

Nearshoring to Atlantic Canada, is it the smart alternative to offshore outsourcing to India?

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This article analyses the growth of offshore outsourcing from the US and the value it delivers to client. It shows how such value received by offshoring in distant lands like India can be easily achieved by nearshoring locations of Atlantic Canada, while mitigating many risks associated with offshoring in far away locations.

The article is split into five sections and answers the following questions,

- *Why offshore outsourcing and why is India a dominant player?*
- *What are the key risks in offshore outsourcing to distant lands?*
- *What is Nearshoring?*
- *What makes Atlantic Canada an attractive nearshoring location as compared to India?*
- *How does the cost and overall values compare, the final low down?*

Why offshore outsourcing and why is India a dominant player?

In today's hectic world, organizations are working overtime to maximize efficiencies worldwide. As a result, organizations are focusing more on their core competencies and relying on service providers to manage critical but non-core processes for them. Relevant work is therefore transferred, often outsourced offshore, while economizing money spent. The distant nations of China, India, and the Philippines have excelled in providing IT Services at economies of scale previously unknown to the industry.

India is one of the key players as on offshore outsourcing destination. According to NASSCOM¹, leading global business intelligence and consultancy firms such as Giga, Forrester Research and McKinsey & Co. have cited various reasons for the increase of offshore outsourcing by Multinational companies (MNC) to India. India's quality and cost benefit edge is one of the major draws for these organizations, these analysts say. According to a study conducted by Forrester in November, 2001, India's edge over other competing nations in the IT outsourcing business is based on the country's decade old experience in this area, fluency in the English language, supportive Government policy infrastructure, and high quality offerings. Apart from that the key advantages include growing infrastructure, competitive costs and available skilled human resource base.

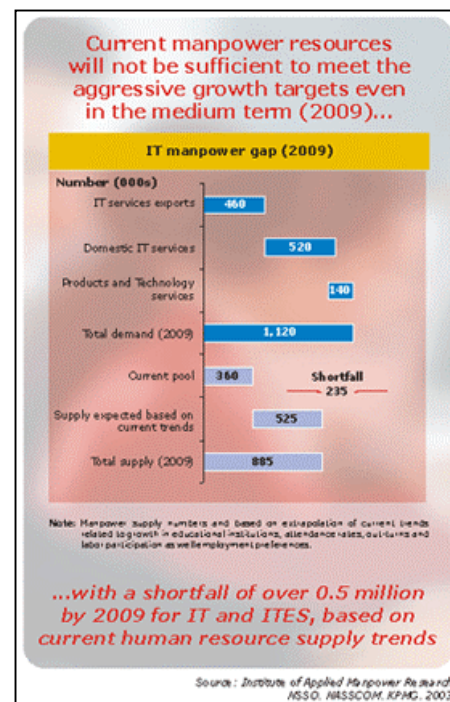
What are the key risks in offshore outsourcing to distant lands?

Even though a country like India has abundant skilled human base as well as competitive costs, there are various risks that companies face when IT Services are offshore outsourced to India. DiamondCluster International's annual study of information technology outsourcing found that the number of buyers satisfied with their "offshoring" providers has fallen from 79 percent to 62 percent. In addition, the number of buyers prematurely terminating an outsourcing relationship has doubled to 51 percent. According to the Diamond Cluster² 2005 Global IT Outsourcing report, the following were the key seven risks identified in outsourcing of IT Services.

1. Increased Management complexity - the more the distance the more the management complexity. The cost of this additional management is an added hidden cost to the project not initially computed.

2. Reduced effectiveness due to communication difficulties - Cultural differences and lack of communication experience in India can easily create tremendous hurdles in a project. Communication is also hindered by the time zone differences that lead to utilization of an onsite layer to communicate to the offshore team adding both translation overheads and therefore additional costs.

