AROUND THE WORLD AND BACK AGAIN: SOURCING SERVICES IN THE USA

June 2013

Executive Summary

The United States is becoming an attractive sourcing location for IT and business services, but how viable is it, and what needs to occur to see more services evolve in Uncle Sam's backyard, employing U.S. talent? HfS Research, with the support of the Sourcing Interests Group, conducted the largest study to date largest-ever study of U.S. enterprises to ascertain how real the prospect of the U.S. being a major competitive sourcing location is becoming.

Are the challenges of moving jobs offshore finally coming home to roost? Are companies now doing a volte-face when it comes to shipping jobs offshore? Will offshore locations in India start competing with Mankato and Martinsburg? Will IT and business process jobs start flocking back onshore? As a result of the recession, are American wage levels finally competitive with India, the Philippines and Malaysia? What will it take in terms of public policy and incentives to flip on the switch?

Although the use of offshore resources to deliver IT and business processes is now an accepted business model, there are signs that the playing field could finally be leveling for the U.S.-based worker. To uncover the extent to which U.S.-based companies may be contemplating keeping jobs onshore—or actually moving jobs back home, HfS launched its Outsourcing to the U.S. study in July through September 2012 to gauge how the U.S., as a location, and Americans, as workers, are competing for back-office or business service jobs.

HfS's groundbreaking study surveyed and interviewed operations executives (termed "enterprise buyers") who make or influence their companies' business operations and outsourcing decisions in addition to leading executives from the suppliers of outsourcing services who invest in locations around the world. With data from more than 235 enterprise buyer respondents and 270 outsourcing supplier respondents, the industry now has real data on the state of play when it comes to sourcing jobs onshore.

Overall, there is a strong case for many U.S. enterprises to find real business value in sourcing IT and business process work back to U.S. shores. As offshore labor and infrastructure costs rise, enterprise buyers can begin to make an economic case for keeping or repatriating jobs that have moved to other countries. With several decades of offshoring experience, enterprise buyers now value other capabilities, especially the cultural understanding that

frequently eludes delivery from offshore locations. However, there will not be a severe course correction. Jobs will not simply flock back offshore overnight; rather, the U.S. will become a viable component of organizations' global delivery models.

Moreover, it will take considerable collaboration and initiative by the enterprise buyer, supplier and government to change the global sourcing delivery map substantially. Enterprise buyers must understand the difference between onshore and offshore capabilities and aggressively encourage suppliers to deliver these capabilities—onshore. Suppliers will have to respond by investing in U.S. delivery locations. And, most importantly, all levels of government must establish policies and programs that foster U.S. sourcing—and make the U.S. a financially viable option for sourcing services in the ever-competitive global war for talent and employment.

Key Findings

- **Outsourcing is no longer only an offshore game; onshore workers are now viewed as outperforming offshore when it comes to key attributes.** Although onshore workers are sometimes characterized as less competitive or under-skilled when compared with offshore workers, enterprise respondents rate American back-office workers higher than non-U.S. workers in the majority of key attributes, namely, understanding the business, initiative and innovation. The market is now realizing that the so-called softer skills—communications and contextual awareness—add real value to business and IT services delivery.
- **Understanding the difference between the Yankees and Red Sox is critical; contextual understanding is key to client satisfaction.** Enterprise buyers are waking up to the fact that there's a relationship between cultural understanding and performance, and ranking U.S. workers substantially higher when compared to non-U.S. staff, especially when it comes to delivering business processes compared to IT services.
- **Enterprise buyers have realized they get what they pay for, but cost still trumps quality.** U.S. workers are still seen as expensive by enterprise buyer and supplier standards, which has been driving the location decisions in recent years. Despite U.S. workers outperforming non-U.S. workers, enterprise buyers ultimately view both worker categories the same value for money. In a few words, cost is still king when it comes to delivering back-office services, as enterprise buyers consider it worth the performance sacrifice to drive down labor costs.
- **Yet there are signs that quality may trump low cost over time.** Our enterprise buyers have established a lower cost-saving threshold for U.S. delivery, 17%, as opposed to a minimum of 22% offshore. This data suggests that the relationship between cost and contextual capability is finally acknowledged.
- **Business leaders acknowledge that the potent combination of capability and narrowing cost is leading them back.** When offshoring pioneers like GE and others start to make public statements about moving or keeping jobs onshore, one can be sure that it's not down to altruism. They are seeing real value in delivering business services close to the business, at an acceptable price point.
- **As a result, the U.S. can be a vital component of a global business delivery model.** When enterprise buyers analyze the skills they actually need for performance, many will turn to onshore delivery. But offshore locations reign when it comes to IT services, with the majority of enterprise buyer respondents already

operating in non-U.S. locations and/or are interested in shifting more IT work to non-U.S. locations. Higher-touch, higher-context processes such as customer care, HR or industry-specific processes are the best candidates for U.S. delivery.

- **And the early signals are clear; there is growing interest in the U.S. as a delivery location.** The good news is that approximately one quarter of all respondents, regardless of business process, are already tapping into U.S.-based delivery. A figure that is obviously not getting a lot of press. Another quarter of respondents are interested or very interested in the U.S. as a sourcing location, while one quarter are neutral.

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Onshore Outperforming Offshore: American Back-Office Workers Now Trump Offshore Counterparts According to Outsourcing Enterprise Buyers

Although onshore workers been characterized as less competitive or under-skilled when compared with offshore workers, respondents now rate American back-office workers higher in the majority of key attributes. When enterprise buyers from around the world (see Appendix 1 for survey statistics) were asked to compare and contrast the quality of their global workforce with their American counterparts, according to attributes such as Hardworking and Process driven, and skills such as Innovative and Understands my business, offshore workers came up short.

As shown in Exhibit 1, across four of six attributes, U.S. workers were rated at least 30% higher than offshore workers. As importantly, respondents agreed that offshore workers and U.S.-based workers are equally *Process driven*, a skill often touted as a differentiator for staff located offshore.

Exhibit 1: Enterprise Buyers' Perspective: Key Attributes of Back-Office Staff

Q. To what degree do these attributes describe your U.S.-based and non-U.S.-based IT and business operations staff?

% STRONGLY AGREE AND AGREE

Staff Attributes	U.S.-Based Staff	Non-U.S.-Based Staff	Variance
Cultural and communications skills	82%	33%	-49%
Understands my business	88%	43%	-45%
Takes initiative	77%	40%	-37%
Innovative	77%	45%	-32%
Hard working	83%	79%	-4%
Process driven	77%	79%	+2%

Source: HfS Research 2012, 235 Enterprise buyers

The responses are clear: U.S.-based workers more often exhibit skills deemed most relevant to productivity in today's business environment. And where American workers score higher, it's down to contextual skills, such as strong communication skills and a good understanding of business. Without these skills, it's difficult to take initiative and be innovative for the benefit of the customer.

These data provide a wake-up call for suppliers, particularly those primarily serving the U.S. market from offshore locations. Given the strong scores attributed to American workers over their offshore counterparts, suppliers must address these skill set gaps to create value for their clients, especially when the staff interact directly. Without these skills, offshore workers will be relegated to the low-cost, low-value end of the outsourcing spectrum, causing enterprise buyers to retain processes that require higher skills.

But attributes only tell part of the story. Client satisfaction is another indicator of outsourcing supplier performance. To understand the extent to which U.S.-based staff and non-U.S.-based staff meet enterprise buyers' expectations, HfS measured enterprise buyers' satisfaction across IT and business process services. Survey results indicate (see Exhibit 1 and Exhibit 2) that ***U.S.-based staff achieve much higher levels of client satisfaction overall than do non-U.S.-based staff.***

The data is nuanced depending upon the service. BPO skills requirements are massively different from those of IT, given the way the work is typically structured. For example, India is an IT factory with an excellent talent development system for technical skills, but when it comes to other capabilities, the education system may be coming up short.

Since offshore IT delivery models are generally more mature than BPO, it is unsurprising that enterprise buyers of IT services have relatively higher levels of satisfaction when it comes to offshore delivery. In fact, the required skill sets are so well defined that the right talent development relationships between suppliers and universities have been extant for some years. After all, reaching an Indian or Filipino help desk is becoming standard.

However, contextual understanding, and all its attributes, still plays a big part in client satisfaction as evidenced by our respondents. With a delta of 12% or more—depending upon the actual service—in favor of American workers, it is apparent that satisfaction still has some way to go.

