STRATEGIC ANALYSIS OF THE OFFSHORE SERVICES BUSINESS UNIT OF PRONTO SOLUTIONS

by

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ABSTRACT

This document analyzes strategic alternatives for the offshore IT services business unit of Pronto Solutions, an IT consulting firm based in Latin America. The purpose of this document is to identify a suitable strategy to improve the market share of this unit.

The analysis suggests that the best alternative for the company is to implement a market development strategy focussed on IT-applications related services, and in particular, those services related to Oracle products. By focusing on a specific set of services, the company can avoid barriers to entry and improve its market share without incurring considerable levels of investments.

In order to implement the recommended strategy, the company must do the following: improve its organizational structure, invest in improving its marketing capabilities and develop a partnership with a North American company with sales capabilities and a team of English-speaking consultants in order to provide on-site service delivery.
DEDICATION

To Patricia, thank you. Your patience and support are what have kept me focused on my goal, and ultimately achieve it. When we began this journey we thought we knew what the Master’s program would demand of us, yet we had no idea of just how much... To my children, Yasmin and Piero, thank you for letting me spend more time with my laptop than with you over these last two years, I love you very much. We have a lot to look forward to, making up for lost time! Someday you will understand the importance of this period in our lives.

And to my mother, whose entrepreneurial spirit and tremendous courage has always been a source of inspiration to me, thank you. You taught me to strive to build something better even in the face of many challenges.
ACKNOWLEDGEMENTS

I would like to thank my professors for their feedback, guidance and counsel at each stage of the MBA program. Your ideas and wisdom have provided me with great insight into the culture of the Canadian business arena. I would also like to thank all the staff at SFU for their support and assistance throughout these past two years.

Finally, I would like to thank my team members, Imraan, Mike, Nancy and Paul, whose friendship, debates, humour and constant support have been an invaluable forum for my plunge into Canadian life.
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GLOSSARY

**Offshoring**  The process of outsourcing or transferring business activities to third parties located abroad.

**Nearshoring**  Business processes transferred to countries that are geographically closer to the customer country.

**IT**  Information Technology

**ERP**  Enterprise Resource Planning

**CRM**  Customer Relationship Management

**BPO**  Business Processes Outsourcing

**VAR**  Value Added Reseller

**RFP**  Request for Proposal
INTRODUCTION

This document analyzes strategic alternatives for the offshore IT services business unit of Pronto Solutions, an IT consulting firm based in Latin America. The purpose of this document is to identify the most suitable strategy for this unit considering threats and opportunities in the industry as well as the company’s internal capabilities, resources and management preferences.

Currently, Pronto Solutions competes with a cost-based strategy in the markets in which it operates (Latin America). However, it is not clear whether the company is able to compete with a similar strategy in other markets (particularly the U.S.) where other vendors for low-cost labour countries are currently providing IT offshore services. It appears that the industry allows differentiation strategies; therefore, the partners of Pronto Solutions must identify whether the company is capable of offering such differentiation. Further, it is imperative that the best strategy be identified with regard to improving Pronto Solutions market share.

This document has been divided into four sections. Section One provides background information about the company, its business units and growth strategy. Section Two presents an analysis of the IT offshore services industry in order to assess opportunities and risks in the market as well as to identify key success factors (KSF’s). This section concludes with strategic alternatives for the offshore IT services business unit. Section Three offers an internal analysis of Pronto Solutions with the objective of determining whether the company has the internal capabilities required to succeed and further, how those areas where it trails its competitors may be improved. Finally, Section Four offers recommendations based on an examination of both the industry and internal analyses.
1 COMPANY DESCRIPTION

Pronto Solutions is a private consulting firm in Information Technology based in Latin America. The company, founded in Uruguay in 1978, currently employs 400 professionals (project managers, technical consultants, functional consultants and administrative staff) and operates in eight countries within the Latin American region. Total revenue for 2005 was US$ 15 million. Pronto Solutions is totally self-funded and owned by five partners, all of Uruguayan origin.

In its early stages, the company provided support to applications development programs for mainframe equipment in Uruguay only. Global expansion began in the late nineties when the company initiated a relationship with PeopleSoft, a software company based in Pleasanton, California, specialized in developing enterprise packaged software for mid-sized and large firms. The company's partners rapidly identified opportunities within the market for implementing Enterprise Resource Planning (ERP), Customer Relationship Management (CRM) and Business Intelligence (BI) systems. Subsequently, the company began to focus on developing the strategy and organizational structure required to pursue such opportunities.

The relationship between Pronto Solutions and PeopleSoft was mutually beneficial. PeopleSoft provided Pronto Solutions with the opportunity to expand within the Latin American market while Pronto Solutions helped to increase PeopleSoft's market share in the region. By 2002, the firm was clearly the most important consulting partner of PeopleSoft in Latin America with operations in Argentina, Uruguay, Chile, Peru, Ecuador, Colombia, Brazil and Mexico. However, the acquisition of PeopleSoft by
Oracle abruptly altered the market dynamic; as a result, the company was forced to adapt its strategy to this new scenario.

1.1 Business Units

Pronto Solutions provides several services related to Information Technology including: implementation of packaged software, offshore IT services, outsourcing, and IT strategic planning. Figure 1-1 shows the distribution of sales by business unit.

Figure 1-1: Portfolio of Services

1.1.1 Implementation Services of Packaged Software

Implementation services of packaged software are by far the main source of revenue, accounting for 87 percent of total revenue. As a certified partner of Oracle and Cognos, Pronto Solutions is able to sell licences as well as provide consulting services for its products to clients in Latin America. These services include: project management,
implementation services, application upgrades, post-Implementation support and training.

1.1.2 Offshore IT Services Business Unit

Pronto Solutions began providing offshore IT services in 1998 upon signing an important contract with a large global German firm to provide application development services by means of a combination of onsite and offshore teams. The client's demand for skilled labour increased and possibilities arose for selling offshore services to other companies in Europe. After four years of operation, however, the company decided to close its office in Germany due to a lack of a clear strategy for this unit in Europe, as well as tensions between the company's partners and the Country Manager.

Although the offshore business unit has continued providing services to clients, the type of services offered and the market served have changed. In contrast to previous projects in which the firm developed customized applications to clients in Europe, recent projects have been related primarily to the implementation of packaged software (PeopleSoft) within American companies. In brief, recent offshore services have comprised a subcomponent of a larger implementation project.

1.2 Growth Strategy

Figure 1-2 illustrates the evolution of Pronto Solution's growth strategy since the company began operations in 1978. Each strategy has been analyzed using two dimensions: products and markets. The combination of these variables provides a framework for understanding the company's strategies over time.
1.2.1 Period 1978 – 1992

Pronto Solutions began operations in 1978 by providing services related to mainframe applications to the Uruguayan market only. In 1990, the company began its consulting practice in IT by providing strategic planning consulting services and developing customized applications for Uruguayan companies. In 1993, the company initiated its partnership with PeopleSoft.

1.2.2 Period 1993 - 2001

From 1993 to 2001, the company's growth strategy involved developing markets and offering implementation services in several countries within the region. Instead of implementing several packaged applications, Pronto Solutions opted to focus on developing the expertise required to implement PeopleSoft and Cognos products only and subsequently offer them in most Latin American countries.
Previous efforts to develop new services and apply a product development strategy were unsuccessful; for example, the company's efforts to launch an Application Software Provider (ASP) model to host applications for clients were ultimately aborted. As a result, the firm decided to focus its attention on implementing packaged software while, at the same time, expanding geographically.

