

## Low-Cost-Country Sourcing

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### ***Is Latin America the Next Big Thing?***

**Maturing labor and supply markets. Rising costs of delivered goods. Increased supply chain risks. Growing awareness of environmental impact. All these factors herald Latin America's rising popularity as a low-cost-country sourcing alternative to Asia.**

In the coming years, supply management professionals can expect Asia to continue to grow as a low-cost-country sourcing (LCCS) alternative. Even so, Ricardo Ruiz-Huidobro, vice president of A.T. Kearney, says Latin America is the next frontier.

"You don't see the train," he says. "But you can press your ear to the tracks and know it's coming."

A recent A.T. Kearney report, *Destination Latin America: A Near-Shore Alternative*, suggests Latin America's cost advantages, cultural affinity and abundant resources make it an increasingly attractive sourcing option. Additionally, these countries offer a growing, relatively low-cost, skilled bilingual workforce and time zones and cultures closely aligned with those of the United States.

Despite these strengths, Ruiz-Huidobro says changing the executive mind set remains a major barrier to implementing Latin American sourcing. "In many organizations, there are historical reasons, legacy reasons, why things are done in a certain way, or why one supplier has been a supplier for many years," he explains. "In my experience, the challenge is to change these behaviors through solid business cases."

As an example, Ruiz-Huidobro points to the United States' confidence in sourcing automotive parts in Latin America. Currently, Mexico is the 10th largest producer of automotive parts, with annual revenue of US\$42 billion, according to the A.T. Kearney report. Given the country's experienced labor force and geographic proximity to the United States, Ruiz-Huidobro predicts the country could increase its production to US\$78 billion by 2015 and US\$118 billion by 2030.

Another strong business case is the sourcing of IT and business process outsourcing (BPO) services in Latin America. In the A.T. Kearney report, analysts cite significant activity in these markets; they might even be at a "tipping point," they say, due to these countries' cultural affinity (relevant language skills, geographical proximity and cultural similarities), cost attractiveness and abundant talent and resources — specifically, a significant number of people between the ages of 15 and 39, which is a proxy for the labor force available for ITO and BPO global service centers.



A.T. Kearney  
Vice President  
Ricardo Ruiz-Huidobro

In terms of cost, the report indicates Latin America can claim a significant advantage over Europe and the United States. Companies which have chosen a Latin American location for outsourced or captive work are enjoying savings ranging from 20 percent to 40 percent based largely on competitive wages, real estate prices, telecommunications costs and travel expenses.



The report offers several examples of companies capitalizing on Latin American sourcing with measurable success, including one of the world's largest health and beauty care companies. By moving call center operations from the United States to Tijuana, Mexico, the organization reduced its costs by almost 30 percent. A large supply of highly qualified, predominately bilingual workers — many of whom learned English as a second language in high school and college — made attrition manageable.

Other organizations cited in the report are no longer choosing between Asia and Latin America, but selecting both. U.S.-based investment, data and market research firm Evalueserve is one example. While the organization had already established operations in China, it recently moved to Santiago, Chile as well. The goal was to provide research about Latin America to investment banks and corporations in the United States (daytime support); offshore research for Spain; and 24-hour, five-days-a-week support for clients internationally. Santiago emerged as the best option based on its predictable business environment, political stability, strong finance and business talent, time zone proximity, and competitive costs compared to São Paulo and Mexico City.

While these examples support Latin American sourcing, Ruiz-Huidobro says many companies still choose Asia, but for the wrong reason: cost alone. In this respect, the report highlights one major challenge facing Asian locations: retaining personnel — especially overnight-shift workers, who are critical to supporting customers in the United States.

Annual attrition rates in these call center markets range from 20 percent to more than 100 percent. In contrast, attrition in Latin American call centers ranges from 10 percent to 25 percent. The report cites higher unemployment rates, less competition for talent, and employees' ability to work during the day as major factors.

Additionally, Ruiz-Huidobro says the cost equation itself is changing. "Now it needs to be balanced with things like environmental impact and supply chain risk," he explains. "And consumers are demanding that companies become more environmentally conscious."

### **Social Responsibility Is A Serious Consideration**

Given its geographical proximity to the United States, reduced carbon emissions are offered up in the A.T. Kearney report as the most compelling argument for sourcing in Latin America. Ruiz-Huidobro cites the example of a 40-foot container shipped to Pittsburgh, Pennsylvania through Savannah, Georgia. As detailed in the report, an estimated 2,024 pounds of carbon are emitted when the container is shipped from Beijing, China whereas shipping from Mexico cuts those emissions roughly in half to 1,127 pounds. He predicts details like this will be very important soon when manufacturers are required to display the environmental impact of their products on the labels.

Aside from closer geographical proximity, Ruiz-Huidobro says Latin American countries are naturally eco-friendly. He says this is especially evident in the pulp and paper

industry, where he considers Brazil the leader. While it takes 50 years to grow and process a tree in the United States, the same process takes seven years in Brazil.

"We now see some of the U.S. manufacturers coming to Brazil to take advantage of these opportunities," Ruiz-Huidobro explains. "They're setting up factories to use this raw material and convert it to finished goods."