Exhibit 2: Enterprise Buyers' Satisfaction with IT Services

Q. How satisfied are you with the current performance of the following functions?

% VERY SATISFIED AND SATISFIED

IT Services	U.S.-Based Staff	Non-U.S.-Based Staff	Variance
Network/server management	74%	56%	-18%
IT help desk	71%	54%	-17%
Applications development	77%	61%	-16%
Applications maintenance	76%	64%	-12%

Source: HfS Research 2012, 235 Enterprise buyers

The delta becomes even more dramatic when looking at enterprise buyer satisfaction with business process services. Looking across the business processes most frequently outsourced, context becomes even more critical in driving satisfaction, especially in high-touch processes such as human resources and customer services. But the difference extends across all process services, even finance and accounting. This delta is understandable; BPO service satisfaction levels depend greatly on supplier staff having sufficient tacit skills to define processes, transfer vital business knowledge and solve problems that are not addressed in a standard workflow. Yet, unlike talent development for IT services, which is heavily reliant on technical skills, offshore training has not yet reached the same level when it comes to the so-called—and very vital—softer skills that make all the difference to enterprise buyers.

Exhibit 3: Enterprise Buyers' Satisfaction with Business Process Services

Q. How satisfied are you with the current performance of the following functions in the U.S.?

% VERY SATISFIED AND SATISFIED

Business Process Services	U.S.-Based Staff	Non-U.S.-Based Staff	Variance
Human resources	72%	41%	-31%
Customer services (CRM)	85%	55%	-30%
Sales and marketing	66%	40%	-26%
Finance and accounting	73%	53%	-20%
Procurement and supply chain	63%	46%	-17%

Source: HfS Research 2012, 235 Enterprise buyers

However, it's Still Location, Location, Location: Labor Cost Drives Decisions

Across the board, our community of enterprise buyers and suppliers agree: The criteria that make the right back-office location for services include skills, experience and availability of the workforce, cost-effectiveness, English-speaking capabilities and ability to scale operations quickly.

Exhibit 4: Location Attributes Enterprise Buyers' and Suppliers' Perspectives

Q. How important are these criteria when making location decisions for outsourced services?

% VERY IMPORTANT AND IMPORTANT

Location Attribute	Enterprise Buyer	Supplier
Availability of qualified workers	99%	95%
Skill and experience of workforce	98%	97%
Cost-effectiveness of workers	92%	97%
English-speaking capabilities	92%	93%
Ability to scale workforce quickly	86%	90%

Source: HfS Research 2012, 505 Respondents, Enterprise buyers and Suppliers

"What I want but what I'll pay for" still presents a conundrum for our respondents. Enterprise buyers are not yet willing to make the trade-offs between the attributes they want and the cost that they will pay. Almost one third of respondents believe that U.S.-based resources are, in one word, "expensive," as shown in Exhibit 4. There's certainly a strong basis for this; globalization fueled by technology has given businesses access to new, plentiful and less expensive talent pools offshore. As a result, the initial financial payback was compelling, despite any real or perceived operational risk. Today, organizations constantly compare labor costs around the world, looking for ways to reduce their cost of operations.

Exhibit 5: Services Staff Attributes Enterprise Buyers' Perspective

Q. To what degree does cost describe your services staff?

% STRONGLY AGREE AND AGREE

Staff Attribute	U.S.-Based Staff	Non-U.S.-Based Staff	Variance
Expensive	61%	17%	+44%

Source: HfS Research 2012, 215 Enterprise buyers

Whether it's perception or reality, the belief that U.S. workers are more expensive prohibits work that has gone offshore from coming back. Enterprise buyers and suppliers stated that their number one reason for keeping work offshore is the cost-effectiveness of onshore workers, whether they provide IT or BPO services (see Exhibit 6). Notably, suppliers see cost as more of a deterrent than enterprise buyers do.

Exhibit 6: Deterrents to Shifting Resources to the U.S.

Q. What is the primary deterrent to shifting resources to the U.S.?

Location Attribute	Enterprise Buyer	Supplier
Cost-effectiveness of IT services workforce	64%	67%
Cost-effectiveness of business process services workforce	64%	66%

Source: HfS Research 2012, 235 Enterprise buyers and 270 Outsourcing suppliers

To put the term "expensive" in context, HfS asked enterprise buyer and supplier respondents what they expected in term of costs savings by location when outsourcing. The results, as shown in Exhibit 6, indicate a change in expectations; enterprise buyers and suppliers alike look for lower savings from U.S. delivery locations compared to India and the Philippines. The numbers cited for offshore locations are striking, especially on the part of the enterprise buyers who no longer profess to expect savings in the range of 30% to 40%. What is clear is that respondents know that the cost delta—onshore versus offshore—is narrowing.

Exhibit 7: Expected Cost Savings from Sourcing

Q. What level of cost savings would you need to achieve in order to move your processes to the following countries/regions?

% EXPECTED SAVINGS

	U.S.	INDIA	PHILIPPINES
Enterprise buyers	16%	22%	19%
Suppliers	20%	29%	29%

Source: HFS Research 2012, 235 Enterprise buyers and 270 Outsourcing suppliers

Will Fewer Jobs Leave and Offshore Jobs Return? The Case for Yes

According to HfS's research, and the current buzz in the industry, early signs indicate that the trend of moving operations offshore for financial benefit is slowly losing favor. Perhaps this is a function of the industry's maturity; during the early days of outsourcing, the path to margin performance was overwhelmingly tied to reducing the cost of labor. Then, as more and more enterprise buyers saw the advantage of obtaining offshore labor arbitrage through outsourcing, others believed that they also had to get on the bandwagon in order to be competitive—call it a massive flight to cost reduction.

But with years of experience with global delivery, enterprise buyers now increasingly understand the plusses and minuses of moving work offshore, developing more nuanced and viable alternatives, which include onshoring and offshoring as part of a delivery ecosystem, tapping into the right source of talent in the right location. Today, sophisticated enterprise buyers more often focus on value rather than cost when selecting a supplier. They understand the capabilities of workers in a range of locations.

The press underscores the case for yes. Business leaders now acknowledge that the gap in cost is narrowing. Take the statements of just one business leader, Jeffrey Immelt, chairman and CEO of General Electric. The fact that GE, a pioneer in the offshoring movement, is now looking onshore, speaks volumes about the increasing viability of onshoring.

- On March 31, 2011, during an address to the Economic Club of Washington, Immelt stated that GE had improved its operations capability and was now able to run call centers in the U.S. that are only 10% more expensive than in India.
- In September 2011, he made similar comments regarding the use of offshore resources for application development. The Times of India noted he believes strong U.S. productivity is shrinking the benefits of labor

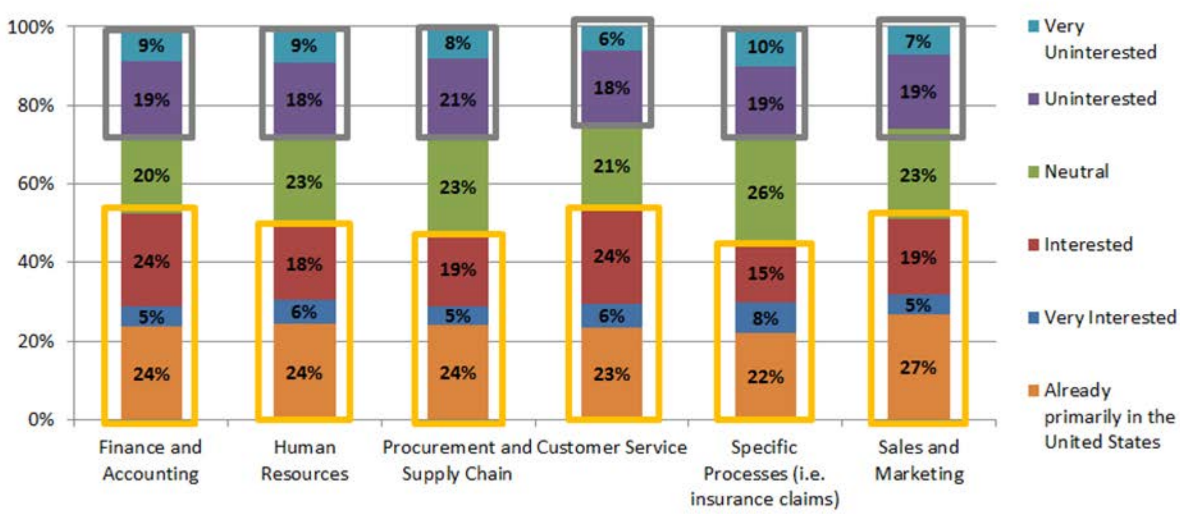
arbitrage for traditional outsourcers and that "the difference in the cost of developing software in the U.S. and India isn't that much."

