

# Lower Cost Domestic Sourcing: A Niche Opportunity for the US

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Dear Reader:

On behalf of our more than 325 member companies, the Information Technology Association of America is pleased to release this thought provoking report by Conscient Partners on the opportunity for increased outsourcing of information technology functions to communities across the United States. While acknowledging that global sourcing is here to stay thanks to the significant benefits it delivers to customer organizations and our economy, the report shows how the United States can compete more effectively for outsourced work.

America has its own unique advantages to offer – not only to American companies, but to foreign-based businesses as well. The prescription for success? Better collaboration and real action by federal, state and local governments, economic development agencies, academic institutions, businesses, and trade associations. We must grow our IT workforce, make high-speed broadband more widely available, and create economic development strategies to attract private-sector investment and technology jobs to more cities, towns and rural areas.

Our nation needs to seize this opportunity. Toward that end, ITAA already is working with the National Governors Association and other organizations to develop a roadmap to expand lower-cost domestic sourcing. We encourage others to join this drive to keep the U.S. in a leadership position in information technology, with all of the resulting benefits to our economy, businesses, communities, and future generations.

[Click here](#) to purchase a copy of the full report. For more information about complementary copies available to the government and media, please contact Charlie Greenwald of my staff at [cgreenwald@itaa.org](mailto:cgreenwald@itaa.org).

Regards,



Phillip J. Bond  
President and CEO  
Information Technology Association of America

The Information Technology Association of America (ITAA) provides global public policy, business networking, and national leadership to promote the continued rapid growth of the IT industry. ITAA consists of over 325 corporate members throughout the U.S. The Association plays the leading role in issues of IT industry concern including information security, taxes and finance policy, digital intellectual property protection, telecommunications competition, workforce and education, immigration, online privacy and consumer protection, government IT procurement, human resources and e-commerce policy. ITAA members range from the smallest IT start-ups to industry leaders in the Internet, software, IT services, digital content, systems integration, telecommunications, and enterprise solution fields. For more information, visit [www.itaa.org](http://www.itaa.org). ITAA is secretariat of the World Information Technology and Services Alliance, consisting of 70 IT trade associations around the world. The Association also maintains affiliations with over 1500 IT companies in the U.S. and Canada through its alliance with the Council of Regional Information Technology Associations.

## *Lower Cost Domestic Sourcing: A Niche Opportunity for the US*

### *Executive Summary:*

Offshoring of IT-related services has become one of the most dominant industry trends over the past decade and a half. Having started with commodity software functions performed remotely in India, the global delivery model for IT related services now encompasses higher-end application functions as well as a wide array of other IT-related activities (contact/call centers, back office transaction processing, infrastructure, et. al). The widespread availability of telecommunications and Internet technologies has made it possible for IT employers to utilize globally distributed virtual teams.

Global sourcing of IT services has become a key strategic initiative for many US enterprises and is fast becoming the standard way to deliver IT solutions. Absent a significant shift in the geopolitical scene or increased country level protectionist behaviors, a distributed, globalized IT labor supply chain will become the dominant IT sourcing model used by G2000 companies.

Today, US corporations are in the forefront of this shift, driven by their need to stay competitive in today's global marketplace. The key benefit to date has been significant cost reduction — with savings estimated at roughly 20-40% for applications related projects. However, global sourcing also poses challenges for the US.

This has led to vigorous debate among industry, government and the media on the impact of globalization on US innovation and the socio-economic effects on the US workforce, as well as what steps might be needed to protect US jobs, intellectual property and security. Some politicians have called for legislation to limit, or even prohibit, IT offshoring, particularly for public sector entities.

In response, IT services providers focused on public sector customers, which in many cases are restricted from using offshore resources, have been examining ways to deliver more cost effective IT solutions domestically. Concurrently, some dissatisfaction with current offshore efforts and concerns over the sustainability of the offshore labor arbitrage advantage are causing some enterprises to reconsider their global strategies and look afresh at new US locations as potential sourcing destinations. This includes lower cost mid-sized metropolitan areas and rural communities that can provide a significant cost improvement over Tier 1 IT hubs such as Silicon Valley, generally in the range of 30%. This is termed lower cost domestic (LCD) sourcing.

