

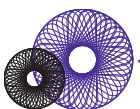
# Offsourcing Vs Nearsourcing



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## Executive Summary

There is no doubt that offshore outsourcing to far-flung places can bring numerous advantages to boardrooms, shareholders and also to the wider economy, but is it a relevant solution for small and medium-sized enterprises (SMEs)?

Certain SME-dominated industries, recruitment and temping agencies for example, are particularly hard-hit during tough economic times, such as the current credit crunch. How can smaller firms gain the benefits that offshore outsourcing offers to the big boys - cost savings, greater efficiency and an increased skills base - and how do you avoid the cultural differences, language barriers and loss of control? Nearshore outsourcing could be the perfect answer but what exactly can be gained and what are the location options?

This paper reviews the offshore outsourcing phenomenon and investigates the possibilities of nearshore outsourcing. It examines current thinking and trends - supported by relevant stats and facts - and highlights the benefits and drawbacks of the outsourcing options available to SMEs. The conclusions drawn will help SMEs understand the outsourcing options and make an educated and informed choice when it comes to payroll and back office service delivery.

## Understanding the Terminology

Offshoring is defined as the movement of a business process done at a company in one country to the same or another company in a different country. Almost always work is moved due to a lower cost of operations in the new location. Offshoring is sometimes contrasted with outsourcing or offshore outsourcing. Outsourcing is the movement of internal business processes to an external company. Companies subcontracting in the same country would be outsourcing, but not offshoring. A company moving an internal business unit from one country to another would be offshoring, but not outsourcing. A company subcontracting a business unit to a different company in another country would be both outsourcing and offshoring - known as offsourcing.

As its name suggests, nearshoring implies the relocation of business processes to, typically, a lower cost foreign location, but in close geographical proximity. Or moving a previously offshore operation to a country located geographically closer, such as a payroll department from India to the Isle of Man. Nearsourcing is the term used to describe a business that is nearshoring and outsourcing.

A further term sometimes used and associated with offshoring or nearsourcing is bodyshopping, which is the practice of using offshored resources and personnel to do small, disaggregated tasks within a business environment without any broader intention to offshore the entire business function.

## Offsourcing Versus Nearsourcing

### Overview

The practice of offshoring has emerged as a hot issue, especially in the US and UK in recent months. While migration of jobs is not new, its impact on the service sector, both in terms of scale and public debate, is quite recent.

The main driver for companies to offshore is cost savings, with some advocates claiming reductions of as much as 70 per cent.

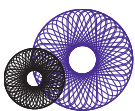
The bulk of offshored activities includes: call centres, large IT projects and IT enabled services such as software development. Increasingly, higher value-added jobs are being offshored, such as complex financial analysis, technology R&D and innovation.

However, with the emergence of key offshoring concerns the outsourcing market is seeing a considerable shift towards nearsourcing. Elements such as business process outsourcing including human resource management, payroll processing, and account reconciliation are all being moved nearer home. Nearsourcing also provides an ideal solution for SMEs and non-IT or finance-based businesses as these companies often want to focus on core areas of business rather than non-specialist areas such as payroll and invoice management.

### Offsourcing - the trend so far

At present, 600,000 people in the UK are employed in call centres alone, generating £13.3 billion in revenues annually. By contrast, the size of the UK offshored services sector is much smaller, representing £240 million in revenues per year. As the trend continues, however, large numbers of jobs are thought to be vulnerable. By 2008 it is estimated that 730,000 financial services jobs will migrate from Western Europe to lower-cost regions. In the US, some 400,000 jobs have already been offshored, a figure expected to rise to 3.3 million in 2015, a potential one per cent of the US population.

The major providers of offshore services are China, India, Ireland, Israel, the Philippines, Poland, Russia and South Africa. Currently, India accounts for 80 percent of the



offshored jobs, employing around one million people in the IT and IT enabled services and contributing to 3.15 percent of GDP. The reasons for this include lower wages, which are around one-third of costs in the US and UK, the widespread knowledge of English and the 2 million university graduates every year eager to work in this sector.

## Benefits and drawbacks

### The Pros

The most obvious benefit of offshoring is the low cost. Compared to a US or UK-based location, offshoring and offoutsourcing offers substantial savings in operational expenses. But there is more to why people are shipping call centres and IT projects to countries such as India besides cost. Benefits such as an educated, English-speaking labour pool, low employee turnover, and complimentary time zones all make offshoring attractive.