1.2.3 Period 2002 - Present

Since 2002 the company has been forced to develop new services (related to packaged software) due to mergers and acquisitions in the industry. In short, the demand for business applications began to show indications of saturation and yielded to low growth rates for software companies. As a result, the industry faced a consolidation process, a situation that has not only reshaped the market share of software companies but is also leading to a standardization of technologies.

A case in point, the acquisition of JD Edwards by PeopleSoft and the subsequent acquisition of PeopleSoft by Oracle have reshaped the position of Pronto Solutions as a certified regional partner. On one hand, this consolidation has forced the company to share the market with other Oracle partners (Pronto Solutions was the largest regional partner of PeopleSoft). On the other hand, it has also provided an opportunity for the firm to expand its portfolio of services and implement additional products under the Oracle umbrella.

Pronto Solutions responded by acquiring firms with expertise in JD Edwards and Oracle products in order to enhance the portfolio of services for the ERP and CRM business unit. The acquired companies provide skilled employees and methodologies as well as the customer base necessary to offer services for the entire range of Oracle products.
1.3 Current Strategy

Pronto Solutions employs a cost-based strategy. The company's expertise implementing packaged software has allowed Pronto Solutions to provide quality services at rates per hour adequate for the Latin American market. Due to the fact that clients in Latin America are price-sensitive, Pronto Solutions offers an excellent combination of price and expertise when compared to other firms such as large consulting firms and even the consulting practice of software companies. Although local companies do exist that offer services at lower rates compared to those of Pronto Solutions, the majority of these firms lack the knowledge and expertise required to implement complex projects.

1.4 Future of the Offshore IT Services Business Unit

The global trend of hiring IT services to companies located abroad (offshoring) promises significant opportunities to IT providers in low-cost labour regions such as Latin America and Asia. Despite this trend, however, the market share of Pronto Solutions in this particular market remains limited.

Figure 1-3 illustrates the position of the company's business units in the Boston Consulting Group Growth-Share Matrix. The matrix is used to identify the position of company's business units in four quadrants, each of which is composed of two dimensions: the relative market share of the business unit and the growth of the industry in which the business unit competes. The figure indicates that the offshore business development unit is currently positioned in the high growth / low share quadrant (labelled "Question Marks"). The future of business units located in this quadrant is uncertain due to the fact that, despite the high growth of the market in which they operate, these business units have a low market share. In the case of Pronto Solutions, this suggests
that if the company's offshore services unit does not expand while the industry grows, it will fall behind at the same rate as that at which the industry is growing. The purpose is then to improve the market share of this business unit and move it towards the high growth / high share quadrant (labelled "Starts"). The ERP and CRM services business unit located in the low growth / high market quadrant (labelled "Cash Cows") should provide part of the financial and other resources required to achieve this goal.

**Figure 1-3: Growth / Share Matrix**

![Growth / Share Matrix Diagram]

*Source: Adapted from EMBA Business Strategy Seminar [EMBA class notes], Bukszar, Ed, Spring 2006*

The company has already taken certain steps to prepare the organization for competition in the global market of offshore IT services. In 2001, it obtained the ISO 9000 certification and is currently in the process of obtaining the Capability Maturity Model Integration (CMMI) certification, an international accreditation issued by the Carnegie Mellon Institute and widely recognized in the industry. However, due to the fact
that increasing the company's share in the market for offshore services requires an important investment, the partners require a strategic analysis for this business unit, including an analysis of the offshore IT services industry.

1.5 Low Cost versus Differentiation Strategy for the Offshore Business Unit

The entrance of new competitors in the offshore IT services market, such as those from countries with higher labour costs compared to those in India, for example, suggests that customers are no longer interested in the lowest rate per hour possible; instead, they are willing to pay a premium in order to obtain other benefits from the offshore provider. Some of these benefits include risk mitigation, cultural compatibility, convenient location and expertise. Therefore, it appears that the industry offers opportunities for vendors with specific skills and characteristics and allows for differentiation strategies. An example of this lies in the differentiation strategy of companies in Eastern Europe, Mexico and Canada. In order to compete with low-cost providers, vendors from these counties are using the concept of nearshoring to differentiate their services and avoid competing merely in terms of cost.

Due to the fact that Pronto Solutions does not enjoy the economies of scale of large firms and labour costs in Latin American countries are higher than in other offshore service supply countries, the partners must determine whether a differentiation strategy is feasible for this business unit. Further, it is necessary to understand in which segment or group of segments of the industry the company will be able compete and differentiate in order to improve the company's market share.
1.6 Decision Criteria

The proposed strategic alternatives for the offshore business unit should satisfy the following criteria:

1. *Financial investment and return*

   Break-even should be achieved on or before the 18 month period. In addition, any investment should be financed using either equity or funds provided by external partners interested in developing this opportunity with Pronto Solutions.

2. *Autonomy levels*

   The partners of Pronto Solutions expect to maintain a controlling share in the company; however, they are open to creating another entity for the offshore services business unit in which a controlling share is not required. Also, the partners prefer to keep the company as a private entity.

3. *Impact on partner's lifestyle*

   Options that do not significantly impact the partner's lifestyle are preferred but not decisive when selecting the best strategic alternative. Due to the fact that three of the partners currently reside in Uruguay, they are more inclined to centralize the offshore development center in this country. However, the feasibility of such decision must be supported by the external and internal analyses.
2 EXTERNAL ANALYSIS

The section analyzes the offshore services industry and, in particular, the segment related to IT services.

The globalization phenomenon and other demographic, socio political, technological and economical factors are the drivers that have contributed to the explosive growth of the offshore services industry. Currently the total value of outsourcing services is US$ 300 billion and, according to the McKinsey Institute, this figure is expected to grow by US$ 80 million by 2008 (Chakrabarty, et al., 2006).

First, background information regarding the industry and its segments is presented. Next, a brief description of the industry size, growth trends and drivers is given. Then, an analysis of factors (suppliers, customers, entry barriers, substitutes and government) affecting rivalry is offered, followed by an analysis of the value chain for IT applications. Given that Pronto Solutions currently competes with the IT applications-related services segment, this segment will be examined in detail. Such an analysis will provide information necessary to identify key success factors (KSF's) required in the industry. Then, in light of the analysis previously performed, a competitive analysis of the company against two Latin American firms (Softtek and IT Sistemas) is provided in order to measure Pronto Solution's performance in terms of key success factors against the selected competitors. Finally, strategic alternatives for the offshore IT business unit are suggested.
2.1 The Offshore IT Services Industry

2.1.1 Background

Outsourcing, the process of transferring part of the production chain to third parties, has been a managerial practice for centuries and is closely related to the concept of comparative advantage developed in the 19th century. More recently, the technological revolution has not only provided opportunities for reducing inefficiencies along the production chain, but has also developed more sophisticated products and services. Although technology provides such advantages, it also adds complexity to company operations and processes due to the fact that the task of managing information systems themselves requires significant effort and is a labour-intensive activity (The Economist, 2004). As a result of this complexity, there has been a trend in almost all industries toward outsourcing internal IT functions to companies specialized in this service.