In order to inform the discussion, ITAA commissioned this new, independent study on the global trends for cost effective sourcing of IT services over a strategic planning horizon of 3-10 years. The goal is to help policy makers, business leaders and others answer the following question — **Is there a viable niche opportunity for lower cost domestic (LCD) sourcing?**

This report synthesizes those opinions and provides a view of how the US can become a more cost effective global sourcing destination by encouraging and nurturing job creation in smaller, often economically disadvantaged American communities, thereby enabling more cost effective IT services delivery in the US.

### *Key Findings:*

*We are all competing in a global market — the fight for customers, capital, jobs and resources is now on a global scale.* The distributed global IT services delivery model is accelerating and

irreversible. For many US businesses developing a global sourcing model is an economic imperative. The likelihood of any significant “return to the US” countertrend has come and gone. According to several studies, the offshore labor arbitrage will be reduced, but should remain significant for 20+ more years as additional countries build capacity and expertise.

*Specialized offshore locations are emerging for different IT-related services and functions.* The success of India and now China, which is expected to emerge as one of the dominant players, has encouraged other developing countries to assess what differentiation their countries can provide. Other sourcing destinations now include the Philippines and other ASEAN countries, nearshore countries (Canada, Mexico and Latin America), Europe, the Middle East and Africa. Increasingly US enterprises are adopting a “cities of excellence” model, sourcing services from the best location for their respective IT functions and processes.

*Offshoring is evolving from a cost-saving tactic into a long-term workforce management strategy.* Almost 70% of the survey respondents stated that offshoring was driven by the need to tap the global talent pool. A shortfall of skilled personnel was also the reason given for offshoring related high-end work — research and development, product design, engineering and innovation. Many other surveys have supported this finding. This shift will have significant long-term ramifications for enterprises, resulting in a new emphasis on human capital development strategies, including sourcing strategies.

*Onshoring will remain an integral component of most enterprises’ global delivery strategy.* For some organizations using offshore services is just not an option. Government entities and their suppliers, semi-regulated industries, companies concerned about IP, data privacy or security, or those very sensitive to any adverse publicity, often tend to be less inclined towards offshoring. Small to medium size businesses limited by scale or management sophistication and larger enterprises when lowest cost is not the primary focus are similarly disinclined. Finally, some work simply does not lend itself to an offshore solution. There are a growing number of examples of companies establishing or expanding remote delivery centers in cost-effective LCD locations. Many view onshoring as a vital component of their global delivery model.

*Workforce demographics, the increased need for IT services, limited IT budgets and offshoring restrictions are all converging to make LCD sourcing timely and relevant in the public sector.* Security and data privacy concerns and the political need to create jobs for US workers will ensure that most public sector work remain onshore. However, the government still needs to provide a multitude of services to its constituents. *Given the increased need for IT services, LCD solutions are now an imperative for the public sector.*

***The US has a unique opportunity to positively impact the economy by emphasizing jobs and skill sets that enable participation in a global economy and promote cost-effective LCD sourcing.*** Today the US is still the dominant supplier of IT resources, and remains desirable on every sourcing selection criteria except absolute labor costs. There are many lower cost rural and mid-size cities that have a talented IT workforce, with colleges and universities eager to collaborate with prospective employers on IT oriented curricula. Thus there are many niche opportunities for both private and public sector entities to utilize LCD destinations to obtain cost-effective IT solutions and delivery.

The success of these efforts depends partially on better educating the public on the total cost of outsourcing (TCO). Today many companies are still lured unrealistically by low offshore wage rates and neglect to consider the many other factors that can significantly reshape the financial proposition — complexity of the work being outsourced, delivery effectiveness and

communication needs. Enterprises need to look objectively at the cost-talent-risk equation and determine how the level of savings obtained from LCD sourcing compares with the total cost and effort involved in moving business functions offshore. Often the savings comes close enough that the additional effort involved in going offshore just doesn't make economic sense.

*Ultimately this will be a fight for talent (skills and availability) — efforts need to be made now to recruit and prepare the highly skilled IT professionals in the US.* Demographic and education trends in the US indicate significant IT labor shortages in the near future. The aging US workforce, and below-replacement birth rates will lead to a tightening labor market. According to a recent ITAA survey of IT companies, 77% of respondents stated that a shortage of qualified talent in the US is their greatest human capital challenge.