Immelt's comments suggest that since cost is now playing a lesser role in the location decision process, other business leaders are getting on the bandwagon. For example, an October 2012 Livemint/Wall Street Journal article stated that cost considerations were neutral for Mamatha Chamarthi, chief information officer of Consumers Energy, when he decided to keep jobs onshore.

Are these organizations' decisions to bring or retain processes onshore the exception or the rule? To determine the extent to which enterprise buyers are interested in U.S.-based process delivery, we asked our respondents. Their responses, as shown in Exhibit 8, tell a more complicated story.

Exhibit 8: Sourcing Business Processes in the U.S.

Q. How interested are enterprise buyers in sourcing business processes in the U.S.?



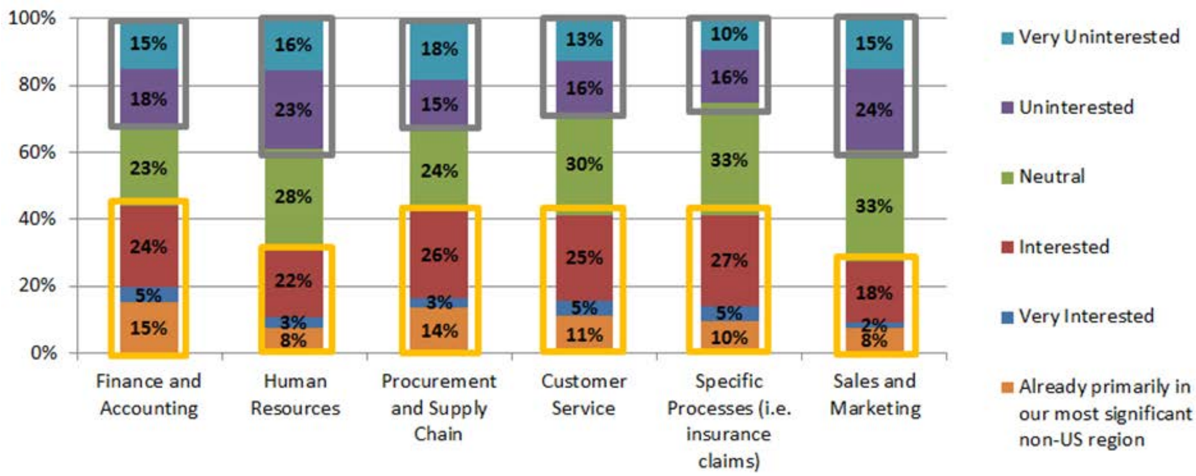
Source: HfS Research 2012, 215 Enterprise buyers

The results suggest a mixed bag. The good news is that approximately one quarter of all respondents, regardless of business process, are already tapping into U.S.-based delivery. A figure that is obviously not getting a lot of press. Another quarter of respondents are interested or very interested in the U.S. as a sourcing location. Another quarter is neutral, while the remainder of respondents profess no interest.

To contrast, when HfS Research assessed enterprise buyers' level of interest in shifting more work to their most significant non-U.S. location, they returned a less clear-cut response: some respondents are pro-U.S. while the others are less so. Moreover, a notable percentage of enterprise buyers are neutral regarding their location preference (see Exhibit 9). Although it is clear no single sourcing strategy dominates today's market, the opinions and perspectives that sway the location-neutral enterprise buyers will certainly shape suppliers' investment strategies for the foreseeable future.

Exhibit 9: Sourcing Business Processes Outside the U.S.

Q. How interested are you in shifting more business services to your most significant non-U.S. outsourcing country/region?

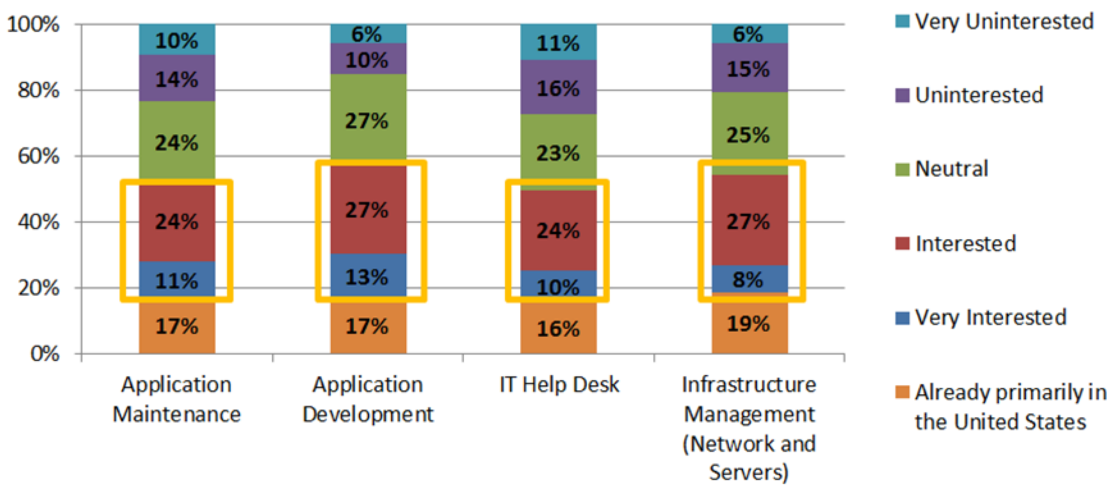


Source: HfS Research 2012, 505 Respondents

As the research illustrates, HfS deduces that there will not be a large wave of IT-related jobs returning to the U.S. in the immediate term; only a third of enterprise buyer respondents are interested in sourcing their IT services work to the U.S., while between 17% and 19% of enterprise buyers (depending upon service) are already using U.S.-based operations to deliver IT services.

Exhibit 10: Sourcing IT Services in the U.S.

Q. How interested are you in sourcing IT services in the U.S.?

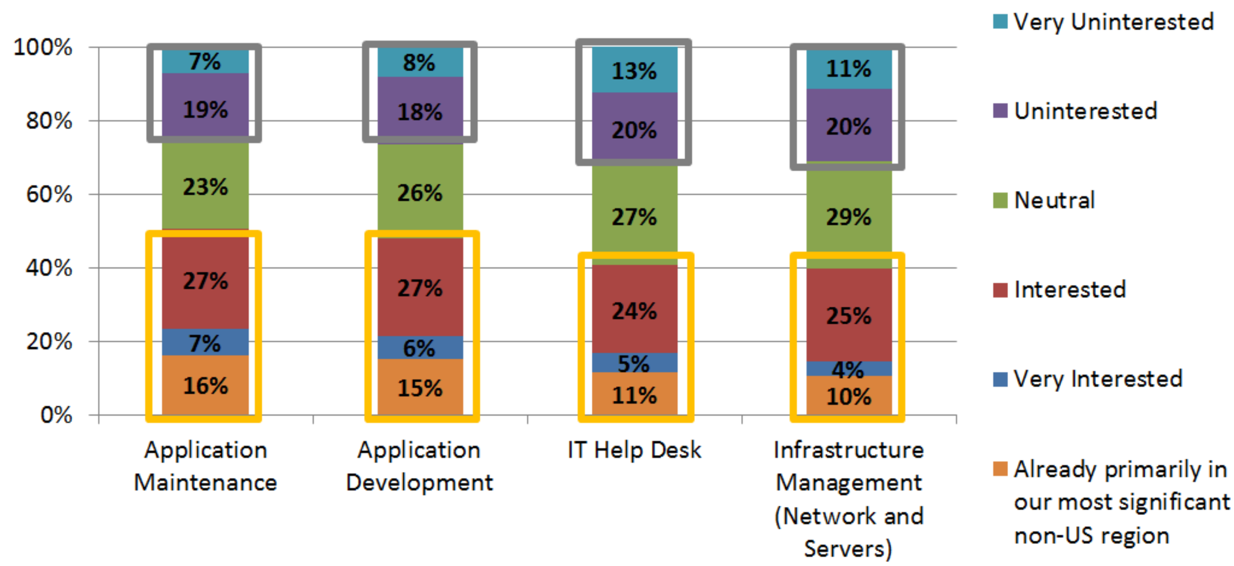


Source: HfS Research 2012, 221 Enterprise buyers

Despite an indication of an increase in U.S.-based IT jobs, the majority of enterprise buyer respondents is already receiving their IT services from non-U.S. locations and/or is interested in shifting their IT work to non-U.S. locations (see Exhibit 10). The offshore adopters we interviewed as part of this analysis agreed. They told us they have spent significant time and resources building offshore management and governance capabilities, and the operational and financial risk associated with a 180-degree turn in services location is too great, while the perceived benefits are too difficult to determine at this stage.