India is home to the largest educated English-speaking population in the world. Other than language, the geographical location of India lends itself well to a 24-7 operation, particularly for US businesses. Another positive feature of India is the country's highly motivated workforce.

As offoutsourcing grows, the cost of labour in India is rising. Many of the same phenomena that the United States and UK experienced during the dot-com explosion are happening now in India. The competition for talent is heating up, and salaries are beginning to skyrocket. Employees are constantly looking to increase their salaries and are switching jobs quickly. Increasing salaries, competition for talent, turnover rate - all of these factors will affect the benefits of offshoring and offoutsourcing.

Chief executives, CIOs and shareholders argue it is a vital tool to remain competitive, that it will save jobs in the long run and benefit the wider UK economy as the country's workers move on to higher value jobs.

The pros and cons contrast each other, confusing the issue further. A recent report sponsored by the Indian IT industry's trade body Nasscom, predicted that more than a quarter of a million UK workers will see their jobs disappear overseas, costing the UK economy £5.7bn in unemployment benefits and retraining costs. However, the same report also said the cost to the UK by not offoutsourcing would be much higher - £34bn - due to a drop in output and slowing of GDP growth.

### Key Concerns

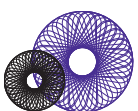
As with any endeavour that offers great benefits, businesses should consider what the catch is. Outsourcing to offshore locations exposes countries to greater risks of many different types, such as country or political instability, regional turmoil, unstable economies, poor infrastructure, lack of exposure to Western business culture, and data insecurity. All these increased concerns need to be addressed when deciding on the best business model for a company and if outsourcing is chosen, during the supplier selection phase.

India has been busy building and promoting its technology sector since the 1980s. As recent events have shown in Mumbai political and cultural tensions in India make it unstable and situations can change within hours. In addition, whenever a company sends its customer data to another company, there is a risk of that data being misused. However, on the infrastructure side, India has recently made enormous infrastructure improvements in many cities that are becoming offoutsourcing hubs, such as Hyderabad, Mumbai, and Bangalore.

The primary issues companies should think about when they relocate services offshore is the expertise in managing remote locations; the calibre and skill sets of the labour force; the cost of labour; language skills; telecom bandwidth, cost, and reliability; infrastructure; political stability; enforceability of intellectual property rights and business contracts; and the general maturity of the business environment.

In a global economy, efforts to cut costs through offoutsourcing are a legitimate company response to competitive pressure. Considerable benefits also accrue to the recipient countries, in the form of much needed jobs, improvement in skills, advances in infrastructure and technology, and significant job multiplier effects. However, wider concerns remain:

**In the UK,** concerns are primarily focused on people who lose jobs. It is argued that when jobs are lost, people are freed up to participate in higher value-added activities. But in reality, while the economy as a whole might evolve in time to a higher level, the individuals who lose jobs are not necessarily the ones gaining the new jobs. Therefore, companies must assist in managing the transition – in terms of training, skills and job development, redeployment – in partnership with governments and communities that may be disproportionately dependent on such jobs.



Abroad, concerns have to do with decent working conditions, for example wages, working hours, benefits and physical environment and other aspects of good practice at supplier companies, such as technology transfer. There is also concern related to company transparency about offshoring practices such as the use of false names or accents to deceive customers about where call centres are located.

Media coverage and labour union campaigning have attracted public attention internationally, raising concerns about the ethics of the practice, as well as its short and long-term consequences. In reaction to the heightened awareness and apparent public opposition to the trend with, for example, some evidence of UK bank customers switching banks in protest at offshoring activities, governments are starting to step in. In the US for instance, companies are barred from offshoring services associated with federal contracts. Meanwhile, British and European unions are increasingly working together to lobby the European Commission against offshoring. Some observers fear a new age of protectionism in developed countries that may be detrimental to free trade and development.

*"20 percent of information Week 500 companies say they have or are considering moving offshored work back or nearer to home."*

Information Week.

## Nearsourcing - the perfect solution?

If your company balks at the cost of outsourcing its IT to a UK provider but is nervous about the risks associated with offshore projects, the outsourcing industry has a third way: nearsourcing. This involves outsourcing work to companies with the economic benefits of an offshore location, but a closer cultural, linguistic and geographic fit with the user organisation.