Concurrently, technological changes such as the Internet and reductions in transportation and communication costs, as well as socioeconomic changes, are forces that have contributed to increased global economic integration. In this context, companies are now able to outsource production and business process activities to suppliers offshore.

Currently, the offshore IT services industry has become a multi-billion dollar industry with a high annual growth rate, promising high returns to both suppliers and recipients of offshore services.

2.1.2 Market Segments

The market for offshore services is largely composed of five segments: business processes outsourcing (BPO), IT infrastructure-related services, IT applications-related
services, systems integration services and consulting. The following is a brief description of services provided in each segment. Currently, Pronto Solutions competes in the IT applications-related segment, a principal focus of the industry analysis.

1. Business Processes Outsourcing (BPO)

   Business Process Outsourcing (BPO) refers to the process of sending back-office functions to offshore vendors. Currently, BPO is the largest segment with the fastest growth in the offshore industry. The most common examples of BPO are IT activities, call centres, human resources, accounting and payroll outsourcing.

   Table 2-1 shows the BPO global market according to a survey performed by PriceWaterhouseCoopers. The IT industry accounts for 43 percent of total BPO services, the largest market is the U.S., with 59 percent of the total market demand (Wikipedia, 2006).

2. IT Infrastructure-Related Services

   For these types of services, the offshore company manages the customer's software and hardware infrastructure with mutually agreed service level agreements (SLA's). Services provided in this segment include database administration (monitoring and tuning), data migration, technical help desk, and user support, among others.

3. IT Applications-Related Services

   In this segment, the vendor assists with the development and implementation of business applications. Depending on the client's business needs, the service may involve the development of customized applications tailored to specific business processes or the implementation of packaged software such as Oracle and SAP. Services within this segment include post implementation support, end-user training, data migration, upgrades, etc. Pronto Solutions has extensive experience in this area and a significant portion of its revenue is generated from these type of services.
Table 2-1: Global BPO Market (By Industry and Geography)

<table>
<thead>
<tr>
<th>Global BPO Market by Industry</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Information Technology</td>
<td>43 %</td>
</tr>
<tr>
<td>Financial Services</td>
<td>17 %</td>
</tr>
<tr>
<td>Communication (Telecom)</td>
<td>16 %</td>
</tr>
<tr>
<td>Consumer Goods/Services</td>
<td>15 %</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>9 %</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Global BPO Market by Geography</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>59 %</td>
</tr>
<tr>
<td>Europe</td>
<td>27 %</td>
</tr>
<tr>
<td>Asia-Pacific (incl. Japan)</td>
<td>9 %</td>
</tr>
<tr>
<td>Rest of the World</td>
<td>5 %</td>
</tr>
</tbody>
</table>


4. IT Consulting Services

Consulting services are provided on demand in several areas including IT security assessment, application testing, application development quality assurance and IT processes improvement.

5. Systems Integration Services

Enterprise Application Integration (EAI) involves the use of software and architectural principles of computer systems in order to integrate a set of enterprise computer applications (Wikipedia, 2006). Integration services are in great demand due to the fact that companies generally have different enterprise applications that require connectivity to improve their use.

The provision of offshore services such as those described above becomes more viable with the consolidation and standardization of technologies. As more companies...
adopt common standards, the process of installing and maintaining their applications becomes routine and can be outsourced offshore (The Economist, 2004).

As mentioned above, the industry analysis focuses on the IT applications-related segment.

2.1.3 Industry Size

According to the McKinsey Institute, the total market size for outsourcing services (including both traditional onsite and offshore services) was US$ 300 billion in 2005. Distribution of such services by segments is shown in Figure 2-1. With US$ 138 billion, BPO is the largest segment, representing 46 percent of the total market. IT applications-related services represent 11 percent of the market (US$ 33 billion) while IT infrastructure-related services account for 26 percent (Chakrabarty, et al., 2006).

Figure 2-1: Global Outsourcing Market by Type of Services

Although the total market size of IT outsourcing services is US$ 162 billion (54 percent of the total outsourcing market), only 11 percent of those services are provided offshore (Chakrabarty, et al., 2006). Figure 2-2 summarizes the penetration of offshoring over the total market for IT outsourcing services. The table also shows penetration by the five segments in the industry.

Figure 2-2: Penetration of the Offshore Industry in the Outsourcing Market (by Segments)

<table>
<thead>
<tr>
<th>Segments</th>
<th>Market Size By Segment</th>
<th>Addressable Market Currently Offshored</th>
</tr>
</thead>
<tbody>
<tr>
<td>IT Infrastructure Outsourcing</td>
<td>% 47%</td>
<td>% 20%</td>
</tr>
<tr>
<td>IT Applications</td>
<td>% 20%</td>
<td>% 31%</td>
</tr>
<tr>
<td>Systems Integration</td>
<td>% 20%</td>
<td>% 5%</td>
</tr>
<tr>
<td>Consulting</td>
<td>% 13%</td>
<td>% 10%</td>
</tr>
<tr>
<td>R&amp;D Services</td>
<td>% 3%</td>
<td>% 30%</td>
</tr>
<tr>
<td>Total</td>
<td>% 100%</td>
<td>% 11%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Segments</th>
<th>US$ 70-85</th>
<th>US$ 30-35</th>
</tr>
</thead>
<tbody>
<tr>
<td>IT Infrastructure Outsourcing</td>
<td>$ 147 billion - $ 178 billion</td>
<td>$ 147 billion - $ 178 billion</td>
</tr>
<tr>
<td>IT Applications</td>
<td>$ 30-35</td>
<td>$ 30-35</td>
</tr>
<tr>
<td>Systems Integration</td>
<td>$ 3-4</td>
<td>$ 4.2-5.1</td>
</tr>
<tr>
<td>Consulting</td>
<td>$ 14-17</td>
<td>$ 16.4-22.0</td>
</tr>
</tbody>
</table>

Source: Adapted from The McKinsey Quarterly, 2006.

It is important to note that IT applications-related services, the segment in which Pronto Solutions competes, has a higher penetration (31 percent) compared to other segments.

2.1.3.1 Growth Trends

McKinsey predicts that the global offshore market (including BPO) will increase by US$ 80 billion by 2008, an increase of more than 26 percent over the next 3 years (Chakrabarty, et al., 2006).
According to The Economist, the U.S. is the largest market for Offshore IT services representing over 70 percent of the entire market. The second largest market is Great Britain. (The Economist, 2004) Furthermore, the Information Technology Association of America (IITAA) estimates that the offshore component of IT outsourcing in the US will grow 21 percent annually (on average) over the next 5 years, from US$ 15.2 billion to US$ 38.2 billion by 2010 (Global Insight, 2005).

It is clear then, that not only more companies will outsource their IT applications and infrastructure (as we can see from the market growth of IT outsourcing), but they will also look for services providers abroad.

2.1.4 Rationale for Offshoring

Advantages of offshoring include the following:

1. **Significant cost reductions**
   
The offshore model allows companies to reduce the cost of implementing, updating or maintaining IT infrastructure, yielding to better financial returns over IT investments. In addition, it allows firms to reinvest their savings in more strategic projects that can, in turn, improve competitiveness.