Exhibit 11: Sourcing IT Services in the U.S.

Q. How interested are you in shifting more IT services to your most significant non-U.S. outsourcing country/region?



Source: HfS Research 2012, 221 Enterprise buyers

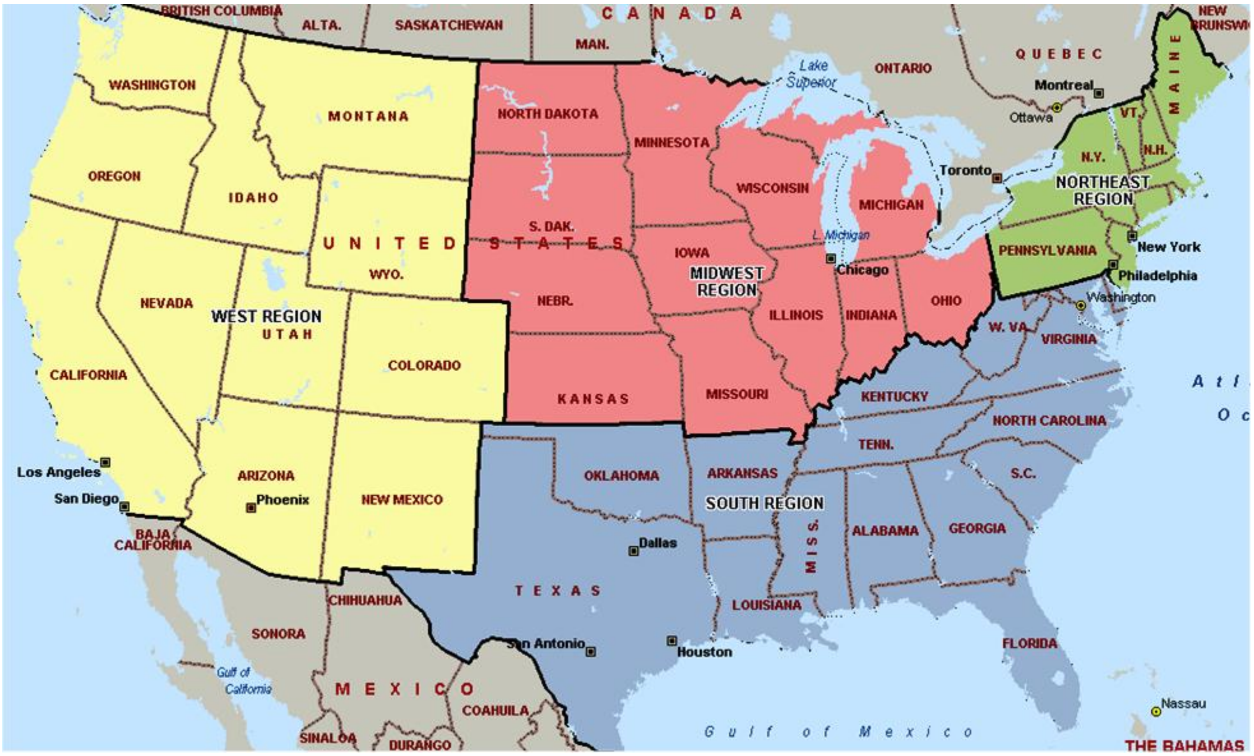
Where in the U.S.? Outsourcing Suppliers Are Already Staking Out Ground

Suppliers are now noting the trend to onshore jobs in the U.S. In response to the many high-profile companies, including General Motors and General Electric, that have publicly announced plans to increase their onshore staff, many offshore-centric suppliers have announced they will be increasing the number of staff at onshore locations.

- September 2012: HCL Technologies announced a plan to hire more than 1,000 staff locally across the U.S. over the next 18 months, and earlier this year, the company said it would hire 10,000 engineers across the U.S. and Europe over the next five years.
- September 2012: McCamish Systems, an Infosys BPO company, started operations in Des Moines, Iowa, with 87 employees, serving seven insurers and covering more than 600,000 insured lives.
- July 2012: Infosys announced plans to hire 2,000 people and set up a new software development center in the U.S. this year.
- May 2012: Cognizant announced it is hiring more staff in the U.S.—lateral and college hires. The company now recruits at between 15 and 20 campuses, and has hired several hundred U.S. college students this year alone.
- February 2012: Wipro announced it would increase U.S. hiring. At Wipro's development center in Atlanta, 90% of the 800 employees are now local hires, and the company aims to duplicate these efforts elsewhere.

Although these numbers are relatively small when compared to the hundreds of thousands of staff these suppliers currently employ offshore, the trend is clear: The U.S. and U.S.-based staff stand to play a larger role in delivering business services. Moreover, the results indicate that business process activities—those typically with greater proximity to the business and involving process standardization and industry knowledge—are more likely to remain or move back onshore than IT services.

It's not easy for suppliers to select the right location for business services delivery. With a land area of more than three million square miles, more than 300 million people and a breathtaking array of potential locations, selecting the best location based on geography alone is daunting. When factoring in education levels, labor costs, population density, intangibles such as work ethic and ultimately economic development assistance, the choices become narrower. It's no surprise that in the outsourcing industry, suppliers tend to cluster in certain locations. To illustrate the extent of investment suppliers are now making in U.S.-based service delivery, HfS conducted a region-by-region analysis, as shown on the following map.



Region Analysis: The South

The South is an area ripe for delivery centers. The region is attractive due to its labor cost; the experienced and educated staff do not expect the higher wages prevalent in the Northeast and parts of the West. High levels of unemployment in key areas and the lower cost of living make many areas of this region a suitable choice, especially for rules-based work. To add to the region's appeal, state and local governments and institutions are aggressively offering incentives to attract new business.

The following exhibit shows the extent to which major outsourcing suppliers are investing in the South. States such as Texas, North Carolina and Tennessee are proving to be particularly attractive.

Exhibit 12: The South: Illustrative Supplier Profile by Service and Location

SUPPLIER	SERVICE	CITY/STATE
Convergys	CRM / Sales	Erlanger, KY; Jacksonville, FL; Pharr, TX; Orlando, FL; Jacksonville, NC; Tamarac, FL; Oklahoma City, OK; Lubbock, TX; Charlotte, NC; Chattanooga, TN; Hickory, NC; Clarksville, TN; Valdosta; GA; Laredo, TX; Brownsville, TX; Longview, TX, Chattanooga, TN; McAllen, TX; Florence, KY
	IT (Architecture, Networks, Support)	Dallas, TX; Orlando, FL; Jacksonville, FL; Erlanger, KY
Infosys	IT / Multiple disciplines	Charlotte, NC; Bentonville, AR; St. Petersburg, FL; Houston, TX; Dallas, TX
Wipro	IT / Multiple disciplines	Atlanta, GA; Houston, TX; Richmond, VA
Cognizant	IT / Multiple disciplines	Tampa, FL; Jacksonville, FL; Atlanta, GA; Nashville, TN; Greensboro, NC; Charlotte, NC
IBM	IT / Multiple disciplines	Durham, NC; Dallas, TX
Accenture	IT / Multiple disciplines	Arlington, VA; Austin, TX
	SCM/Fin/CRM	San Antonio, TX; Charlotte, NC; Charlotte, NC; Atlanta, GA
HP	IT / Multiple disciplines	Columbia, SC; Austin, TX; El Paso, TX; Herndon, VA; Richmond, VA; Alpharetta, GA; Lexington, KY
	Finance & Accounting/CRM	Plano, TX; Houston, TX; Jacksonville, FL; Charleston, WV

Source: HfS Research 2012

Spotlight: Making a Market in the South

Ultimate Software Group is investing onshore to deliver business services and IT needs for U.S. companies. Based in Weston, Florida, with additional locations in Fort Lauderdale, Florida, Atlanta, Georgia, Dallas, Texas, and Santa Ana, California, the company provides end-to-end, strategic HR, payroll and talent management functionality by combining all aspects of these business processes in one Software-as-a-Service (SaaS) solution.

Ultimate Software Group differentiates its services by tailoring them to the U.S. market, growing the company's roster of clients. For example, the company focuses on fast transition by highly trained staff. Professionals meet each customer face-to-face, determine requirements, design and deploy to meet unique needs, convert data, train staff and provide ongoing support. Additionally, the company provides customer support via dedicated, long-tenured service professionals who are required to become Certified Payroll Professionals (CPPs).

Ultimate Software Group's high-touch, high-standardization, low-overhead structure is attractive to clients and financial markets. With 2011 revenue of $269 million and a market capitalization of $2.72 billion, the company has a 96% customer retention rate and more than 2,300 customers, including Adobe Systems, The Container Store, Culligan International, Major League Baseball, Nikon, Pep Boys, Revlon and the Texas Roadhouse.

