

Nearshore outsourcing is more cost efficient than offshore outsourcing

Harry Boersen, Wouter van Gils & Martijn Zantinge

Vrije Universiteit Amsterdam, The Netherlands

harry_boersen@yahoo.co.uk, wvgils@few.vu.nl, mzantinge@unet.nl

Abstract

One of the reasons for companies to start with offshore outsourcing is to save money and thereby being more cost efficient than before doing so. In the last few years most companies, which saw the opportunities of outsourcing, realized they needed to conduct a thorough research whether offshore outsourcing is a viable alternative for the companies current solution. During this research nearshore outsourcing is mostly overlooked although it is a good alternative compared to offshore outsourcing. In this paper nearshore outsourcing and offshore outsourcing are, cost efficient wise, compared, to show that in certain situations nearshore outsourcing can be more cost efficient. This is done by looking at offshore outsourcing and nearshore outsourcing from three different views namely, distance and time zones, cultural differences and wages. The paper concludes with non-cost related factors which are different in offshore and nearshore countries that are also of importance in the process of making a decision between offshoring and nearshoring.

1 Introduction

To get a clear understanding of this paper it is important to be familiar with the terms outsourcing, nearshoring (nearshore outsourcing) and offshoring (offshore outsourcing). Outsourcing is delegating an internal non-core business process to an external company which is specialized in that process [10]. Nearshoring and offshoring are two types of outsourcing where nearshoring is to delegate it to a company which is in the same or near time zone and it is intra continental. We speak of offshoring when the work is delegated to a company when the gap between time zones is more than 3 hours, it is in another continent and there is a large difference between the cultures. However, sometimes there are some exceptions to these definitions. For example, the language spoken in South-Africa is similar to the language of The Netherlands. This could provide South-Africa as a nearshore company despite the intra continental location.

There are some significant cost issues that differs nearshoring from offshoring. These issues are discussed in this paper. First the differences in the distance and time zones which can increase the costs of managing a project will be discussed. Next is the difference in cultures and the culture costs between the country of origin and the near/offshore facilitator. The last cost related difference between nearshore and offshoring that is discussed in this paper are the costs savings by wages. After the cost differences are discussed non-cost related factors are introduced which should be considered when there is a need to choose between offshoring and nearshoring. At the end of this paper these issues are summarized and a conclusion is drawn.

2 The costs of distance & time zones

Since outsourcing has evolved from basic programming to currently supporting the business processes the amount of communication is increased. Also “nearshore practitioners stress the advantages of accessibility, real-time and face-to-face interactions in facilitating control and smooth operation” as mentioned by Abbott, P., Jones, M. [3]. These two reasons make the distance and time zone differences between the company’s location and the outsourcing location a very important issue as mentioned by Rao, MT. [4]. ”The importance of the time zone differences is a function of the level of communication required for the project.”

There are various reasons why the difference in time zone will add costs. Most of these costs are not incidental but will occur during the whole project or working period.

The overlap of time by different time zones has an impact on planning a meeting. Employees of both countries will have to take in account that they can only arrange meetings in a limited time span per day cause of the difference in time zone. This will also make it harder to speak with people “on- the-fly”.

The distance will also increase the costs. In general flights to intra-continental countries are more expensive then flights within the continent. Except the higher costs of intra-continental flights they are also longer. During a flight, an employee, in most cases, cannot work as efficient, which adds to the project costs.

3 Cultural differences are expensive

Culture is also a factor in the costs of outsourcing. While cultures can have very complex structures they can be defined as follows “everything a group thinks, says, does and makes – Its customs, language, material artefacts and shared systems of attitudes and feelings” Czinkota [7].

Because different cultures share different customs something which seems normal to one culture can be seen as unacceptable or even alien by another culture. For example in many Asian countries not agreeing or discussing a decision with a manager is shown as a sign of disrespect, while in western countries in some cases this might be applauded, as it might give new perspectives to the manager which he or she didn’t think off.