2. **Manage workload and peaks**
   
   By having an external IT provider, companies can rapidly increase or decrease their headcount and IT organizational structure in order to match demand and business requirements. This flexibility is an important advantage due to the fact that technology is in constant flux and finding the right balance can be challenging.

3. **Access to skilled resources**
   
   The expected shortage of a skilled labour pool in developed countries can be covered by external resources located abroad.
4. **Access to high standards in IT methodologies and best practices**

Companies can benefit from the methodologies and best practices provided by vendors. The industry has developed standards and international certifications that reduce risk, information asymmetry and transaction costs.

5. **Maintain round-the-clock shifts**

By sending work packages and data from different production centres in different time zones, companies are now able to have organizations that operate 24 hours a day, thereby enabling them to operate around the clock in different countries.

### 2.1.5 Drivers of Industry Growth

#### 2.1.5.1 Demographic Drivers:

It is expected that a decrease in the ratio of the working population in developed countries will occur. According to The Economist magazine, some analysts predict that the US alone will require an additional 8.6 million people over the next 20 years just to maintain those levels achieved in 2000. By contrast, several developing countries have a younger workforce with the levels of skills and education required to fill the expected shortage in other areas of the world. India, for example, produces 300,000 engineers per year: in contrast, the US produces only 50,000 (The Economist, 2004).

According to the United Nations, although developed countries will not experience population growth during the next fifty years, the population in developing countries is expected to increase by 50 percent, while in the least developed countries it is expected to more than double (United Nations, 2004).
2.1.5.2 Economic and Business Drivers

Clearly, offshoring provides significant cost savings to customers. The cost of skilled labour in developing countries in Asia, Latin America and East Europe are 60 to 80 percent lower than those in the US. Cost savings, however, is not the only reason why companies are looking abroad for IT providers. The business model allows companies to remain competitive by focusing on their core business; further, it also allows the creation of round-the-clock shifts for their global operations.

Some analysts argue that, overall, this process benefits both countries involved in the exchange. Table 2-2, developed by the McKinsey Institute, exemplifies the economic benefits that the U.S. and India incur through a commercial exchange of offshore services. The importer country (in this case the U.S.) would not only benefit from the cost savings but also from the re-employment of workers in other industries, in addition to other economic benefits. On the other hand, the exporter country (India), benefits from the inflow of capital and technology as well as from tax collection. (The Economist, 2004)

2.1.5.2.1 Technological Drivers

Reduced communication costs, the availability of high speed data connections and hardware and software technologies have made it possible to transfer information in a cheaper, faster and quality-efficient manner, allowing geographically dispersed teams to collaborate. A report by HSBC shows that the cost of a one minute telephone call from India to America and Britain has fallen by more than 80 percent since January 2001 (The Economist, 2004).
Table 2-2: Benefits per US$ 1 of Spending Sent Offshore (Estimated, 2002)

<table>
<thead>
<tr>
<th>United States</th>
<th></th>
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</thead>
<tbody>
<tr>
<td>Saving accruing to US investors/customers</td>
<td>0.58</td>
</tr>
<tr>
<td>Imports of US goods and services by providers in India</td>
<td>0.05</td>
</tr>
<tr>
<td>Transfer of profits by US-based providers in India back to US</td>
<td>0.04</td>
</tr>
<tr>
<td>Net direct benefit retained in US</td>
<td>0.67</td>
</tr>
<tr>
<td>Value from US labour re-employed</td>
<td>0.45-0.47</td>
</tr>
<tr>
<td><strong>Potential net benefit to US</strong></td>
<td><strong>1.12-1.14</strong></td>
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</tbody>
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<table>
<thead>
<tr>
<th>India</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Labour</td>
<td>0.10</td>
</tr>
<tr>
<td>Profits retained in India</td>
<td>0.10</td>
</tr>
<tr>
<td>Suppliers</td>
<td>0.09</td>
</tr>
<tr>
<td>Central government taxes</td>
<td>0.03</td>
</tr>
<tr>
<td>State government taxes</td>
<td>0.01</td>
</tr>
<tr>
<td><strong>Net benefit to India</strong></td>
<td><strong>0.33</strong></td>
</tr>
</tbody>
</table>


Internet and the reduction in data processing costs have also played a key role in the industry’s growth. Such technological advances have changed the production and distribution systems related not only to goods and services, but also to information.

**2.1.5.3 Socio-Political Drivers**

Political and economic stability achieved in some developing countries has facilitated the exchange of products and services over the last decade. Political institutions in these countries have become more stable and their young democracies are maturing. Overall, developing countries registered positive growth last year.

Although some thinkers such as Samuel Huntington believe that large divisions and conflicts in humanity will be culturally-based (Huntington, 1997), others believe that global economic integration will actually help to reduce cultural gaps between nations. Similar to the industrial revolution, the knowledge economy is generating significant changes within national cultures due to the fact that the new economy is anti-traditional.
and anti-authoritarian. Moreover, some thinkers believe that globalisation is creating a global culture, with global social casts among which English is the universal language.

2.1.6 Geographical Location of Offshore Service Providers

Figure 2-3 shows those destinations considered attractive for IT offshore services based on the country's financial conditions (cost advantages), political and economical environment and labour pool.

Figure 2-3: Country Attractiveness for IT Offshore Services

![Graph showing country attractiveness for IT offshore services.](image)


The ranking shown in Figure 2-3 suggests that although the financial condition (primarily cost advantages) is an important component to determine the overall attractiveness of a country as a destination for offshore services, the political, economical and cultural environments as well as the existing labour pool must also be taken into account. The Canadian and Irish socio-political environment, for example,
appear to be more attractive than those of other countries with better financial conditions (China and Russia for example), placing these countries in a better position to compete in the offshore industry.

Figure 2-3 also shows two Latin American countries, Brazil and Mexico, as the most attractive in the region for offshore services. Both countries have the largest economies in Latin America. Measured in April 2006, Brazil's economy is larger than that of Canada (US$1.1 trillion) while the economies of Brazil and Mexico together are similar to that of the United Kingdom (US$ 1.9 trillion).

2.1.7 Nearshoring versus Offshoring

Nearshoring is a concept used for the form of outsourcing in which business processes are transferred to locations that are, generally, cheaper and yet geographically closer (Wikipedia, 2006). Nearshoring has emerged as a differentiation strategy by countries looking to compete with early entrants in the industry such as India and China.

Due to the fact that the IT offshore services model is new and, as a result, involves greater risk, some companies in Western countries are evaluating the possibility of hiring services to providers located in close or culturally-alike countries. For companies based in the U.S., Canada and Mexico are potential options not only due to their proximity to clients but also to language skill levels and cost. More specifically, Canada offers several advantages for U.S. firms, including time zone similarity, geographic proximity, country stability and cost. These benefits provided by companies located in Canada and Mexico should be considered by the partners of Pronto Solutions for the location of the offshore development center.
Finally, depending on the project type, traveling costs to the offshore development center can be high, increasing the overall cost of the project as well as the risk. Typically, the offshore model requires 20 to 40 percent of the implementation team on site and the remaining 60 to 80 percent at the remote development centre. Travel for training and team coordination purposes is also required. The onsite team identifies the functional requirements and acts as a liaison with the customer, while the offshore team carries out the development activities. The exact proportion will depend, among other variables, on the complexity and scope of the project.