Region Analysis: The Midwest

The Midwest is an attractive region due to the right combination of cost, available talent and high-quality infrastructure. Education levels are particularly high, especially in the upper Midwest. However, many northern states, particularly North and South Dakota, Iowa and Minnesota, have maintained unemployment rates below 6%, driving up wage rates.

Across the region, several of the world's largest outsourcing suppliers have established a base of operations from which to deliver services. HfS has developed an illustrative list of the suppliers' activities and locations (see Exhibit 13).

Exhibit 13: The Midwest: Illustrative Supplier Profile by Service and Location

SUPPLIER	SERVICE	CITY/STATE
Convergys	CRM / Sales	Olathe, KS; Cincinnati, OH; Omaha, NE; Appleton, WI; Hazelwood, MO; Arnold, MO; Wichita, KS; Cincinnati, OH
	IT (Consulting)	
Infosys	IT / Multiple disciplines	Hoffman Estates, IL
Wipro	IT / Multiple disciplines	Indianapolis, IN; Columbus, OH; Milwaukee, WI; St. Louis, MO
Cognizant	CRM / Insurance	Minot, ND; Des Moines, IA
	IT / Multiple disciplines	Topeka, KS; Chicago, IL; St. Paul, MN; Milwaukee, WI
IBM	IT / Multiple disciplines	Dubuque, IA; Columbus, OH
Accenture	IT / Multiple disciplines	Midland, MI; Minneapolis, MN; Chicago, IL; Bolivar, MO
HP	IT / Multiple disciplines	Detroit, MI; Sterling Heights, MI; Warren, OH; Omaha, NE
	Fin/CRM	Pontiac, MI

Source: HfS Research 2012

Spotlight: Up and Coming in the Midwest

Caleris is a U.S.-based business services supplier that specializes in inbound call-center services, technical support and help desk services, and social media monitoring. The company, headquartered in West Des Moines, Iowa, operates three call centers in nearby, more rural communities. Although the metropolitan statistical area (MSA) is not densely populated, by tapping into the right talent, the organization reported 2010 revenues of $8.2 million, up 14% from 2007. Caleris currently employs 350 staff and serves 70 companies within the technology, broadband products, high-end consumer electronics and high-end software products segments.

When compared to global services organizations, the Caleris operating model is small. However, global suppliers looking to grow their footprints in the U.S. can learn valuable lessons from this organization. For starters, the company relies on its strong customer satisfaction rating to grow through word of mouth. Moreover, Caleris has developed a value proposition that resonates with U.S.-based customers; alleviating communication issues from operators whose first language is not English reduces call length by nearly 50%, and the company's friendly and knowledgeable workforce drives a high quality of service. The company admits it cannot match Indian labor rates, but still estimates it can save companies 50% while maintaining the high level of service their customers desire. By identifying the right mix of attributes (cost savings without sacrificing quality), Caleris continues to thrive in a rural setting.

Region Analysis: The West

Moving farther west, there are fewer attractive locations in which to establish or expand service delivery operations. A combination of high salaries, increased costs of doing business, greater regulation and a higher cost of living (especially on the West Coast) may prove unattractive for many suppliers. Suppliers will find competition in the areas where the business and cost environment is less challenging. For example, the vicinity surrounding Phoenix, Arizona, is already a popular hub for business services organizations. However, as in the Midwest, the ability to tap into an experienced, more highly skilled workforce is an advantage.

Across the region, several of the world's largest outsourcing suppliers have established a base of operations and have begun to deliver services. Exhibit 13 presents a partial list of the suppliers' activities and locations.

Exhibit 14: The West: Illustrative Supplier Profile by Service and Location

Supplier	Service	City | State
Convergys	CRM / Sales	Pueblo, CO; Ogden, UT; Salt Lake City, UT; Denver, CO; Pocatello, ID; Tucson, AZ; Orem, UT
	IT (Consulting)	Salt Lake City, UT; Tucson, AZ
Infosys	IT / Multiple disciplines	Los Angeles, CA; Irvine CA; Torrance, CA; Redwood Shores, CA
Wipro	IT / Multiple disciplines	San Diego, CA; Cupertino, CA
Cognizant	IT / Multiple disciplines	Sunnyvale, CA; Cypress, CA; San Jose, CA; Oakland, CA; Albuquerque, NM; Murray, UT
IBM	IT / Multiple disciplines	San Jose, CA; Littleton, CO; Costa Mesa, CA; Boulder, CO
Accenture	IT / Multiple disciplines	Sacramento CA; El Segundo, CA
	SCM/Finance & Accounting CRM	Phoenix, AZ
HP	IT / Multiple disciplines	San Diego, CA; Seattle, WA; Colorado Springs, CO
	Finance & Accounting / CRM	Rio Rancho, NM

Source: HfS Research 2012

Spotlight: Market Marker in the West

Established in 1965, Barrett Business Services combines human resource outsourcing and professional management consulting. The company's main services include Professional Employer Organization (PEO) and staffing. For PEO clients, Barrett becomes a co-employer, and takes over some or all of the human resources management responsibilities. On the staffing side, Barrett helps companies find staff for on-demand or short-term staffing assignments, as well as long-term or indefinite-term contract staffing and on-site management. From the company's 1,815 staffing services clients and 1,935 PEO clients, Barrett looks to generate nearly $2 billion in revenue in 2012.

Enterprise buyers and suppliers looking to deliver services in U.S. markets should note several business strategies that have helped Barrett grow. The company identified an underserved market, small-to-midsize businesses, delivering some of the more resource-heavy and complex, but not core, elements of their business. By taking on greater control of clients' organizations, which increases Barrett's business risk, the PEO model rewards Barrett for what it does best. Thus, this model transfers value more frequently than most enterprise buyer/supplier relationships. As important, most of the company's clients are within 50 miles of a branch office, allowing greater opportunities to meet face-to-face with clients and develop stronger relationships. The customer intimacy model has paid off: referrals account for 40% of new business, and the company boasts a 90% client retention rate.

Region Analysis: The Northeast

The Northeast has many advantages and disadvantages as a service delivery location. Like San Francisco, Los Angeles and San Diego, key cities in this region, including New York City, Boston and Philadelphia, continue to attract the world's best and brightest. Managers looking for specific skills or experience will welcome the Northeast's high concentration of talented, educated workers. However, there is competition for this talent: The region is a hub for global multi-nationals and the center of the U.S. financial services and insurance industries.

The region's high average salaries, high cost of doing business, low business friendliness and high cost of living often deter all but the most complex or industry-specific processes or those that require proximity to the business in major metropolitan areas.

Exhibit 15: The Northeast: Illustrative Supplier Profile by Service and Location

Supplier	Service	City/ State
Infosys	IT / Multiple disciplines	Hatboro, PA
Wipro	IT / Multiple disciplines	Boston, MA; Stamford, CT; Syracuse, NY
Cognizant	IT / Multiple disciplines	Philadelphia, PA; Windsor, CT; Randolph, NJ; Bloomfield, CT; New York City, NY
IBM	IT / Multiple disciplines	Rochester, NY; Armonk, NY; Waltham, MA; Poughkeepsie, NY; Yorktown Heights, NY; Alban, NY; Essex Junction, VT; Hopewell Junction, NY; Princeton, NJ; Marlborough, MA; Boston, MA
Accenture	SCM/Fin/CRM	Hartford, CT; Pittsburgh, PA; Wayne, PA
HP	Finance & Accounting /CRM	Hingham, MA

Source: HfS Research, 2012

Implications for Industry Participants

Our analysis suggests a sharp turn from the predominant sourcing strategy many organizations have implemented—sending as many processes offshore as possible without considering the U.S. as part of their delivery networks. More than a decade of experience in offshore IT and business process delivery is now leading enterprise buyers to reconsider the U.S. as a part of their business services delivery ecosystem. Enterprise buyers are now crafting strategies that underscore many of our conclusions:

- **Context counts.** Enterprise buyers now believe that U.S.-based workers demonstrate a higher level of critical contextual attributes than their offshore counterparts (communication, business understanding and ability to innovate).
- **Quality of the experience matters.** Low cost is no longer sufficient; enterprise buyers believe that onshore delivery means higher levels of client satisfaction.
- **Trending toward tradeoffs.** The data clearly shows that organizations are willing to consider U.S. locations even if the savings are not commensurate with those offshore. This trend may be exacerbated by the narrowing of offshore locations' cost advantage, especially when considered in light of total cost of ownership (TCO), factoring in such costs as travel, rework and management time.
- **Right shore versus offshore.** Enterprise buyers are now increasingly more focused on developing the right—as opposed to the cheapest—global delivery model to create value at the right cost.
- Together, these trends signal a sharp turn from the sourcing strategies the majority of companies have implemented over the last 10 to 15 years.