According to the *Destination* report, the availability of water is an important factor in environmental impact and supply chain sustainability. Water is less expensive — and more plentiful — in Latin American countries. While China faces a shortage in 30 of 32 of its largest cities, Latin America has the largest accumulation of freshwater in the world.

"In fact, these countries possess more than 50 percent of the world's renewable water resources," Ruiz-Huidobro points out. "The Amazon rainforest offers natural, renewable sources of water that is more pure and less costly to use as a resource."

### **Shorter Supply Chains Deliver Bottom-Line Results**

Geographical proximity to the United States also means a shorter, less complex supply chain. This is especially important given the rising cost and volatility of fuel.

Ruiz-Huidobro also points out that longer supply chains are more susceptible to failure — even terrorism — when compared with shorter, more manageable supply chains.

With regard to travel expenses, U.S. executives making site visits or attending on-site meetings in Latin America can get there much faster versus traveling to China, which can take nearly a full day. Four-hour flights to Mexico are common, as are overnight flights to Santiago or Buenos Aires. For conducting phone meetings, similar time zones help eliminate scheduling conflicts.

Not to be ignored are the significant recalls in Asia of late, as well as natural disasters — particularly tsunamis and pandemics such as avian flu. For U.S. organizations, these factors invite public criticism and pose serious threats, including lost customer goodwill, increased costs, and decreased sales.

### **Labor Costs Leveling Out**

In the past few years, companies made their decisions to outsource specific commodities, goods or services, using what Ruiz-Huidobro calls a "pure cost" equation. Today, certain factors greatly affect this equation — and, in his opinion, change it.

For example, the labor market in China is maturing. While the country has seen a 19.8-percent increase in the last five years, labor costs rose by just 2.7 percent in Peru, 4.9 percent in Mexico and 10.1 percent in Argentina. Ruiz-Huidobro predicts the dollar-per-hour labor rate in China will catch up to many Latin American countries by 2011.

He also estimates that keeping up with current supply chain demand in China will require a \$165 billion investment.

"If you have a cost equation that's built on the labor arbitrage, the cost saving is not there anymore," he explains.

## Latin America Country Attractiveness Assessment

Criteria	Argentina	Brazil	Chile	Mexico	Colombia	Costa Rica
Cost attractiveness						
Availability of skilled labor						
Language capabilities						
Political and economic stability						
Government support						
Cultural affinity						
Total attractiveness						
Key highlights (pros and cons)	<ul style="list-style-type: none"> <li>Lowest wages for skilled labor in the region</li> <li>Political and economic stability for a relatively short time compared to neighboring countries</li> </ul>	<ul style="list-style-type: none"> <li>Significantly outnumbers country peers in call center and ITO industries, though it has a strong domestic focus</li> <li>Limited number of English and Spanish speakers</li> </ul>	<ul style="list-style-type: none"> <li>Remarkable stability of political and business environment</li> <li>Limited availability of professionals fluent in English</li> </ul>	<ul style="list-style-type: none"> <li>Closest to the United States</li> <li>More developed market for BPO in the region, especially in finance and accounting</li> <li>Key costs (salary, real estate) are higher than most peers</li> </ul>	<ul style="list-style-type: none"> <li>Stable economy with available labor</li> <li>Reputation impact; although crime rates in Bogotá are lower than in São Paulo, the country's reputation reduces the inflow of investments</li> </ul>	<ul style="list-style-type: none"> <li>Very good bilingual skills</li> <li>Strong presence of large international (captive) service centers and vendors</li> <li>Limited workforce availability given population size and potential saturation</li> </ul>

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### The Reality of Political Instability

Decisions to source in Latin America are often clouded by a perception of instability — the populist movement in Venezuela, Bolivia and Ecuador and the guerilla war in Colombia, for example. However, Ruiz-Huidobro says these perceptions are often flawed.

"I think many supply management professionals connect what happens in a specific country to the whole region, but we can't really think about Latin America as one Latin America," he says. "It's very heterogeneous. Countries are at different stages of development and political stability."

As Ruiz-Huidobro points out, Mexico, Chile and Peru have enjoyed stable governments and governing policies for years, and even decades. These factors are improving the conditions for LCCS.

"In reality, the analysis has to do with what specific good or service you're looking to source from what specific country," he says. One good example of an industry in which Latin America is very competitive — perhaps more competitive than China and many other countries — is the minerals market in Peru and Chile, where copper and zinc are abundant. "Manufacturing of semi-finished goods in those countries can be a really good opportunity," says Ruiz-Huidobro.

### Latin America's Time Is Coming

To accommodate increased low-cost sourcing, Ruiz-Huidobro says Latin America's infrastructure has a lot of growing to do. Progress is being made in the form of enhanced ports and roads.

A.T. Kearney analysts predict the next three years will determine which Latin American countries provide the best offshoring and nearshoring platforms. In the end, they say, the key contenders will be those countries which best capitalize on the "Latin American trifecta": privileged location, abundant talent and competitive spirit.

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