*Absent a large qualified US workforce, LCD sourcing becomes a moot point.* Simply put, the US cannot nurture the creation of jobs in lower cost venues without a skilled IT workforce. As technology jobs grow faster than the rest of the economy, existing US labor shortages for engineers and software developers will grow to increasingly critical levels. Going forward, LCD sourcing will be constrained by IT workforce employment trends — the 'graying of America', availability and quantity of skills, education and training opportunities, immigration restrictions — and not by IT offshoring.

### **Recommendations:**

A rapidly globalizing economy poses policy and economic development challenges for the US. Without fundamental change to outdated, counterproductive policies, the country's current dominance over the global IT industry will wane. However, there are strategies that foster the creation of IT jobs in lower cost, often economically disadvantaged areas of the US — that will allow the US to remain an attractive, competitive, global sourcing destination.

The fundamental strategic shift necessary can be described as the disassociation of US supply from US demand. In other words, the US supply side must stop viewing demand from US enterprises as a monopoly. The increasing number of emerging supply regions is a direct result of active coordination and participation among governments, universities and the IT services industry in each country. For example, the Indian central and state governments provide tax incentives and develop custom-bonded export processing zones, universities work with industry to develop curricula that supports their resource needs, and the industry works through NASSCOM (National Association of Software and Service Companies) to build greater competitive advantage. Other countries are following a similar course.

To take advantage of the current opportunity, proactive agendas must be initiated on two fronts:

***1. US policymakers need to support the creation of a viable, sustainable niche market in LCD sourcing.*** Government, industry and academia must collaborate to develop a competitive country model — first by addressing the following workforce issues:

- Vigorously promote investments in science, technology, engineering and math at all educational levels
- Prepare IT professionals with skill sets valued in the future, complementing their technology background with business and people skills
- Encourage programs between IT companies and educational institutions to ensure that students living outside major IT hubs train for the IT jobs of the future

- Expand visa programs for skilled knowledge workers so that IT employers can more easily hire highly educated, foreigners to offset domestic talent shortages. Such workers have proven to be significant long-term contributors to the US economy
- Leverage the up and coming pool of military and boomer retirees who are ready and eager to work.

And then by addressing a number of key non-workforce issues, including:

- Enact policies and provide incentives to dramatically increase the speed and availability of broadband nationwide, an essential infrastructure component for enabling global delivery.
- Aggressively brand and market “Brand US Sourcing”, both domestically and globally.

**2. A proactive agenda is required at the regional and local levels to foster opportunities for IT job creation.** Proactive, innovative strategies are needed at the state level to help LCD communities effectively compete for IT work. For example, the state of Virginia has developed a comprehensive, innovative economic development strategy to attract private sector investment and technology jobs to the more economically depressed areas of the state. The goal is to successfully position rural Virginia as an attractive rural sourcing destination. Unfortunately, programs in other states appear to be non-existent or in the embryonic stage and not publicly discussed. States and economic development organizations should be examining Virginia’s approach to attract private and public sector IT employers and other state strategies as they unfold.

While global IT services delivery is an irreversible trend, the US IT industry will always command a share of the US IT market. There is an opportunity today to optimize that market share with the development of cost effective, high quality LCD solutions in the US and the promotion of America as an attractive IT provider in the global sourcing arena. The US can generate more IT jobs, wages, tax receipts and other economic and productivity benefits, if federal, state and local policy makers join hands with universities and industry in a concerted, nonpartisan effort to make US localities more competitive and attractive for IT businesses. Many companies, cities and regions have proven that the right combination of factors can deliver new jobs to small town USA.

*For a complete copy of this report, please contact Charlie Greenwald at [cgreenwald@itaa.org](mailto:cgreenwald@itaa.org)*

Conscient Partners is a firm that provides global sourcing advice and research to services providers, enterprises and public sector entities. By leveraging its expertise in global sourcing, exploiting its links within the industry, and following a robust methodology, Conscient Partners helps global service providers develop and execute strategic plans for sustainable growth and enterprises to execute all phases of the global sourcing life cycle with high performance.