What does our analysis signify for the industry's key players?

Implications for Enterprise Buyers

The onus is on the enterprise buyer community to drive the movement to keep or return business services onshore. When buyers make demands on suppliers, suppliers will follow.

HfS believes that enterprise buyers will continue to see increasing benefits and return on investment when they incorporate third-party outsourcing suppliers in the buyers' business models. Because of outsourcing, enterprise buyers have been able to lower margins, standardize business processes, create variability and flexibility, promote rapid business model change, tap into technology and finance transformation.

However, enterprise buyers must advance their sourcing strategies as follows:

- **Spend more time developing the right sourcing strategy**, rather than implementing an automatic decision to move processes onshore.

- **Understand the quality of service you require**, matching the capability of on- and offshore workers with the processes in scope.
- **Determine what is important, and where you will trade off cost** for key attributes such as heightened contextual knowledge and communication skills, among others.
- **Capture the total cost of ownership** as part of your business case to understand the hidden costs of moving processes offshore; this will enable you to develop a true picture.
- **Better define core and non-core processes**, and, importantly, the proximity and communication required for optimum delivery.
- **Understand what can be feasibly delivered in the U.S.,** and what should remain offshore because of access to talent, price point, impact on the customer and other criteria. Do not look at U.S. locations as a replacement for offshore delivery but rather a key component in an effective delivery system.
- **Understand how your offshore supplier will actually deliver onshore.** Will they move partial processes, only keeping a middle office onshore and sending the rest offshore? Or will they make a commitment to onshore delivery for the processes in scope?
- **Understand how your supplier will manage an onshore delivery center.** Will management understand that U.S. human resources practices vary from those offshore? Will staff be managed by leaders who are culturally aware? Will all key decisions about delivery be made offshore?

Implications for Suppliers

The marked gap between desired attributes and satisfaction levels onshore versus offshore should be a wakeup call for suppliers, especially those that have not yet invested heavily in a U.S. footprint. Frankly, growth in the face of these skills gaps is not sustainable, especially in light of lower labor arbitrage benefits.

Non-U.S.-based suppliers will struggle to grow long-term partnerships if the suppliers do not meet their clients' expectations when it comes to capability. Simply delivering at the lowest costs, or meeting contract obligations such as service level agreements, is not sufficient in today's competitive marketplace. Clients are increasingly looking for a better service experience driven by proximity, contextual knowledge and better communication skills.

- **Go global.** A global delivery model is always local. Ensure that U.S.-based delivery centers look and feel like American operations; do not try to be an offshore island. Build brand in the local community as an American player.
- **Manage locally.** With enterprise buyers reporting that they value contextual capabilities, do not impose offshore management and HR practices.
- **Develop the right mix of service offerings and delivery locations**. It's time to update delivery models.
- **Understand what makes U.S. workers tick.** U.S. workers are not motivated in the same way as offshore workers. U.S. workers are more independent and have a different set of values.

- » **Understand U.S. recruiting practices.** Rarely is U.S. staff attracted by wholesale recruiting at universities. Other channels, particularly referrals and word of mouth, are critical to developing a talent pipeline.
- » **Be seen as a player in the local community.** American organizations are active participants in their community—through charities, schools and other organizations. This is critical, especially in smaller cities where the delivery center will be a major employer.
- » **Locate near clients.** Where feasible, leverage locations to enhance relationships with existing clients, who should in turn increase share of wallet and assist in moving up the value chain.
- » **Develop a blended location strategy.** The lowest cost of labor will not be optimal when certain skills are vital or there are client proximity or time zone challenges.
- » **Understand clients' U.S. location preferences.** As in other parts of the world, U.S.-based clients have location preferences—and prejudices. The U.S. is not one country; it is in reality many. Factor in any bias as part of a location strategy.
- » **Consider travel times.** Look at transportation routes in light of clients' travel times. Think about your management's travel as well; a low-cost location accessible only by two flights and a two-hour drive may not prove feasible.
- » **Design a network.** It is highly unlikely that delivery centers will reach the same scale as offshore centers. Make location decisions in light of a delivery network setting to govern when it's time to move to another locale.

Implications for Government

Enterprise buyers, suppliers and government are comrades in arms when it comes to moving or keeping business services jobs onshore. However, when it comes to leveling the playing field with low-cost locations, U.S. government entities arguably hold the trump card.

It's time that the federal government understands how to ride the offshoring trend. Taxation policies or subsidies alone will not stop companies from implementing global resource models or reverse decisions by companies that are desperate to shed staff to reduce costs. Similarly, protectionism policies only distort market realities. By understanding what it takes to become competitive, and developing comprehensive programs on the ground, it will be possible to narrow the cost gap between U.S. and offshore workers.

When compared to countries such as India, the Philippines, Malaysia and Poland and even cities such as Berlin and Bogota, the U.S.'s lack of public policy and coordinated economic development activity across federal, state and local jurisdictions makes U.S. location analysis and decision-making a long, detailed and sometimes painful process.

According to a seminal article written by HfS Research Fellow Deborah Kops as long ago as 2010, the U.S. needs to develop a coordinated effort to attract business process jobs back onshore. Kops believes that India's impressive growth in this sector (1998: $4 billion rising to as much as $175 billion by 2020) is a calculated bet by government and industry, working together, to reform policies and provide aligned incentives to support investment, and

provide assistance to recruit, train and retrain staff. Source:
http://www.outsourcemagazine.co.uk/articles/item/3518-nothing-north-of-watford.

Kops says, "We already have the many of the tactics, if not the policy framework, to compete. Jobs training programs have been on the books for years. Local economic development agencies have developed financing tools and other incentives such as tax abatement and increment financing districts. Not-for-profits or NGOs know how to tap into grants to train or create jobs. Tax credit programs abound at the local and federal levels. Corporate foundations are always out in the market seeking pro bono opportunities. And, in some locales, government-owned facilities, such as redundant military bases, are empty and waiting. Why not put these tools and techniques together into a framework that levels the playing field with offshore locations?"

What must government do to reverse the tide of jobs moving offshore, harnessing the particular skills that U.S.-based workers bring to business process services?

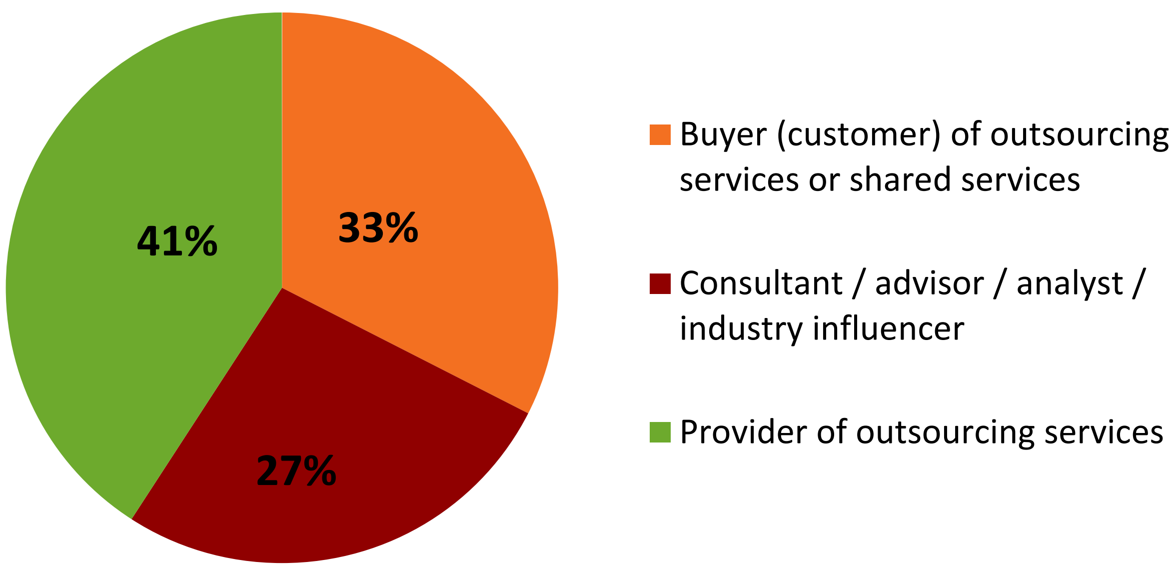
- **Stop confusing outsourcing with offshoring**. They are not synonyms. Outsourcing is not the economic evil that politicians make it out to be; in fact, there's nary a U.S. company of any scale that does not turn to third parties to provide some level of service. GM turns to third parties in Toledo to build parts; that's outsourcing. Companies contract with Sodexho or Aramark to run their cafeterias; that's outsourcing. Pitney Bowes or Xerox runs American mailrooms; that's outsourcing. What we're talking about is offshoring—moving jobs offshore. It's time to use the right terminology. If offshore suppliers hire American workers, that's outsourcing; if they move them offshore; that's offshoring.
- **Understand that globalization of the workforce is here to stay.** Government dictates, especially at the federal level, seem to ignore the fact that, with the advent of technology and a rising educated workforce offshore, American companies owe it to their stakeholders to tap into the right labor at the right cost. Decrying the evils of outsourcing just to make a point with the American electorate is a populist play, not an acknowledgement of a new reality. If the government works with suppliers to help develop local skills and concentrations of talent in high unemployment areas, the enterprise buyers are ready to move the work.
- **Stop wielding the taxation club as an incentive to keep jobs onshore**. In a world with a globalized workforce, taxation is not the only stick to encourage American companies to keep jobs onshore. It takes a comprehensive program of incentives to cut the cost differential.
- **Align federal policy to promote onshoring.** Many government policies work against U.S. delivery. For example, H1B visas are assigned based on the ratio of jobs that move offshore, a disincentive for offshore suppliers to retain work onshore. The U.S. government needs to take a hard look at the many regulations on the books, and adjust accordingly.
- **Coordinate programs across all levels of government.** Enterprise buyers and suppliers cite long, drawn-out processes to determine the feasibility of locating onshore when training is controlled locally, incentives are managed out of statehouses and the long list of the federal government's incentives take a PhD to navigate. Assigning one office to coordinate at the state level, with staff that understands that the competition is not South Carolina but India and Malaysia, will go a long way toward making U.S. locations competitive.

