

TRENDS



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Mexico Starts Its Offshore Services Engines

The Big Challenge Now Is To Increase Scale

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EXECUTIVE SUMMARY

Every company with a formal offshore program management office is considering diversification. Some are worried about the attrition and rising wages in India, while others are simply looking to mitigate risk by adding new locations. Mexico represents an excellent nearshore alternative for US companies that are looking for diversification or that can't or don't want to use an offshore vendor. While the Mexican software and services export market is not as mature or as large as the Indian market, there are significant benefits that can be gained by using an IT services firm in Mexico, especially as the industry there continues to mature.

TARGET AUDIENCE

IT sourcing and vendor management professional

THE BENEFITS OF NEARSHORE OUTSOURCING

Projects with intensive collaboration requirements, internal domain expertise requirements, or a medium to high degree of end user participation are often more suited to nearshore outsourcing models, as travel between vendor and client is easy and time zones permit real-time collaboration. As successful as offshore/Indian relationships typically are, time zone differences, cultural differences, and travel requirements sometimes make them too challenging to maintain. In addition, companies are starting to believe that it is imperative to find locations outside India for low-cost remote IT resources to mitigate the risk associated with having all offshore resources in one country. Benefits of a nearshore outsourcing arrangement include:

- **Time zone.** For firms based in North America, especially companies located on the West Coast, time zone issues with offshore vendors in locations such as India can severely hamper the success of an offshore initiative. With time zone differences in the 9.5-hour to 13.5-hour range, vendor staff, internal IT staff, and internal customer staff will struggle to establish viable and collaborative relationships. Nearshore arrangements work to the firms' advantage, as both client and provider can work together in real time. Mexico, for example, follows mostly US Central Time, allowing business users, project managers, and external resources to communicate during normal business hours.
- **Proximity.** When project work requires collaboration, a nearshore arrangement is preferable to an offshore one due to the fact that the vendor is within reach of the client. In a nearshore partnership,

project managers can easily commute between both the vendor and the client, facilitating interactions between each and minimizing overall risk. This works especially well for companies in states such as California and Texas, where clients can even drive to vendor locations in Mexico. In fact, some vendor resources even commute between the US and Mexico on an almost daily basis.

- **Ease on process change requirements.** Companies that have immature or nonstandard software development and IT customer management processes usually have to alter their processes to outsource successfully. In a typical offshore relationship, the IT organization has to clean up or optimize its processes so that it can effectively communicate and collaborate with offshore outsourcing staff that use very mature software development processes. In an outsourcing relationship, end user requirements have to be considered and detailed enough so that a business analyst, a technical writer, internal IT, the offshore vendor, or some combination thereof can interpret them and write a specification based on them. The flexibility afforded by a nearshore relationship — the client and vendor can discuss requirements during normal business hours — makes it easier for vendors to meet a client's process change requirements.
- **Cultural affinity.** While there are significant cultural differences between the US, Canada, and Mexico, these differences pale in comparison with those between the US and India. Mexicans are familiar with US customs, lifestyles, television, and other cultural facets. Mexicans and Americans also have similar means of communication: There are 40 million people in the US that speak Spanish, as well as a sizable immigrant population from Mexico and Latin America.

MEXICO: STRENGTHS AND WEAKNESSES

While Mexico has limitations in terms of resource pools and language skills, the government is heavily investing in the software development industry. Mexican colleges and universities are turning out qualified English-speaking software engineers. Mexican companies such as Softtek and US companies such as IBM have achieved the Software Engineering Institute's (SEI's) Capability Maturity Model (CMM)-level certifications and have strong customer references to prove their capabilities. The US North American Free Trade Agreement (NAFTA) makes trade with Mexico simple, and the cost to outsource to Mexico is almost as low as the cost to outsource to India.

Mexican Nearshore Outsourcing: Strengths

As companies look to accommodate an ever-increasing piece of their IT portfolio using lower-cost remote resources, they will find Mexico a useful alternative for projects or systems that are not suited to long-distance offshore outsourcing. Companies interested in the cost and quality benefits of offshore labor but that require a closer, less risky solution should strongly consider Mexico as an important nearshore option. Mexico's strengths as a nearshore outsourcing option include:

