

# **Nearshoring or Offshoring – current trends and a research agenda for business model evolution**

Mikko J Ruohonen  
Department of Computer Sciences  
CIRCFI  
Center for Research on  
Information, Customer & Innovation Management  
  
University of Tampere  
FIN-33014 UNIVERSITY OF TAMPERE  
FINLAND

## **Abstract**

Outsourcing of information technology (ITO) and business processes and administration (BPO) has increased tremendously during the last 10 years and provides a great business advantage. However, labour cost competitive countries have dominated but it is evident that not just labour costs matter. Now and in the future service levels, competencies and community-based activities are growingly needed. India seems to be the most attractive country for both ITO and BPO practices. Having said that we should remember that East European nearshoring countries such as Poland, Czech and Hungary are getting a better market position. This creates a challenging business case for many European companies: “Nearshore or offshore?”. Strategic offshoring has created different business models which are now in a state of flux. Organisations are looking for new strategies and comparisons of nearshoring and offshoring models. These models are reviewed in this article and research-in-progress findings are presented. Objectives of the forthcoming research are to i) investigate Indian ICT service markets and main players ii) examine different business models and competitive factors and iii) compare those to western (European) equivalents. A special focus is put on European (and Finnish) software and services markets. Preliminary Future avenues for this collaborative research are suggested.

Keywords: Nearshoring, offshoring, sourcing strategies, India, Europe

# 1. Changing nature of outsourcing markets

Offshore outsourcing or briefly offshoring of information technology (ITO) and business processes and administration (BPO) has changed its nature in last two decades. As a business it has grown globally and provides a great business advantage (Lacity & Willcocks 2001, 2008). Typically also the size of the outsourcing deals has grown in addition to the general volume of agreements. This challenges also European and Finnish software industry (Market-Visio 2006). Nordic countries (including Finland) are small, but they have good ICT network readiness and due to that are competitive in a global scale (Dutta 2008). Therefore they serve well as a basis for ICT-enabled new openings.

According to IDC (2004) direct outsourcing or offshoring without any middle-man organizations was a business of over 1 billion EUR. The total exports of Indian ITO and BPO business on FY 2007 was estimated 31 billions USD (Finpro 2008) and the global marketshare approximately 4 % (Kumar & Joseph 2005, NeoIT 2005, Gartner Group 2007, Nasscom 2008). NASSCOM (2008) predicts that the overall Indian IT-BPO revenue aggregate is expected to grow by over 33 per cent and reach USD 64 billion (including hardware) by the end of the current fiscal year (FY2008 i.e. April 2008-March 2009) of which software and services are expected to cross USD 40 billion.

USD billion	FY 2006	FY 2007	FY 2008 P
<b>IT Services</b>	<b>17.8</b>	<b>23.6</b>	<b>30-31</b>
Exports	13.3	18.0	-
Domestic	4.5	5.6	-
<b>Eng Services and R&amp;D, S/W Prods</b>	<b>5.3</b>	<b>6.5</b>	<b>~8</b>
Exports	4	4.9	-
Domestic	1.3	1.6	-
<b>ITES-BPO</b>	<b>7.2</b>	<b>9.5</b>	<b>11-12</b>
Exports	6.3	8.4	-
Domestic	0.9	1.1	-
<b>Total Software and Services Revenues</b>	<b>30.3</b>	<b>39.6</b>	<b>49-50</b>
<b>Of which, exports are</b>	<b>23.6</b>	<b>31.4</b>	<b>39-40</b>
<b>Domestic</b>	<b>6.7</b>	<b>8.2</b>	<b>~10</b>
Hardware	7	8.2	-
<b>Total IT Industry (including Hardware)</b>	<b>37.4</b>	<b>47.8</b>	<b>-</b>

**Table 1: India exports/domestic IT business (Nasscom and FinPro 2008)**

However, the East-European countries are getting more visibility and growth, too. For example, maturity of Russian outsourcing markets have grown which has enabled sourcing phenomenon called “nearshoring” (Hawk & McHenry 2005, Lepeak 2007) Czech, Poland, Hungary are also growing their IT/BPO service exports.

## 2. Next challenges in offshoring

In the current situation we already know that not just the labour costs dominate anymore, the model is more complicated (Sridhar & Bharadwaj 2005). For example, improved service levels, supply of different competencies and community-based activities are also needed (Carmel 1999, Barthelemy 2003, Järvenpää et al. 2005, Ruohonen 2005a). Cultural fit and suitability of administrative environment are important to notify when making outsourcing decisions (Deloitte 2005, 2006, Walsham 2007). Outsourcing is too often considered one-sided: handing over assets, people, activities and knowledge to third-party management, but it can also be a contract for two-way collaboration to release your own knowledge and learning potential, and releasing the provider's potential, for mutual gain (Oshri et al. 2007, Ruohonen 2005b, Nilekani 2008).

India – the global back office and studio – seems to be the most attractive country for both ITO and BPO practices. After having said that we must remember that East European nearshoring countries such as Poland, Czech and Hungary are eagerly competing (Mukerji 2008). However, to get the whole picture we should remember that the 2006 global sales of ICT services was 672 billion USD of which US-based companies take 57% with IBM, EDS, Accenture ja HP leading [6]. Naturally the current financial crisis in the world will affect the figures for year 2008 and potentially next year, too (see for example Business Week).

