as a destination for IT development and call-center operations, and boasts ongoing efforts to improve its infrastructure. Convergys Corp. is one U.S. company currently outsourcing operations there.

Mexico offers a large, educated workforce. Even better, it's close and it's a bargain in terms of labor costs. This offshoring neighbor to the United States supports high-volume IT projects and call-center services for Spanish-speaking customers. Operational costs are somewhat higher than other outsourcing destinations.

Among the industries supported by Mexico's sizable workforce are auto parts, plastics and rubber, appliances, machinery and wood and paper products. Armonk, N.Y-based IBM and Omaha, Neb.-based West Corp. are just two of many firms with offshoring facilities in Mexico.

Just to the south, Costa Rica is emerging as an offshoring candidate. Good educational systems, English-language proficiency and low wages contribute to that country's appeal, specifically for business-process outsourcing and IT outsourcing. However, the limited size of its workforce, relative to other larger countries, is a drawback, along with infrastructure and telecommunications limitations.

A number of firms have placed call centers in Costa Rica, including Motorola, Procter & Gamble and Western Union.

Outsourcing companies have also turned their eyes to several Central and South

American nations. Their location, in the same time zones as the United States, creates the greatest appeal for outsourcing there. Experts say their governments have been working to develop the infrastructure necessary to make them attractive outsourcing sites.

"South and Central America are getting shafted because so much attention is being focused on China," Jacoby says. "Latin and Central America are very, very cheap." In terms of labor, they're "American in culture and in spirit," and they "understand what we want in terms of quality."

The Czech Republic's alignment with Western countries, along with its central European location, have created some interest among offshoring pros, who say Czech business culture lends itself to forward thinking and implementation of practical business approaches.

Its well-educated and multilingual workers make it attractive for both assembly and manufacturing operations, but firms in the human resource, software development, chemicals, electronics, textiles and pharmaceutical businesses have also set up shop there. Most investment is directed toward the automotive and high-tech industries, with the result that the Czech Republic has a strong talent pool to support such operations.

As the workforce expands its skill sets, sectors such as banking services and aircraft maintenance are also becoming viable. And it remains a major hub for call centers; IBM Global Services currently has operations in the Czech Republic.

Similarly, nearby Hungary boasts educated young people, with particular affection for Western culture, offshoring experts say. High-level IT skills and comfort with the English language also position the Hungarian workforce as successful outsourcing providers. Other markets for outsourcing operations include auto parts, manufacturing and pharmaceuticals. Infrastructure in Hungary is relatively good but improvements are still needed. Currently, less than 20 percent of the population has home Internet access and a significant portion of the country is served by small roadways.

U.S. companies with offshore operations there include EDS and General Electric.

According to Jacoby, outsourcing growth in Eastern Europe presents a stark contrast to China. Year after year, the amount of business done by outsourcing firms in China increases between 9 percent and 12 percent, Jacoby says, while "Eastern Europe is developing at about half that."

Although the Iron Curtain has fallen, Russia still dominates Eastern Europe in terms of outsourcing. It's known to have a highly skilled labor pool, especially in terms of science and engineering. But observers warn of significant levels of corruption, high crime rates and a scarcity of intellectual-property laws.

Still, some companies have found opportunities there: Both Boeing and Caterpillar conduct research and development in Russia, the BLG study indicates.

Key Considerations

Finding an ideal outsourcing site abroad requires extensive analysis, and a number of outsourcing advisers have materialized to help. Selecting consulting firms based in the countries themselves can be a good way to improve the chances of success, Chowdhary says.

Of course, there are complex problems in any offshoring venture, consultant or no consultant. Entering the mix are culture, language, technical skills and qualified personnel, says Jacoby. "You need the right blend," he says.

Jacoby says identification of offshoring partners typically occurs in one of several ways: through natives of foreign countries who act as agents or brokers, through software-type companies with databases of providers or through consultants.

Some businesses from offshoring countries have established liaison operations in the United States to facilitate American procurement of offshore operations. The Internet, cell phones and reductions in costs of air travel have eased the process considerably, Jacoby says. "The cost differential now is so transparent."

In the absence of an agent or consultant, it may take as long as two years to get an offshoring operation in place. Otherwise, the process could be accomplished in as short a time as six months.

"It's not easy to form an enterprise and often you need a foreign partner to do it," Jacoby says. A foreign partner can successfully accelerate both the offshoring process and the learning curve, says Jacoby, adding "there's a lot of hand-holding companies need to make this transition."

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