Appendix: Survey Methodology and Statistics

Between July and October 2012, HfS conducted the first major study of domestic versus offshore outsourcing with U.S. enterprise outsourcing stakeholders, covering 215 quantitative enterprise buyer interviews and 270 outsourcing supplier executive interviews. HfS also conducted 40 qualitative interviews with selected senior enterprise outsourcing buyers and suppliers to add further context to interpret the survey data.

Exhibit 16: Survey Respondents by Activity Type

Q. Which of the following roles best describes you?



Source: HFS Research 2012, 661 respondents

Exhibit 17: Mix of Enterprise Buyer Respondents by Industry

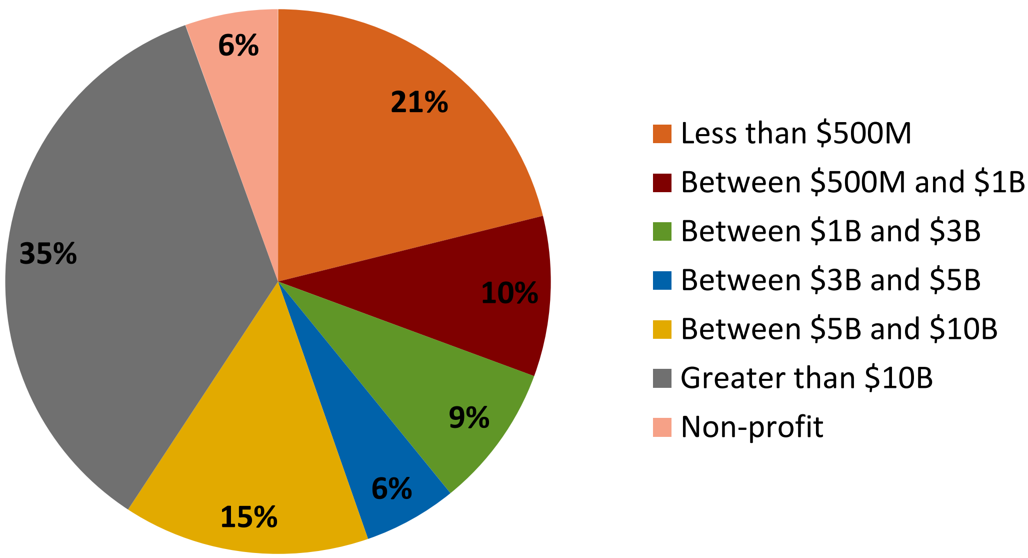
Q. Please specify your company's industry.

Industry	% Respondents
Financial Services and Banking	34%
Pharma, Life Sciences, and Health Care	11%
Software and Hi-Tech	11%
Manufacturing / Industrial Products	9%
Insurance	7%
Consumer Packaged Goods	5%
Entertainment, Media and Publishing	5%
Government and Education	5%
Retail and Hospitality	4%
Energy, Oil and Gas	3%
Transportation and Logistics	3%
Utilities and Telecom	3%
Public Sector	1%

Source: HfS Research 2012, 221 Enterprise buyers

Exhibit 18: Enterprise Buyer Respondents Split by Company Annual Revenue

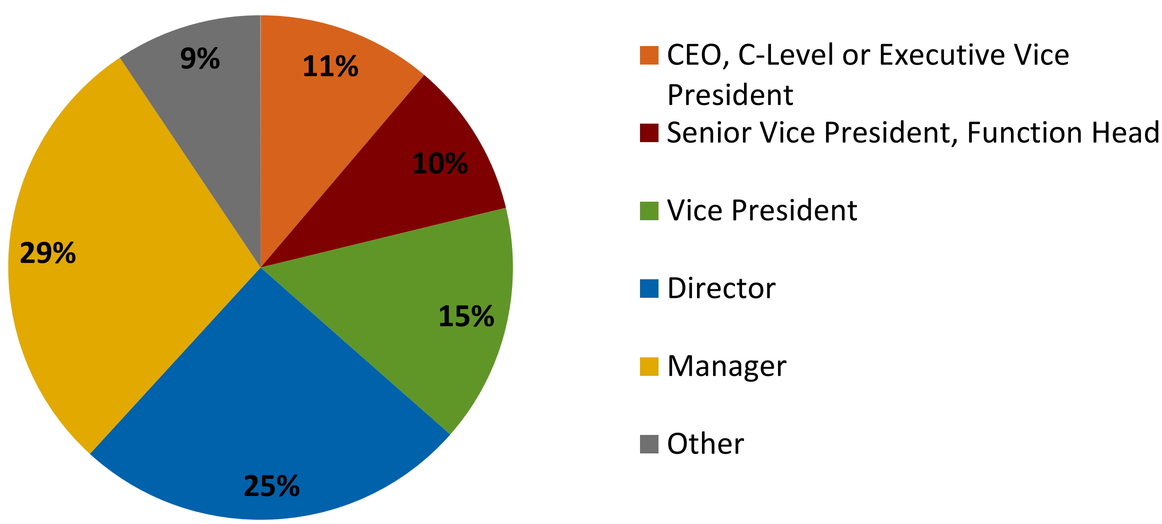
Q. What are your company's annual revenues? (in U.S. dollars)



Source: HfS Research 2012, 221 Enterprise buyers

Exhibit 19: Enterprise Buyer Respondents Split by Role within Their Organization

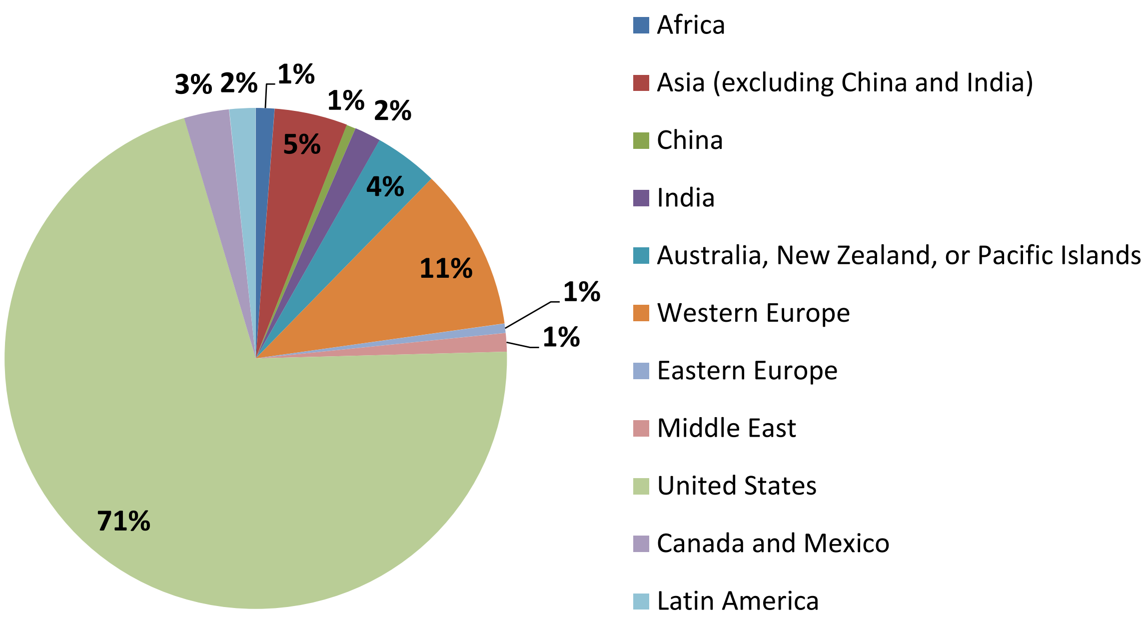
Q. What title best describes you?