As highlighted, operations in Bangalore may offer thousands of workers to handle straightforward business processes and software development tasks with a relatively low level of business impact, but when it comes to providing services that have a greater effect on the business and its customers, companies need suppliers with a certain cultural affinity.

When Nelson Hall surveyed organisations about their preferred location for external application development and maintenance resources for its Application Management Market Review, the clearly stated preference was for off-site resources based in the local area. The

local, off-site option came in ahead of having resources at the client offices, with offshore resources in the Asia coming in as the least favoured option.

In addition, businesses need to evaluate the choice on the type of function to be outsourced. Horizontal functions require generic back-office skills, such as processing transactions or basic applications maintenance. Vertical skills are more linked to the idiosyncrasies of the business. Offshore outsourcing centres rarely provide vertical expertise, where as the nearsourcing players provide real, proven expertise in these areas.

Linguistic skills are an obvious driver for nearshore contracts, but not all considerations are as clear-cut. There are "softer" elements to consider, such as the cultural affinity between outsourcing customer and supplier. It is more difficult to convert these into objective measurements, but they could still add to overall productivity. If we can communicate more effectively, productivity could increase.

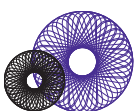
Companies will find cost reduction less of an advantage when working in nearshore operations but project costs are still much lower than in the UK. It may be difficult for nearshoring operations to match the very low labour costs that can be found in areas such as India and China. The trade-off between cost and the sophistication of the services available is clear.

As highlighted previously, costs in some of the main markets for offshore work is rising steadily. Due to the level of inward investment, the whole cost base is increasing and that can make nearshore contracts more attractive, because the differential between nearshore and offshore today will be squeezed over the next few years.

*"Nearsourcing offers reassurance to SMEs during this time of uncertainty. Allowing them to focus on sales and core business growth."*

Nerys Roberts, Group Commercial Director,  
Charterhouse International

However, this can happen in some of the more developed nearshore locations too, so companies must be careful. Ireland is a good example. A high level of investment sent property and labour rates rising, making it a less attractive nearshore proposition. Consequently, companies should focus on more than just price in the long term. They should concentrate on other benefits of nearshore operations, such as lowering the overall risk of an existing offshore project, gaining access to pockets of skills, and achieving 24-7 support.



Definitions vary as to what qualifies as a nearshore location. Moving across a close country border without crossing an ocean is a good way to define a nearshore contract. But how close? Anywhere within two hours' flying time, would be ideal meaning most European destinations qualify. However, the further away the more it becomes a significant overhead when putting people on the ground at the outsourcing location, which is something most companies should do. Nearsourcing is easier travel-wise, more flights and easier time zones.

operations without incurring too much risk. This is the ideal solution for SMEs that want to grow but without the added cost or worry of dealing with back office areas that are outside of their core expertise.

## Conclusion

In truth, all nearsourcing and offsourcing locations sit along a spectrum of potential sites. At one end sit the far offshore locations such as India and China, separated by both cultural and geographic distances. In the middle are areas such as the new entrant states to the European Union - for example, Poland and the Czech Republic.

Finally, at the close end of the spectrum - almost onshore but not quite - sit places such as Ireland, the Isle of Man and the Scottish isles.

These nearest locations offer what can be described as bestsourcing – no languages or time barriers, considerable cost savings, logistically favourable locations and the required skills to expertly do the job at hand. Established service providers, such as the Isle of Man-based PayDynamics - part of Charterhouse Group International - offers a 100 per cent flexible payroll and back office service designed especially for SMEs, particularly recruitment and temping agencies. In addition to the location benefits, the figures are impressive too – savings of 84 percent on the cost of administering payroll through this particular service provider. The usual salary costs of £40,000 plus for hiring an in-house payroll professional are reduced to just £6,300 by nearsourcing with a business such as PayDynamics.

*“Numerous surveys indicate that anywhere from 17 per cent to 53 per cent of customers have not realised business value/return on investment from outsourcing.”*  
CIO

In general, nearsourcing operation gives tighter control over critical business processes while yielding the benefits of a nearshoring practice. Clearly, nearsourcing offers the ability to maintain a high level of control while mitigating the cost of doing business. The range of different models that can be attached to a nearshoring operation brings flexibility to companies who want to streamline their