Company	Turnover 2006	Market share %	Turnover 2005	+/-%
IBM	48 247	7,2	47407	+1,8
EDS	21 268	3,2	19 757	+7,6
Fujitsu	17 887	2,7	17 903	-0,1
Accenture	17 231	2,6	15 989	+7,8
HP	16 442	2,4	16 104	+2,1
CSC	14 682	2,2	14 611	+0,5
Others	535 608	79,8	500 108	+7,3
Total	672 365	100	631 879	+6,4

**Table 2: Global IT services sales MUSD (Gartner Dataquest)**

Lepeak's (2007) latest survey states that the use of remote, lower cost offshore resources to deliver ITO and BPO services continued to grow during the third quarter of 2007. However, wage inflation in leading offshore markets like India

and the falling value of the U.S. dollar negatively impacted margins of service providers with extensive offshore operations. This, coupled with changing buyer demands and the need for service providers to access talent with more diverse skills, further drove the expansion of delivery capabilities beyond the Indian market into locations like China, Central/South America and Central/Eastern Europe. Similarly, as wage rates across markets converge, more outsourcing buyers in the U.S., along with non-U.S. based services providers, have increasingly begun looking closer to home for onshore delivery resources. Investments in the India market remained strong, however, for both captive and outsourced delivery capabilities, and Indian service providers continued to broaden their delivery capabilities into BPO and newer ITO areas like remote infrastructure management.(Lepeak 2007)

### 3. Strategic offshoring business models

Simple sole-source contracts are now moving toward strategic partnerships with selected best-of-breed vendors (Nilekani 2008). Strategic offshoring has created different business models which are in a state of flux. **Network strategy** requires development of value network to face growing and varying needs of customers. Indian companies attempt to move forward in the value chain in order to foster partnership and make customer innovations. Body shopping [10] is moving to countries with lower salary costs. Instead of that Indian ICT service companies have invested in Tier II cities. For example cities such as Pune, Kolkata, Chandigarh, Jaipur, Coimbatore are gaining visibility in India for lower costs of operation and better supply of manpower. A number of Indian ICT service companies set up excellence centers in China for using huge potential of Chinese engineering workforce. Finally Indians have acquired IT companies from near USA and from Europe to get closer to customers. In general, according to Deallogic, the data provider, in the first three quarters of 2006, all Indian companies announced a record 112 foreign acquisitions, with a combined value of \$7.2 billion (Mukerji 2008).

According to Mukerji (2008) two key trends emerge: firstly, the location of the outsourced services becomes a more complex decision and secondly, the actual services that are outsourced are increasingly reduced to a basic process, enabling greater standardization of service. Capgemini has even trademarked the term “rightshore” which means “cutting across geographies to access the right service, in the right place, at the right price” (Mukerji 2008). When considering the outsourcing location the nature of service process should be analyzed. Voice-based bank balance information service is easier than replying to stressed customers about their credit card claims. Non-voice and more back office type of outsourcing can be executed in the most competitive location. ICT service companies are therefore networking to be nearer the customer but in the same time making effectiveness in their engineering work development.

In addition to that Indian ICT service companies are heading for building vertical-specific expertise in many industries and upgrading their knowledge in business transformation outsourcing. Traditionally customer intimacy has been the competitive weapon for many of the US and European ICT service companies. This strategy is moving now towards a **middle-man or broker model** in which ICT service companies which are culturally nearer to customer can also use the cost-effective offshore outsourcing and maintain its position in between the customer and the outsourcer.

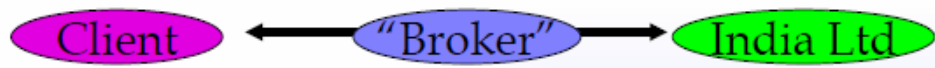


Figure 1. Brokering offshoring services through your own service business by using, for example, Indian ICT service company

However, also Indian ICT service companies can make a second tier in their business model and outsource, for example, non-voice services to China, and also use in voice-based services labor arbitrage and educated English speakers in other countries. For supporting client needs and in the same time improving one's service processes, Infosys – one of the biggest Indian ICT service companies - has development centres in China, a large multi-lingual nearshore European workforce in Czech Republic, and onshore delivery capabilities close to client locations in the U.S., Canada, Germany and the UK (Nilekani 2008). This makes a third model which can be called **strategic agility model** in which strategic sensitivity is high, resource base for service processes is flexible and management is following the same strategic agenda despite the many sourcing locations (see Doz & Kosonen 2008 on strategic agility)

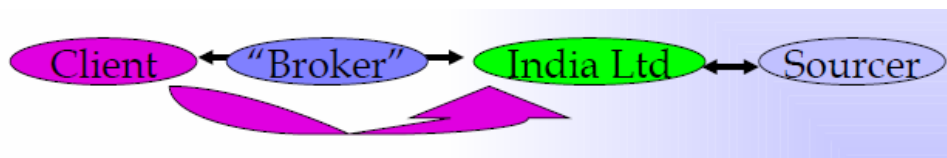


Figure 2. Strategic agility model for providing offshoring services

The fourth model is to invest, recruit and finally set up your own software and service **development center** which is either partly or fully owned, now also possible in India. However, only the biggest and maybe very small and niche-focused companies can use this approach.



Figure 3. Providing offshoring services through your own software and services center

## 4. Proposed research agenda

The paper presented first preliminary findings for executing comparative research and constructing research framework. Objectives of the future research are to

- i) investigate Indian ICT service markets and main players
- ii) ii) examine different business models and competitive factors and
- iii) iii) compare those to western (European) equivalents.

A special focus is put on European (and Finnish) software and services markets. The forthcoming work will be executed in collaboration with leading universities and institutes in India, Delhi and Gurgaon area. A research period in India will be done for company visits, field work and interviews in major Indian ICT service business hubs. It is also planned to create a research program agenda for a larger Indo-European research on ICT services markets and outsourcing potential.

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