3. Lower quality of output - Though there is an expected perceived quality of output due to availability of resources and processes that are expected to assure quality, in reality there is lack of experienced manpower and there is a gap between the documented processes and the actual processes followed in practice leading to lower quality. Lower costs are often compensated by loading additional resources to execute the tasks, which actually fritter away the cost benefits of lower per hour prices. Other possibilities for lower quality include absence of claimed capabilities, absence of claimed resources and attrition. High attrition rates are due to high demand-low supply situation⁸ in the market, leading to employee churn. "The country could fall short by 250,000 qualified workers in the next four years",



Indian officials⁹ say. An attrition rate of over 20% is normal in the Indian software industry leading to not only lower quality of output, but also lost domain and technical knowledge and expertise, built over a period.

4. Lack of direct control over resources - Lack of control leads to slippage and lower quality and lack of proximity leads to lack of direct control. Indirect control adds overheads in terms of management costs and management complexity.

5. Uncertain financial payback - The value of the project is finally what is paid out and not the price reflected in the rate cards. Additional management, indirect management and overheads add more than costs to the projects. In a recent widely reported survey done by Ventoro³, they report that generating any cost savings proved difficult for more than 50 percent of the offshore engagements that Ventoro reviewed. The survey found that 28 percent of the offshore outsourcing or offshore development projects actually increased costs and 25 percent did not generate any significant savings in spite of significantly lower rates offered by countries like India.

6. Uncertain information confidentiality - There are plenty of stories of information leak offshore. Safeguards are often in place, but they are as good as how they are practiced. Cultural differences introduce lack of respect towards safeguards and copyright standards. E.g. Piracy of software is more rampant in Asia than in the developed world.

7. Lack of proximity to staff/vendor – Lack of availability of resources only a phone call or a short-haul flight away leads to slipped project schedules and delayed completions. There are innumerable visa hassles in making a trip anytime from India to execute the project, whether it is in the inception stage or in the final implementation. These include non-availability of work visas like H1 or L1 and resource not being eligible for visas like B1. You would be surprised to know that many resources on the team are not eligible for visas since they do not have even a travel document like the passport since they don't meet the required eligibility criteria for a passport. Also, post 9/11 there is growing security concerns of international travelers from Asian countries that have been travel difficult and complex.

What is Nearshoring?

Despite the numerous offshore outsourcing success stories, the path to successful offshoring is obscured by a lot of unanticipated practical difficulties as seen by the risks listed in the previous section. With the risks and pitfalls now visible due to first-hand experiences, firms are looking for simpler hassle free alternatives like **adding IT Services in their own backyards**.

Nearshoring, the practice of sending work to nearby countries instead of overseas, continues to gain momentum in the United States as companies discover that countries such as Canada, Mexico, and Ireland can be smart choices for affordable, reliable outsourcing. While enjoying the benefits of outsourcing this offers the low risk alternative which companies are catching up to quickly. Canada is fast emerging as the prime candidate for nearshoring for US companies. Similarly former East European countries¹⁰ like Czech Republic, Hungary and Ukraine are fast growing nearshoring locations for countries in the European Union. Nearshoring offers great benefits for IT Services. Activities like Production Support, Database administration and high quality application development greatly benefit by the proximity and synchronous time zone availability of the service provider.

What makes Atlantic Canada an attractive nearshoring location as compared to India?

Let's look at the obvious allure Atlantic Canada has:

History and Culture:


USA and Canada share a lot of history together. Their people have coexisted in harmony and friendship for centuries. Their similarities are numerous and compatibility is very high. Their trade partnership is the largest among any two nations made possible by the NAFTA and US-Canada Free Trade Agreement. They speak the same language including their accents and share the same time zone(s). Their basic social etiquette is no different from each other and work place transparency is cherished.

Their government and legal frameworks function on a common standard, which makes great business sense in terms of doing business. They share the same accounting guidelines, which needs no adjustments to be accepted.

Countries like India are culturally totally diversified. It is still a very conservative society, which is just slowly emerging. Radically different work environments and lack of systems in place often lead to confusions in execution. Acquiring government sanctions and licenses are often stressful and long drawn procedures.