HfS Source: HfS Research 2012, 221 Enterprise buyers

Exhibit 20: Enterprise Buyer Respondents Split by Primary Work Location

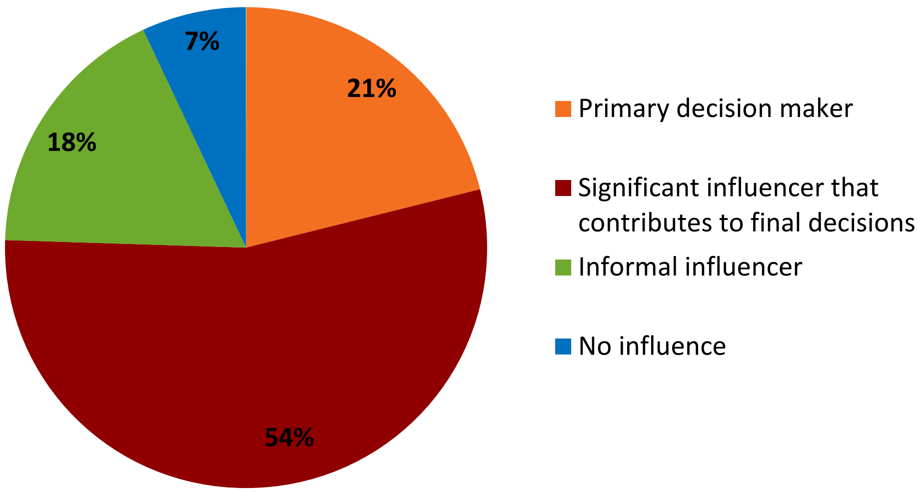
Q. What region best describes your primary work location?



Source: HfS Research 2012, 221 Enterprise buyers

Exhibit 21: Enterprise Buyer Respondents Split by Level of Influence over Outsourcing Decisions

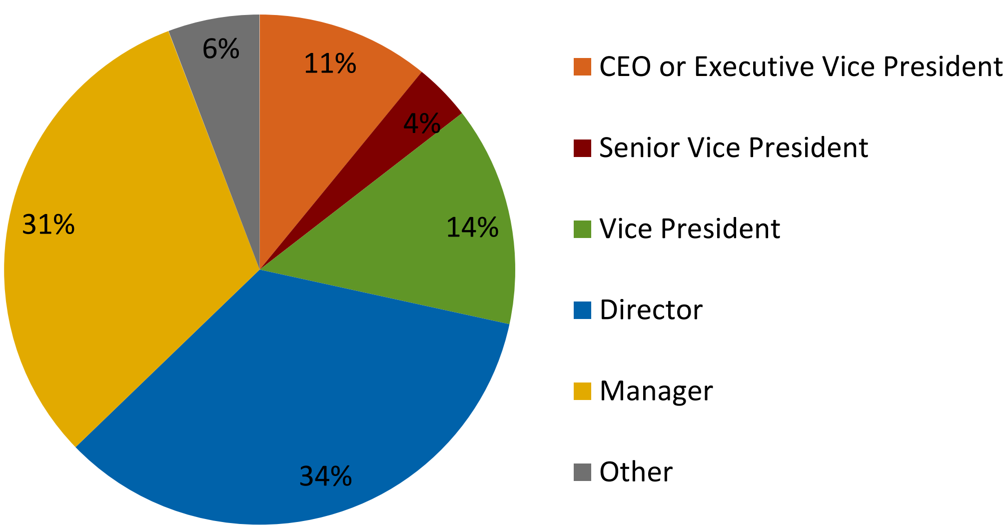
Q. What role influence do you have over your company's outsourcing location decisions?



Source: HfS Research 2012, 221 Enterprise buyers

Exhibit 22: Supplier Respondents Split by Title within Their Organization

Q. What title best describes you?



Source: HfS Research 2012, 270 Suppliers

Exhibit 23: Supplier Respondents Split by Type of Services Provided to Enterprise Buyers

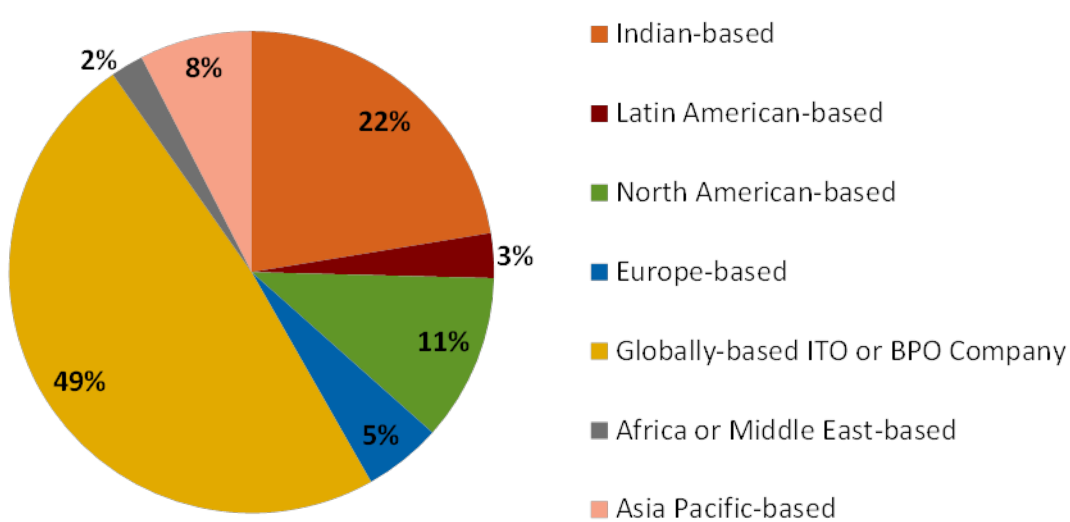
Q. Which services does your company provide?

Industry	% Respondents
IT	64%
Finance and Accounting	53%
Customer Service	53%
Industry-specific process/es	48%
Human Resources	40%
Procurement and Supply Chain	40%
Sales and Marketing	27%

HfS Source: HFS RESEARCH 2012, 270 Suppliers

Appendix Exhibit 24: Supplier Respondents Split by Services Delivery Footprint

Q. Which of the following best describes your delivery center footprint?



HfS Source: HFS RESEARCH 2012, 270 Suppliers, 176 Advisors

About HfS Research

HfS Research (www.HfSResearch.com) is the leading independent global analyst authority and knowledge community for the business and IT services industry. HfS is unique in that it serves the research and strategy needs of business operations leaders across finance, supply chain, human resources, marketing, customer management, IT and core industry functions.

In addition to researching business operations strategies, HfS educates and facilitates discussion among the world's largest knowledge community of enterprise services professionals, currently comprising 120,000 subscribers. HfS Research also facilitates the HfS Sourcing Executive Council, the acclaimed elite group of sourcing practitioners from leading organizations, which meets bi-annually to share the future direction of the global services industry and discuss the future enterprise operations framework.

Led by recognized industry expert Phil Fersht, HfS Research differentiates itself with its global team of expert services analysts with real industry experience, provocative and opinionated research, unrivaled market analytics and a view of technology as an enabler for business process improvement. HfS Research's on-demand expertise relationship model helps clients leverage HfS knowledge and strategic insight in a rapid, responsive and engaging manner.

In 2010 and 2011, HfS was awarded Analyst of the Year by the International Institute of Analyst Relations (IIAR), the premier body of analyst-facing professionals, and achieved the distinction of being voted the research analyst industry's most Innovative Analyst Firm in 2012.

Now in the sixth year of publication, HfS Research's acclaimed blog "Horses for Sources" is widely recognized as the leading destination for unfettered collective insight, research and open debate of sourcing industry issues and developments.

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