2.2 Analysis of Industry Factors

In this section, a more detailed analysis of factors affecting the industry is presented based on analysis using the five forces model developed by Michael Porter. These forces include: threats of entry, threat of substitutes, bargaining power of customers, bargaining power of suppliers, rivalry among competitors and government. Each of the five forces is analyzed in light of the variables affecting them, which are then summarized in Figure 2-4. The direction of impact of these variables has been identified with a positive (+) or negative (−) sign. A positive sign indicates that the variable intensifies the degree of influence of the market force while a negative sign generates the opposite effect.

With the exception of the business processes outsourcing (BPO) segment, the other four segments (applications, infrastructure, consulting and systems integration) are similarly affected by those industry factors described in this document. The analysis, therefore, can be applied to any of the segments in which Pronto Solutions is interested in competing.
Figure 2-4: Six Forces Analysis

(+I-) Trade Policies

(+I-) Immigration Policies

(+I-) Labour Policies

(-) International certifications

(-) Knowledge management and learning curve

(-) Minimum efficient scales are required

(-) Cost advantages

(-) Access to customers

(+I-) In-house development (on-shore/off-shore)

(-) Labour pool

(+I- Industry-Specific Policies

(-) Antitrust Policies

(+I-) Type and duration of contracts

(-) Exit costs

(+I-) Type and duration of contracts

(-) Labour pool

(+I-) Exit costs

(+I-) Type and duration of contracts

(-) Labour pool

(+) R&D Policies

(-) Anti-trust Policies

(+I-) In-house development (on-shore/off-shore)

(+) Government Purchases Policies

(-) Concentration is moderate

(-) R&D Policies

(+I-) Industry-Specific Policies

(-) Anti-trust Policies

(+I-) Type and duration of contracts

(-) Exit cost

(+I-) Labour pool

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2.2.1 Threat of Entry

Threats to entry are moderate but are expected to increase rapidly in the coming years. Although the market provides opportunities for new entrants, the industry has matured in the last decade, thereby increasing barriers to entry.

Key success factors for entering the market are: international certifications, knowledge management capabilities, company size and access to customers. At the country level, other key success factors that limit or facilitate the entrance of new competitors from certain countries include: cost advantages, language skills and the country’s overall environment.

The following is a brief description of each factor.

2.2.1.1 International Certifications and Industry Standards

An important barrier to entry involves the international certifications required in the industry, such as the Capability Maturity Model Integration (CMMI) developed by the Carnegie Mellon institute and the ISO certification, issued by the International Standards Organization.

The CMMI certification is perhaps the most widely recognized by customers. This methodology provides guidance to organizations in the systems engineering field on how to improve their processes. This certification is comprised of maturity levels achieved by the company, in which level 5 is the highest level granted.

One benefit to customers of certifications involves a reduced searching cost. The cost of finding the right IT provider in the global market can be high, considering that customers now have the option of selecting a partner from many countries with different
business practices. In this context, international certifications provide a mechanism for standardization of supply, thereby reducing cost and effort for customers.

Certifications also mitigate the adverse selection and information asymmetry problem. In general, service industries face the problem of adverse selection. Such a problem may be incurred by a party through opportunistic behaviour due to a greater control of information over another party. Certifications help to reduce this risk by means of auditing activities performed on vendors by independent parties, which certify the veracity of services, methodologies and practices offered to customers.

Finally, certifications provide transparency and reduce transaction costs. International accreditations reduce the risk of failure during the various stages of commercial transactions as well as the cost of contracts performed by parties from different jurisdictions.

In summary, customer prefers to hire vendors with international certifications in order to reduce uncertainty. Vendors whose practices and methodologies comply with international standards and have also been certified by accredited institutions, therefore, have a competitive advantage in the industry.

2.2.1.2 Company Size (-)

 Depending on the IT service type and project size, the investment required can vary significantly. Small firms specialized in niche services require less up-front investment while large firms that provide offshore infrastructure outsourcing and maintenance require significant levels of investment in leasing facilities, communications platform, software and hardware and business development activities.
Although small companies with boutique-style services require less investment, the industry is capital-intensive and financial resources are needed to develop a customer base, obtain certifications, develop a knowledge management process and methodologies as well as other operational activities. Further, it is expected that customers will hire providers with a solid financial performance, enough resources to mitigate any potential risk during their IT projects and a sufficient labour pool to handle their resource demands. This suggests that, unless the offshore vendor provides specialized technology or supplies a market niche, the company’s size is a key success factor in the offshore industry.

2.2.1.3 Minimum Efficient Scale and Industry Consolidation (-)

In general, as an industry matures, it is expected that leading firms will achieve minimum efficiency scales leading to consolidation of the industry and consequently, limiting entries of IT providers from other regions. Such a forecast confirms that company size is a relevant factor for success in the industry.

In the offshore services industry, successful firms (particularly from India) are achieving economies of scale, which allow them to provide services not only at low costs but also at excellent quality levels. Consequently, this leads to a competitive advantage that will be more difficult to match over time. Currently, large companies are acquiring small consulting firms based in countries attractive in terms of proximity to clients and business environment. Here, the purpose is to operate development centers strategically located in countries in order to serve clients with specific needs and, at the same time, achieve economies of scale in order to limit the entrance of new competitors in the market.
Indian firms, by far, dominate the industry. Five companies, Tata Consultancy Services, Wypro, Infosys, HCL Tech and Satyam, had a combined revenue of US$ 5.8 billion in 2004, which translated into a 33 percent market share. (The Economist, 2004) Further, India controlled 65 percent of the total market in 2005. Softtek is the largest provider of offshore services in Latin America. However, with US$ 142 million in revenue, the company has only 0.7 percent of the total market share.

Latin America has also experienced a consolidation. Pronto Solutions for instance, has acquired two companies during the last three years and other companies have been also been acquiring small firms with experienced consultants and specific knowledge in certain technologies.

In summary, although the offshore industry will continue to grow (as previously confirmed in Section 2.1.3) and, as a result, attract new entrants (of different sizes), the consolidation process currently in place is leading to a concentration of the offshore IT services industry in fewer companies. Such companies are achieving the economies of scale and size necessary to provide a high volume of IT services at low prices, thereby limiting the entrance of new competitors in the market. Therefore, new entrants must consider size and scale in their business strategy in order to successfully compete in the industry.

2.2.1.4 Knowledge Management and the Learning Curve Effect (-)

Knowledge Management capabilities is also a key competitive factor. The efficiency and knowledge accumulated from past projects will render vendors more competitive, thereby reducing threats posed by new entrants. Despite the fact that the industry is relatively young, existing competitors have progressed notably along the learning curve and have achieved productivity levels that will be difficult to match.
Due to the fact that significant knowledge must be acquired, stored and shared in IT services projects, those companies with a knowledge-based culture and knowledge management practices are able to reduce inefficiencies and, therefore, costs. Two characteristics of the industry are the high employee turnover ratio and the increasing demand for the most qualified resources. In this context, firms with knowledge management capabilities will be able to reuse past experiences and lessons learned in order to gain a key competitive advantage over new entrants.