This difficulty in communication can decrease the efficiency of employees and increase costs to the project, because more communication between the client and the outsourcing party is required. This difficulty can also increase risks in such a way, that projects have known to have failed merely on the difference in culture [1]. The difficulty in communication however, is an obstacle that in certain situations can be resolved by adapting and understanding the other culture. Adapting to a culture takes time which adds to the cost of a project. Therefore it is often considered only a valid option for long term projects or a large number of short projects because it’s not cost efficient enough for a single or a few short term projects. This is because the costs to adept to each other culture are not continuous but incidental so the longer the outsourcing takes the more cost efficient the adapting process will become since the adapting process only has to take place once.

Even if certain cultural differences remain between nearshore countries, the difference in culture is often less of an obstacle, making the communication between the different parties easier, more time efficient and making the adapting process easier.

4 Wages can be misleading

Cost cutting, especially the reduction of wage costs, is often noted as the main motive by many firms for offshoring or nearshoring their services. This is further supported by numerous surveys, such as that by the DIHK [1] [5]. In a study conducted by Moczdlo [6], 92% of the interviewed responded that lower wage were a “very important” reason for their offshoring decision. However, are these wages as transparent that we can compare them, directly, with each other?

An average application developer in New York has an annual compensation of \$72.000,- where an average nearshore application developer has an annual compensation of \$50.000,- and lastly an application developer from India has an annual compensation of \$30.000,-. Based on these numbers [2] you could say an application developer in India only costs 41% compared to an American application developer. These wages are misleading though. The reason they are misleading is because of the productivity level which is not being taken into account. According to KLG [2] it is “very rare to find organizations which experience the same or comparable productivity rate to that of the location from which the jobs were deployed” when offshoring certain operations. Not only just after the operations have been established but also for the years to come. “In most cases, estimates range from 35% to 50% productivity relative to the origination point” KLG [2]. In contrast to nearshore locations where “it is rare to find employers who have carefully chosen nearshore locations that have not achieved productivity levels equivalent to that of the origination point” KLG [2]. Research has shown us that productivity levels at offshore locations do increase over time but after several years it still isn't near the productivity level of nearshore locations.

5 Non-cost related factors to consider

Factors that are not cost related should also be considered when choosing between near- or offshoring. One of these factors is the intellectual protection laws of a country, which is a major concern for certain companies. In 2004 the global damage caused by intellectual property theft was estimated at 600 billion US dollars [9]. Unlike many western countries only a few offshore countries have laws to protect companies or individuals against theft or espionage of intellectual properties. The offshore countries that do have such laws in place, often have trouble to enforce such laws when they are violated [2].

Terrorism attacks, civil war and coups can also be considered a non-cost related factor. Unfortunately this is a factor to consider worldwide, but does occur more frequent in certain offshore regions. India for instance came second in last years ranking of the 50 most risk full countries to do business in. Above countries such as Afghanistan [8]. For certain companies this can be a factor to consider when choosing outsourcing, as it can be a potential risk for the success of a project.

6 Conclusion

Many companies see offshore outsourcing as the way to be more cost efficient. Certain effects can negatively influence the cost savings of offshore outsourcing, making the cost saving less than expected or when compared to nearshore outsourcing.

The difference in time and culture can be the cause of extra costs. This is caused by the extra time that has to be invested because of the difficulty in communication by which more personnel is required to close this (communication) gap. Nearshoring could offer an attractive alternative in these cases. The time differences are smaller and, often the cultures of the country of origin and the nearshore country appear less foreign to each other than when comparing it with the culture of an offshore country.

There are also other situations where nearshoring is a good alternative due to the productivity level, which is significantly higher in nearshore countries than at offshore locations. This means that companies will need more people at offshore locations to achieve the same productivity as at nearshore locations, which will add extra costs thus making nearshoring more attractive cost efficient wise in certain situations. All these factors can make nearshoring more cost efficient than outsourcing in certain situations.

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