Infrastructure and Security:

Canada has excellent infrastructure in terms of roads and railways. It is one of the pioneer nations of broadband and IP telephony. Canada exports oil, gas and hydroelectric power to the

Checklist of infrastructure roadblocks and bottle necks that affect offshoring in India	
	Regulations and bureaucracy that block access and slow things down - for eg. VoIP equipment cannot connect to PSTN
	prohibitive cost of technology and equipment - VoIP, internet bandwidth, etc. - for eg DSL is five times more expensive, not available in all locations and bandwidth is very sparse
	hassle of getting the equipment/technology across to india and making them work
	courier and custom delays in getting equipment across, nothing like a guaranteed next day FedEx delivery available
	limited airport access and hotel room availability - resources flying out face limitations and constraints - air tickets at last minute from or to US may not be available
	prohibitive project management costs both onsite and running the offshore team - offshore project managers are actually more expensive per hour compared to the onsite counterparts
	high operating costs including administration, HR and overall management

USA and is a very self-sufficient nation in terms of natural resources. Low commercial real estate prices are another enticing factor that keeps overheads low leading to lower rates.

Developing nations like India have inadequate infrastructures now staggering under the sudden explosion of people and vehicles brought about by the BPO boom. What we take for granted, like Power, water, Internet access and transportation are huge bottlenecks. Add power failures and connectivity issues⁶ and you have chaos right in the midst of critical deadlines. IT players have to setup shop in designated areas to provide power, water and telephone. Internet access is still at a premium.

Employees are provided transportation and food services at no cost or at a subsidy. All these add to the overhead. That is the reason why even though a typical junior developer is available at US\$500 a month salary and billed at US\$5,000 a month, the infrastructure costs and management overheads fritter away the cost savings from labor.

Canada's e-governance laws offer utmost security and here Canada scores way over nations like India where a recent fraud in Pune, due to security breaches rocked the BPO industry. The peace of mind offered by the low risk of security concerns is priceless since critical work can be near shored without any problems. Data transfer without any confidentiality loss, a prerequisite for any project, is guaranteed. Though there are laws in India to protect intellectual property scant respect for such property due to cultural reasons adds a degree of risk to the outsourcing process. Intellectual Property protection is much easier and easily implemented when dealing with companies in Canada because of the legal structure and broader acceptance and practice.

Education and People:

Canada spends about 8.4% of its GDP on education making it one of the best among G7 nations. India spends a meager 2.8%. It is true that India has a large English speaking population, but it is heavily accented and often communication is tough because it is difficult to comprehend and gaps occur in understanding which it turn leads to misinterpretation of requirements. Lack of

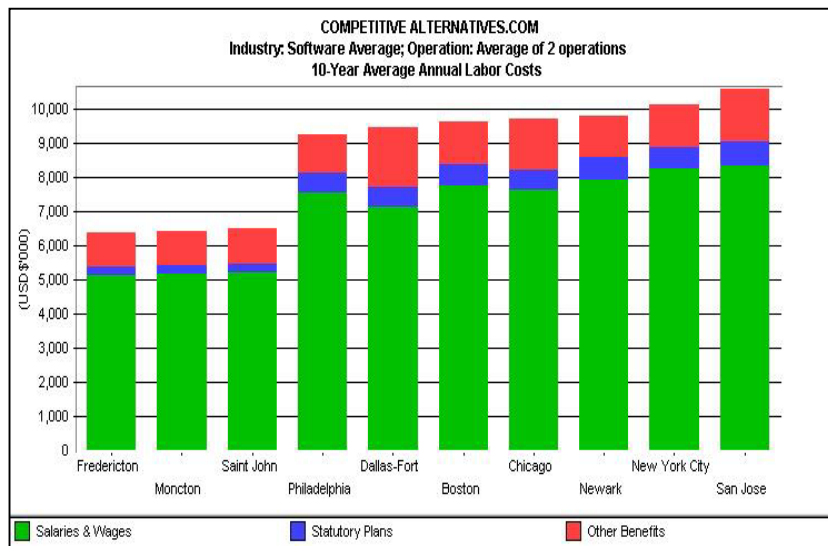
communication introduces serious risks for projects executed in India since what is discussed is really not what it was understood to be.