- **Ease of travel.** Mexico's proximity to the US allows for increased collaboration over the course of the project. There are more than 300 flights between the US and Mexico available each day, allowing for greater opportunity for internal and external resources to work together in real time. Also, competitive IT hubs like Baja California share borders with US states such as California, making transportation by land easy as well.
- **Costs.** Nearshore efforts in Mexico carry estimated operating costs 20% to 30% lower than a US-based operation.¹ Overhead costs are typically less than those associated with an offshore relationship because of reduced telecom costs, travel costs, and due diligence costs. Forrester estimates that labor costs range from between \$25 and \$40 per hour. Hourly rates for similar categories of staff tend to be 10% to 20% higher than equivalent Indian skills. Overall, US companies can expect to save between 15% and 45% of what similar projects would cost in the US.
- **Low attrition.** Thus far, attrition in Mexico in the IT services sector is much lower than in many other offshore locations, granting customers access to a more stable resource pool.
- **Manufacturing history.** Since the signing of NAFTA, hundreds of US and European companies have set up manufacturing facilities ("maquiladoras") in Mexico to take advantage of the low-cost labor and free trade status. It is no coincidence that Monterey, the "Silicon Valley of Mexico," is also Mexico's manufacturing capital. Free trade initiatives have welcomed global companies such as Ford, John Deere, General Electric (GE), Johnson & Johnson, and Carrier to Mexico. Manufacturing has helped build up and bolster the economy of cities such as Monterey and Guadalajara, enticing other global firms, including software developers, to the region.
- **Physical infrastructure.** The physical and communications infrastructures of a particular country have everything to do with its success as a nearshore destination. In Mexico, for example, the telecom, power, and transportation infrastructure has improved significantly since the signing of NAFTA. Privatization and foreign investment have built up the physical infrastructure of the country, while the communications infrastructure also continues to thrive. Telecom improvements in particular provide seamless links between the US and Mexico. Given all this, customers can even consider hosting their systems in Mexico.
- **Government support.** The Mexican government is extremely supportive of the software industry. State initiatives in places such as Aguascalientes and Baja are further supported by the federal government's ProSoft (Programa para el Desarrollo de la Industria del Software) program.² The government actually subsidizes companies' efforts to open new technology facilities and train staff, covering as much as 50% of the startup costs. ProSoft is an initiative spearheaded by the Mexican Ministry of Economy to promote the development of the Mexican software industry. Like India's National Association of Software and Services Companies (NASSCOM), ProSoft strengthens the government's focus on the software development industry as a critical priority for economic growth. In 2006, the government doubled its efforts, launching a formidable advertising and recruiting campaign for ProSoft in May.

- **Manufacturing and automotive industry expertise.** Due to the manufacturing industry's pull in Mexico, Mexican IT firms have deep expertise in both this and other related industry sectors. Given this, there is an excellent pool of Mexican resources with expertise in areas such as SAP, product life-cycle management (PLM), and supply chain technologies.

Mexican Nearshore Outsourcing: Weaknesses

Despite the relative advantages, firms do need to consider the risks associated with using Mexico as a nearshore destination. While its stable political environment, infrastructure, and proximity to the US make Mexico a viable nearshore option, issues with language, education, and industry maturity can also raise cause for alarm.

- **Education.** A smaller pool of skilled graduates does weaken Mexico's appeal as a nearshore option. Presently, Mexico has only about one-tenth of India's yearly IT graduates. Also, unlike in India, Mexican students are not routinely nor exclusively taught engineering or software development in English. Business development at both the state and federal levels in Mexico has concentrated on educational reform as a means of pushing vocations in IT-related fields. Monterrey is home to the Monterrey Institute of Technology — what *Fortune Magazine* calls “Mexico's answer to MIT.” Monterrey is also the capital of the state of Nuevo León, in which there are 30 universities. The Baja region is now home to 114 institutions of higher education, 114 technical training centers, as well as 17 R&D facilities. Between 2000 and 2004, Baja alone graduated 7,000 individuals with IT-related degrees.
- **Language skills.** To be sure, one of the biggest challenges for IT services vendors in Mexico is finding or training programmers to speak English. Mexican vendor Softtek devotes a large portion of its training budget to English-language training in order to ensure that its staff communicates effectively with US clients. Vendors that are less mature or less reputable than Softtek do not invest in as much language training effort, and this will be problematic during an engagement.
- **Scale.** Mexico simply does not have enough IT professionals at present to grant it the scale that India has. Companies will not be able to grow their projects by 200 people in two weeks' time; instead, they will have to work with their vendors and carefully plan for future resource needs.
- **Market immaturity.** There are very few indigenous Mexican vendors from which to choose. With few exceptions, those that do exist are not yet very good at marketing to, or selling to, American customers. This suggests that these firms also do not have deep experience in delivering to American or nearshore customers. The landscape has improved, yet it is several orders of magnitude smaller than India. For the market to develop and grow, potential customers need to have more than one Mexican vendor on their shortlists.

THE VENDOR LANDSCAPE: A SMALL NATIVE MARKET AND GLOBAL PROVIDER PRESENCE

A range of vendors offer nearshore outsourcing options in Mexico. These include domestic players such as Softtek, Hildebrando, and Neoris — a subsidiary of CEMEX, one of the largest cement companies in the world, Neoris has offices (or facilities) in Monterrey — as well as larger, global firms, such as IBM Global Services and EDS. The top vendor for nearshore outsourcing in Mexico today is Softtek.