Some of the factors that have led to the knowledge management boom include: globalization, competition, change, new technologies and sophisticated consumers. In this context, many companies have been incorporating a knowledge management culture as part of the company's business strategy. Moreover, several companies have realized that knowledge is what their clients ultimately acquire from them; in other words, company knowledge is the end product or service offered to clients (Davenport & Prusak, 1998).

A common misunderstanding is that knowledge management is primarily a technological initiative. Organizations have focused more on the technological rather than the cultural aspects of this process. As a result, the organizational changes required to adopt a knowledge management culture have not been addressed and managed adequately. Knowledge management requires not only technological innovation, but also cultural change, and in many cases is required in core aspects of business (Davenport & Prusak, 1998).

2.2.1.5 Access to Customers (-)

Access to customers is crucial and can be a strong barrier for new companies. Due to the fact that customers and vendors are geographically dispersed, those
companies with sales and marketing or partnership capabilities will be able to build an installed customer base early on and will have a greater potential for securing long-term contracts that yield to improvements in the learning curve and economies of scale over time.

A key success factor involves the partnership capabilities of the vendor. A common strategy is to develop joint ventures and alliances with local IT services firms that can provide the front-end services on-site and act as the liaison between the client and the offshore team. Such a work structure allows the offshore firm to focus on their costs and project execution capabilities while the local firm manages the relationship with the customers and provides sales and marketing activities. By contrast, if the offshore firm offers their services directly to the end customer and extracts all the profits generated, they will have to develop strong marketing and business development expertise and, at the same time, be able to manage their cost structure in order to remain competitive.

2.2.1.6 Cost Advantages (-)

One of the main drivers of the offshore industry growth is the need in developed countries to reduce the cost of IT and other business activities. Therefore, a key success factor is the lower cost offered by the offshore vendor compared to other alternatives for customers.

Clearly, vendors from some countries have a lower cost structure than others. However, the success of one vendor over another in the offshore market is not necessarily based merely on the lowest cost possible due to the fact that other factors such as experience, methodologies, reputation, quality and other non-economic criteria are included in customers' decision criteria (as previously mentioned in section 2.1.6).
However, the offshore vendor should, in the end, provide a lower cost option overall to customers instead of traditional in-house or local outsourcing options.

2.2.1.7 Language Skills (+/-)

Companies can differentiate their services and enter the market by providing other advantages such as specific language skills, security, risk mitigation and convenient location instead of merely offering lower costs to customers.

In general, English-speaking countries have a competitive advantage, limiting the entrance of non English-speaking vendors to certain markets. However, countries with other language capabilities are in a position to offer services to markets with similar characteristics or specific needs. Latin American countries, for instance, can provide services to US companies that may require Spanish-speaking resources due to the fact that 14 percent of the US population speaks Spanish (The Economist, 2003)

Although countries with specific language skills can have a competitive advantage in specific markets, most of the international IT businesses function in English; as a result, a key success factor is the ability of the vendor’s team to speak this language.

2.2.1.8 Country Identification and Cultural Fit (-)

The manner in which the vendor’s country is perceived by the international market may serve as an important differentiator in the offshore industry. India, for example, is widely recognized for having a large skilled technical workforce. Countries such as Mexico and Canada are seen as attractive suppliers of offshore services due to cultural compatibility, proximity to the US market, and similar time zones, factors that facilitate the interaction of onsite and offshore teams.
Such country advantages allow offshore services providers to differentiate their services. Vendors located in Canada, for instance, can offer several advantages to customers located in the US. Canadian firms are in the position to offer nearby services, political stability and a healthy economic environment, thereby reducing uncertainty and risk.

Cultural fit is another factor that can be used by vendors to differentiate their services. Vendors located in Eastern Europe for example, are targeting firms from other more developed European countries with whom they share cultural similarities. This cultural factor has been for Eastern European vendors a key success factor that has afforded them the opportunity to compete against low cost vendors from India and China.

2.2.2 Threat of Substitutes

Threat of substitutes is moderate. Although captive development centers and traditional onsite outsourcing, as well as technology and innovation are substitutes for the offshore business model, additional external drivers (mentioned in section 2.1) also contribute to the industry’s growth trend.

As mentioned in section 2.2.1, some offshore vendors have acquired significant knowledge and expertise executing IT projects from remote locations, making the option of creating a captive offshore development center less attractive for companies. Such companies can perform IT tasks more economically and effectively than the internal IT departments of organizations, even though the center is located offshore. Further, cost advantages offered by the offshore alternative are significant.
Other previously identified key success factors that render the option of contracting offshore vendors more attractive to include the methodologies and process improvement practices developed by offshore service providers and certified by international organizations. Some vendors use best practices to execute IT projects, reducing potential risks and inefficiencies (and therefore cost) along the project lifecycle.

What follows is a description of substitutes to offshoring.

2.2.2.1 In House Development (On-Site/Offshore) (+)

The main substitutes to offshore service providers are captive onsite departments (also known as in-house development) or offshore facilities created by customers to support their own operations. Although some firms have done so, the trend is to outsource non-core competencies to third parties. When an industry matures, generally firms must outsource non-core activities to improve cost structure, and at the same time, focus on core competencies. Further, a company may decide to pay higher prices and outsource to companies located in its own country (traditional outsourcing) in order to avoid uncertainty and political risk; however, as previously mentioned in section 2.2.1, the cost advantages of offshoring are significant.

In order to compete with offshore vendors, large American technology and outsourcing firms such as IBM and Accenture are installing their captive offshore teams and recruiting directly, particularly in India. However, these firms are so large that even the hiring a considerable number of employees makes little impact on the overall cost structure (The Economist, 2003). In addition, managing a large consulting practice in a foreign country may be a challenging task due to cultural differences.

Although such options are valid, the trend is to use third parties for offshore services due primarily to cost. Currently, highly-specialized vendors have developed the
knowledge and methodologies necessary to perform large scale tasks. Therefore, they are able to handle complex projects, consistent with the assertion that cost advantages, knowledge management capabilities and international certifications are key success factor for IT offshore vendors.

2.2.2.2 New Technologies and Innovation (+/-)

Although the development of new technologies is one of the factors that has resulted in a higher incidence of offshoring, such technologies may in fact limit the growth of this industry.

As products and services become homogenized in developed markets, non-core activities are sent offshore due to the fact that developed countries compete in innovation. Further, when innovation slows, the trend is to shift part of the production activities to lower cost countries.

When new technologies evolve, however, they return production activities to developed countries, where labour qualified to perform activities under the new technology is available, thereby reducing the demand for low cost labour. Irving Wladawsky-Berger of IBM, cited in The Economist magazine, argues that "...Technology too may place some constraints on offshoring... some of the tasks currently going to low-cost centres may eventually return because their underlying technologies will evolve in a way that makes economic sense of putting them back in rich countries" (The Economist, 2003, para.21).

By contrast, some analysts are questioning the ability of developed countries to remain innovative due to the fact that not only jobs but also knowledge have been transferred from one country to another. However, knowledge and innovation have been
transferred between countries around the world for decades, resulting in greater wealth for each country involved in the transaction (The Economist, 2003).

2.2.3 Bargaining Power of Customers

The bargaining power of customers is moderate. The demand for offshore services is driven by strong cost pressures and demographic changes in developed countries, forcing companies to take measures to mitigate such factors.