Canadian Universities are some of the best in the world. The curriculum is same as in the US and the Students come out with very high quality degrees and skills. Canada churns out bachelors, post-grads and PhDs every year that are well versed in the conceptual understanding of the two nations workings which gives them an edge in any project to comprehend its intricacies related to its execution. Canada welcomes immigrants with open arms. More than 200,000 immigrate to Canada every year which delivers a healthy mix of nationalities and diverse talents who work for wages far lower than comparable USA rates. This includes people from the USA as well who bring with them the hands on expertise of working in US firms. Labor shortages and thereby increase in offshore rates are looming in the horizon in India and over the next 5 years, nearshoring will become more attractive with the passage of time due to rising costs in India.

Labor and attrition:

Labor costs are much less in Atlantic Canada as compared to the US. According to a study by KPMG⁴, labor costs in Atlantic Canada⁵ are up to 35% less than in the US. Research and development costs are low as well and this leads to affordable innovative technology. In India for instance the attrition rates⁷ are an astounding 25% or greater. This is a threat to a critical project, when a resource leaves, the knowledge transfer is often done hurriedly and much of the specialized information is lost. The new resource coming in takes time to scale and much valuable time is lost resulting in delayed milestones, leading to a domino effect.

In Canada the attrition rates are at an all time low of 10% or lower and Atlantic Canadians⁵ are some of the most loyal workers around. This ensures the smooth execution of the project and the knowledge acquired remains on the team, which facilitates



not only execution but also even trouble shooting due to the intimate and specialized knowledge of the inner workings of the project done.

Proximity and Time Zones:

This is obviously the easiest to understand. Proximity of Canada to the USA offers lesser travel time, greater supervision and ease of control. No visa restrictions, critical resources available at the required timeframes and all in all hassle free reporting and no loss in communication. Canada wakes and sleeps along with the United States and is up and about ready to go same time as their clients. Typically Indian companies negate the proximity by having an onsite team through the life cycle of the project. However, this adds to the project complexity in terms on introducing a translation layer as well as increases the costs of the projects tremendously.

Costs and overall values compared, the final low down 1:1

Yes, we are now down to the most important factor. Isn't outsourcing all about cutting costs and realizing the savings? So how does nearshoring compare with outsourcing and what is the overall value that is on offer?

Let's start with an example. Let us take a typical six-month project to execute the development of a web based Intranet application. In this six-month project, the first one-month is for requirements gathering and the final month is for UAT and Production implementation, both of which are done at the customer's site. We have taken some sample rates based on our knowledge of the Indian and Atlantic Canadian industry for comparison purposes.

The typical cost structure of the Indian offshoring of this sample project:

Project phase	Location	No. of resources	Rates for these resources	Total costs
First month – Startup phase of project	Onsite	2	US\$80 per hour, US\$14,000 per month	US\$28,000
	Offshore in India	2	US\$25 per hour, US\$4,400 per month	US\$8,800
Second to Fifth month – Development phase	Onsite ^A including project management costs	2	US\$80 per hour, US\$14,000 per month	US\$112,000
	Offshore in India	10	US\$25 per hour, US\$4,400 per month	US\$176,000
Sixth month – UAT and implement phase	Onsite	3	US\$80 per hour, US\$14,000 per month	US\$42,000
	Offshore in India	3	US\$25 per hour, US\$4,400 per month	US\$13,200
			<i>Travel cost @ US\$2,000 x 3 person trips</i>	US\$6,000
TOTAL COST of project				US\$386,000

The typical cost structure of the sample project executed from Atlantic Canada:

Project phase	Location	No. of resources	Rates for these resources	Total costs
First month – Startup phase of project	Onsite ^B	1	US\$80 per hour, US\$14,000 per month	US\$14,000
	Offshore in Canada ^B	2	US\$45 per hour, US\$8,000 per month	US\$16,000
Second to Fifth month – Development	Onsite ^C	0	US\$80 per hour, US\$14,000 per month	\$0
	Offshore in Canada ^C	8	US\$45 per hour, US\$8,000 per month	US\$256,000
Sixth month – UAT and implement	Onsite ^D	1	US\$80 per hour, US\$14,000 per month	US\$14,000
	Offshore in Canada ^D	3	US\$45 per hour, US\$8,000 per month	US\$24,000
			<i>Travel cost @ US\$1,000 x 2 person trips</i>	US\$2,000
TOTAL COST of project				US\$326,000