Softtek Is The Most Important Mexican Vendor

Softtek is the obvious choice for Mexico-specific nearshore outsourcing, based both on its experience as well as its innovative and global approach to nearshore outsourcing. Softtek is Mexico's largest software company and, with reported 2005 revenues of \$146 million, a driving force in Mexico's burgeoning tech economy. The company has four development centers in Mexico, two in Brazil (to serve Latin American clients), and one in Spain (to serve Europe). As the largest IT services provider in Latin America, Softtek also boasts a 24-year legacy as well as a staff of about 4,000 IT professionals.³

Softtek has a strong Six Sigma focus that it has developed through its partnership with and support of GE. Not only has Softtek been a GE service provider for a number of years, but the company also purchased one of GE's captive Mexican IT and BPO facilities in 2004.

In terms of service offerings, Softtek is most focused on applications-related work, but it does have a BPO business and a small infrastructure outsourcing business. Softtek has a very strong SAP offering — not surprising given Mexico's manufacturing heritage.

Softtek Has An Impressive Customer List And Good Testimonials

Despite the fact that Softtek already counts six of the Fortune 50 among its client base, it recognizes that its growth potential is somewhat limited by its country's ability to gain a reputation in the nearshore outsourcing segment. Softtek is extremely involved in developing and promoting the Mexican software development industry. It works very closely with the government to encourage and support the emergence of a more competitive nearshore environment. Recently, Softtek co-hosted the Nearshore Summit with the state and federal governments of Mexico. The summit featured government and industry speakers, as well as current nearshore outsourcing clients. The feedback from Mexican nearshoring clients was striking. Clients, most of whom had no significant previous *offshore* experience, discussed the benefits of working with a vendor situated in their own time zone and continent. Not only were many of the cultural and communication difficulties neutralized, but it was clear from their reports that the clients and their customers did not have to make the same investment in process change in order to get the relationship right.

To illustrate the cultural differences between a Mexican and Indian IT services vendor, one large media and entertainment client cited a situation in which it had asked Softtek to ramp up a number of resources for an urgent project within a short time frame. The client wanted to use Softtek rather

than its offshore providers. While the project was commercially attractive, Softtek had to turn it down because it could not properly resource the project in the allotted time. The client was shocked at the forthright nature of the vendor, particularly its ability to say “no.” This, the client stated, was in stark contrast to interactions with his Indian vendors — which often said “yes,” even when unable to deliver what was requested. Of course, this anecdote also underscores the problems associated with Mexico’s inability to rapidly scale.

RECOMMENDATIONS

MEXICAN NEARSHORE OUTSOURCING IS AN INCREASINGLY ATTRACTIVE SOLUTION

The following companies should consider Mexico as a nearshore option:

- **Those interested in the cost and quality benefits of offshore labor.** In particular, those that also have intensive collaboration requirements, internal domain expertise requirements, or a medium to high degree of end user interaction should strongly consider Mexico as a nearshore option.
- **Those struggling with the rigid processes needed to make offshore outsourcing work.** These firms will benefit from the time and distance proximity of Mexico. Less rigid processes are required when clients and vendors can communicate in real time.

However, these same companies must keep in mind that:

- **The Mexican nearshore outsourcing industry is immature.** Although Mexico is not as risky as some offshore or nearshore locations, due to its political environment, infrastructure, and proximity to the US, the Mexican nearshore outsourcing industry is still developing. Many vendors have not honed their remote management processes to the degree that the large Indian vendors have. Thus, clients must check US references and also ensure that the vendors they choose have a track record of success.
- **Mexican firms often lack the necessary language skills.** Companies must interview their project teams to ensure that English language skills are sufficient.

WHAT IT MEANS

COMPANIES REQUIRE A PORTFOLIO OF VENDORS IN DIFFERENT GEOGRAPHIES

Given the needs of most large companies today, an all-India strategy will not be satisfactory. It is important that companies utilize the best vendors in the geographies that make sense for their business and the types of tasks that they want to outsource. For sure, some types of work are more efficiently and effectively done in India or in other offshore locations, but there are many tasks that cannot be efficiently completed in such distant or culturally different locations. Companies must invest in gaining the knowledge required to select the appropriate location and vendor.

SUPPLEMENTAL MATERIAL

Companies Interviewed For This Document

Prosoft

Softtek

ENDNOTES

- ¹ Source: Softtek presentation, “The Nearshore Experience,” *Near Shore Summit Ensenada*, Mexico, November 2006.
- ² Please see <http://www.software.net.mx/desarrolladores/prosoft/programa/> for more information.
- ³ Please see Softtek’s English language site <http://www.softtek.com/nearshore/> for more information.