As previously mentioned, although cost is an important decision criterion to select an offshore vendor, customer requirements extend beyond cost; customers seek companies with knowledge and expertise as well as with international certifications (key success factors previously identified in section 2.2.1). At the country level, customers evaluate language skills, business environment and cultural fit of the country in question (also identified in sections 2.1.6 and 2.2.1). Consequently, such a demand for more than simply low cost services confirms the existence of opportunities for differentiated services.

2.2.3.1 Buyers Concentration (-)

The market for offshore services is comprised of a significant number of customers from different industries and sizes.

Perhaps the concentration of clients may be best analyzed from a geographical perspective. Currently, 70 percent of the demand for offshore services lies in the U.S. while the remaining 30 percent is dispersed throughout most of the developed western countries (primarily Britain, Germany, France and Italy) and Japan. In this context, protectionist policies in the US against offshoring could seriously harm the industry. The
influence of government on the industry is analyzed in a later section (see Section 2.2.5).

2.2.3.2 Purchase Process (+)

Although buyers are not concentrated in few customers, the buying process is mainly bid-based and customers may push vendors to participate in price wars in order to win contracts. However, Figure 2-3 demonstrates that other factors are taken into account in the evaluation criteria.

Some IT providers are looking for ways to differentiate their offering by targeting markets with specific needs in which they can avoid competition based solely on price. The concept of nearshoring emerged precisely to supply the demand for culturally-alike offshore vendors.

2.2.3.3 Switching Costs (-)

Once a contract is awarded, clients may be locked in for the duration of the agreement, thereby increasing their switching costs. This is more significant for long-term contracts. Moreover, the client could become dependent on specific skills and knowledge held by the offshore team and may therefore require their participation in future maintenance-related activities. This dependency is stronger when the outsourced service involves developing customized business applications for a company.

2.2.3.4 Cost Pressures in Target Markets (-)

A factor that reduces customers' power lies in heightened pressure faced by executives to reduce IT costs due to global competition. There is significant pressure to demonstrate a better return on IT investments. In this context, the offshore alternative
provides important cost reductions for labour-intensive activities, such as integration, migration and implementation of applications.

2.2.3.5 Demographic Changes in Target Markets (-)

Finally, demographic changes and a shortage of skilled workers in consumer markets are variables that force executives to consider the offshore alternative.

Retention of professional talent has become more crucial in recent years in developed countries due to the pending retirement of a significant number of professionals from the “baby boomer” generation as well as a shortage of skilled professionals. According to a report published by Deloitte in 2004, by 2008, the first members of the “baby boomer” generation will turn 62, the average retirement age in the large, developed economies of North America, Europe and Asia. The report also states that a massive skills gap is expected in developed countries, especially in the area of engineering. In the U.S., colleges and universities will produce only 198,000 engineering students to replace the 2 million scheduled to retire between 1998 and 2004. The report also suggests that while 42 percent of students in China earn undergraduate degrees in science and engineering, only 5 percent of U.S. students do so. In Germany, the number of engineering graduates has declined by almost a third since 1995, to about 36,000 – one-tenth of the engineers produced by Chinese universities (Deloitte Research, 2004).

In summary, although large size firms can have significant purchasing power, they face strong pressures, which, in turn, lead them to evaluate the offshoring alternative.
2.2.4 Bargaining Power of Suppliers

Bargaining power of suppliers in the offshore industry (mainly labour) is low.

As mentioned in section 2.2.2, a key success factor is the cost advantage of offshore IT service providers compared to other substitutes to offshore outsourcing. This is possible due to the abundant low cost labour in developing countries. The availability of resources suggests that this production factor does not have significant bargaining power in the industry. However, companies are beginning to compete for the few skilled workers available; as a result, those countries with a limited skilled labour force are in disadvantage with those where the labour pool is not only abundant, but also highly trained.

2.2.4.1 Labour (-)

Currently, companies have access to abundant low cost labour in regions where offshore development centers are located. However, the availability of skilled employees in these countries may be limited. Further, it is expected that these employees will continue to gain bargaining power, yielding to higher costs. For example, wage inflation at major IT services providers in India such as Wipro and Infosys is increasing at an average rate of 15 percent to 17 percent annually (The Economist, 2004). In Latin America, the demand for skilled IT employees is also increasing.

Indeed, according to the report prepared by McKinsey and shown in Figure 2-3, the labour pool is a key success factor in order to compete in the industry. This figure suggests that although countries like Russia have lower labour costs than Ireland, for example, the latter is considered a more attractive offshore destination by customers, confirming that the availability of skilled labour in the country is a key success factor in the industry.
2.2.4.2 Telecommunications Infrastructure (+)

Another important resource involves the telecommunications infrastructure available in the country. In Latin America, the telecommunications infrastructure has improved significantly due to a deregulation process during the 1990's in most of the countries in the region. However, some countries have better infrastructure than others, thereby improving their overall attractiveness for offshore services.

Although Mexico has the second largest IT market in Latin America, the country has poor telecommunications infrastructure due to underinvestment by the dominant carrier (Telmex). Brazil, by contrast, has seen significant growth in the telecommunications market after deregulation and privatization of the state telecommunications operator in 1998. After the government opened the telecommunications market in 2002, the country has seen the number of telephone main lines (per 100 inhabitants) increase from 10.43 in 1998 to 20.59 in 2002 (American University, 2006).

In Uruguay, Antel, the state owned telecommunications provider retains a monopoly over local telephony; however long-distance services, mobile telephony and internet are all open to competition. Although the country is small, it leads Latin America in many key indicators including teledensity, computer and Internet penetration (American University, 2006).

In general, as mentioned earlier, telecommunications costs have decreased sharply over the last decade; it is expected that this trend will continue due to deregulation policies, foreign direct investment in developing countries and globalization.
2.2.5 Government Influence in the Industry

Government policies can have a severe impact on the future of the offshore industry. The political and economic environment of the offshore country has been previously identified in section 2.1.6 as a key success factor used to determine the attractiveness of the offshore destination.

A country's environment is influenced by both internal policies (such as industry-specific policies targeted to the technology industry as well as educational policies) and international agreements between the exporter and importer countries (such as immigration policies and regional or bilateral agreements) resulting in a better business environment in the offshore destination.

The government of India, for example, has declared the IT industry to be strategic and provides specific incentives to this industry such as tax incentives; it also grants special tariffs for technological equipment. In Uruguay, software and IT services companies are demanding more government participation in marketing the software development capabilities of local companies. On the other hand, in developed countries, labour policies that respond to public opposition against outsourcing may reduce expected growth in the industry. According to a survey conducted in August 2004 by Zogby, a company specialized in marketing and polling services, around 71 percent of U.S. voters say that outsourcing jobs overseas hurts the U.S. economy, and 62 percent think that the U.S. government should tax or legislate against companies who engage in outsourcing (Zogby, 2004).

Countries that are members of regional agreements, such as the NAFTA, can obtain special benefits (i.e. larger quotas for visas, lower tariffs, etc) and gain a competitive advantage over vendors from other regions. The following are examples of
policies that both exporter and importer countries apply in an effort to influence the industry in their respective economies.