Notes:

^A It is important to remember that communication at odd hours to India requires a secondary project management and coordination team that needs to continue for coordination purposes with the client onsite. If such a team is not available then the onus of onsite communication is moved to client folks and they would be need to paid overtime to work late nights, early mornings and weekends to maintain such communication with the offshore team.

^B Working in tandem during the inception phase the onsite and offshore team in Atlantic Canada work as one single team in the same hours during the inception phase, thereby reducing the onsite team requirements. There are no management or translation overheads in managing a remote offshore team.

^C There is no requirement for an onsite team during development phase since the offshore team is directly in touch with the client and stakeholders during project execution negating the requirement for a costly onsite coordination team. Also, a smaller 8 member team offshore in Atlantic Canada can easily deliver the same work a 10 member team will do offshore in India. It is normal industry practice in India to have more team members than required since they try to cover the less experienced resources as well as the attrition risks by having a larger team size than actually required. The client eventually pays for such a team, which adds to the project cost.

^D During the implementation phase, the onsite and offshore Canada teams once again work in tandem with the client in the same time zone eliminating need for a large onsite team. In fact, many times the implementation and UAT can be done entirely from Canada, working remotely with the client technical resources, thereby eliminating onsite resources completely.

Voilà, the actual project executed from Atlantic Canada offers more value overall and is less expensive by US\$60,000, a savings of over 16% for a similar project offshored to India with the added bonus of all the other risks that were mitigated and eliminated at the same time. The larger the project, the complexity of executing the project offshore in India increases further more, leading to more inefficiencies and higher project costs. Such projects are more apt to be nearshored and the savings will be even greater than the 16% shown above for the sample project. Similar cost savings are possible for other activities like Production support, database design and administration and any work that can be offshored can be nearshored cost effectively.

Conclusion:

In summary, during a meeting, an senior management executive in the Technology Group of Citibank in New York and who was regularly outsourcing work to India was heard bragging about getting an excellent IT resource from India at just US\$5,000 a month. He seemed to consider it an enormous bargain!

On careful analysis we have arrived at the conclusion that, without the risks of the time zone differences, without the management overheads, without the communication gaps and the misunderstandings, a North American English bred workforce can meet these costs right here in Atlantic Canada. Would you have to circumvent the globe and take the work half way across to get such a bargain? Absolutely not! Clearly the risk is not worth it and the value of the project-executed near shore is greater than executing such a project in India. Right here, right now, right in the heart of the North American continent, value based offshore outsourcing is available in Atlantic Canada minus the risks. Go for it!

About the author:

The author of this white paper, Srikanth Ramanujam, heads the Nearshoring IT Services group of Indosoft Inc. for its offshore outsourcing activities, based out of Fredericton, New Brunswick in Atlantic Canada. He has tremendous first hand experience in this field, giving him the knowledge of the benefits that the industry offers as well as the risks that need to be mitigated to execute successful projects and service activities, and thereby deliver maximum value to the customers.

He has completed his Masters in Technology Management from the Chifley Business School under La Trobe University, Melbourne, Australia and is a certified MCSE and Project Management Professional. He has over two decades of IT Services and Application development experience with over a decade of it in complex Project, Program and Delivery management.

He has executed projects for Mphasis, Federal Express, Singapore Airlines, Unisys, United Overseas Bank, Delta Airlines, Charles Schwab, Bank One, Sabre, JPMorgan Chase, News Corp and others in various worldwide locations for the Financial, Banking, Supply Chain, Airline and Travel industries. His expertise includes being involved in many multi-million dollar IT projects and his recent Program Management included a US\$6.5 million project for the merger of online banking web sites of Chase.com and Bankone.com, a 100 man year project executed with a 150 member project team located in multiple locations in India and in New York.

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