2.2.5.1 Trade Policies (+/-)

Governments of IT services importer countries may limit entry to the market by imposing tariff or non-tariff barriers on foreign companies. Tariff barriers can be imposed directly on offshore services in general or may target non-commercial partners. For example, some nations have different commercial policies for countries that have a nuclear agenda in place.

Non-tariff barriers can be imposed on foreign investors for example, by forcing them to incur additional fixed costs such as hiring a minimum amount of local employees in order to alter the proportion of local versus foreign labour.

2.2.5.2 Immigration Policies (+/-)

Governments can either limit or foster new entrants by changing their immigration policies. The U.S. government, for instance, has reduced the annual quota of visas for technical training granted to certain countries in order to prevent employees of foreign companies from taking U.S. knowledge abroad (The Economist, 2004). By contrast, Mexican companies enjoy the benefits of belonging to NAFTA. Although Mexican offshore firms have higher rates per hour compared to Indian firms, the legal framework of NAFTA provides them with access to higher professional visa quotas (types E, TN, L, H1) and guarantees intellectual protection for U.S. importer firms.

Tougher immigration policies can be a double-edged sword. While such policies reduce the inflow of immigrants in developed countries (with a predominantly older
population), they also push companies to look to the offshore model in order to access those resources unavailable in local labour markets.

2.2.5.3 Industry-Specific Policies (+/-)

Governments often stimulate or retard the development of new technologies by offering subsidies to large mature industries or to providers of new technologies, depending on the case.

The case of India offers a useful example of industry-specific policies. In May 1998, the Prime Minister of India formed a National Taskforce on Information Technology and Software Development. The purpose of this taskforce was to develop a long term National IT policy for India and to remove barriers to growth in the industry (NASCOMM, 2006). Currently, the industry enjoys tax incentives, reduced tariffs for technological equipment imports and policies that aim to improve the technological and communications infrastructure of the country.

The government of Brazil, a strong Latin American challenger in the industry, began to take measures in the early nineties to improve the country's competitiveness in the global IT industry. In 1992 it created SOFTEX, a government agency to foster software development and raise software exports. SOFTEX's main goals included: fostering the creation of new software companies, developing the adequate infrastructure and providing financial support for existing firms (American University, 2006).

Similar to Brazil, the Mexican government created a government agency called PROSOFT and declared the software sector to be a priority. PROSOFT goals include: to reach a production level of USD $5 billion of software and related services, match the IT
expenditures of the OECD countries and become Latin-America's leader in the software and related services industry (American University, 2006).

2.2.5.4 Government as Purchaser (+)

In most countries, governments are the largest purchaser and have a significant influence on the demand of certain products and services. In the U.S. for example, lawmakers in New Jersey have proposed a bill that prohibits government agencies from hiring companies with foreign workers (The Economist, 2003).

2.2.5.5 Labour Policies (+/-)

Labour policies protecting employees can increase the overall cost of labour in developing countries over time. Currently, most countries that are providers of offshore services have flexible labour legislation, allowing employers to hire people without incurring high burdens and benefit costs; however, this may change in the future due to pressure from the international community and lobby organizations that seek to force governments to adopt labour laws that provide a more secure and healthy environment for employees.

Finally, educational policies can increase the number of skilled workers available, thereby reducing their bargaining power. Student loans and tax incentives granted to companies that promote training and skills development for employees are examples of useful educational policies.

2.2.5.6 Anti Trust Policies (-)

Some analysts consider outsourcing practices to be similar to dumping due to the perception of outsourcing as a technique used to increase overall business profitability (Wikipedia, 2006). The debate is ongoing and countries may take future action to stop
international trade activities related to offshore services, arguing that such practices violate international anti dumping policies.

2.2.5.7 Foreign Investment Policies (+/-)

Over the past two decades, the deregulation of the telecommunications industry has contributed to the reduction of communications costs in most countries.

Government policies in the technology and communications sectors, which attract foreign investment, frequently lead to competition and improvements in the country’s technological infrastructure, improving the country attractiveness as an offshore destination.

2.3 Industry Value Chain Analysis

This section examines the value chain of the IT applications segment and enterprise packaged software in particular. The purpose of this section is to identify how value is created through the different activities in this segment of the industry, the one in which Pronto Solutions competes. Further, the analysis will help to identify any new success factors for competition in the industry.

Figure 2-5 illustrates the value chain for this segment. Each block represents an activity along the chain that can be performed by one or more firms; further, each firm may have a footprint in more than one activity. Pronto Solutions’ footprint in the value chain is shown in red with a brief description of some of those services provided by the firm in each activity. The proportion of Pronto Solution’s participation in each activity has been illustrated through size differentiation in the figure.
### Figure 2-5: Value Chain of the IT Enterprise Applications Industry

<table>
<thead>
<tr>
<th>PROCESS CONSULTING</th>
<th>ENTERPRISE SOFTWARE</th>
<th>HARDWARE/INFRASTRUCTURE</th>
<th>PROJECT EXECUTION</th>
<th>CHANGE MANAGEMENT/TRAINING</th>
<th>POST IMPLEMENTATION</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Business processes consulting</td>
<td>- Global and regional marketing</td>
<td>- Supply of hardware and communications</td>
<td>- Project management</td>
<td>- Change management</td>
<td>- Product maintenance</td>
</tr>
<tr>
<td>- IT strategy consulting</td>
<td>- Direct sale of licenses</td>
<td>- Infrastructure providers (Collocation facilities)</td>
<td>- Integration services</td>
<td></td>
<td>- Product support</td>
</tr>
<tr>
<td>- R&amp;D Services</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>- Infrastructure Maintenance</td>
</tr>
<tr>
<td>- Indirect sale of licenses (Value Added Reseller)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>- Application upgrades</td>
</tr>
<tr>
<td>- Project roadmap</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>- Application Maintenance</td>
</tr>
</tbody>
</table>

Footprint of Pronto Solutions

Adapted from EMBA Business Strategy Seminar [EMBA class notes], Bukszar, Ed spring 2006
The industry value chain analysis indicates that the vendor's ability to develop alliances and partnerships to execute projects is a key success factor in the IT-applications related segment, confirming the previous analysis performed in Section 2.2.1 (Access to Customers). In the industry in general, it is common to see industry alliances and partnerships between participants along the chain in order to deliver a complete solution to clients. Frequently, clients prefer to hire a turn-key solution instead of purchasing services from several vendors; therefore, it is important that firms in the industry be capable of developing alliances with other firms.

The expertise and knowledge of vendors in their respective activities along the chain is another important success factor. The IT applications industry has matured and, as a result, demands specialization in the value creation process. Therefore, the industry value chain analysis confirms the key success factor identified in Section 2.2.1: companies with strong expertise and the ability to manage their accumulated knowledge are able to compete in international markets. Another key success factor mentioned previously in Section 2.2.1 and confirmed in this section is that most customers prefer services offered by consulting firms that are certified by the software vendor; in addition, customers also look for international standards and process certification by accredited institutions in order to minimize the potential risks in their IT projects.

The following is a closer look at each activity in the value chain.

2.3.1 Processes Consulting and IT Strategy

Most companies start the process of implementing an enterprise system by gathering information and mapping out their existing business processes. This is done in order to identify interactions between these processes and track the flow of information
throughout the organization. At this stage, the company may also require the services of a consulting firm in IT in order to align the strategy of the IT department with that of the corporation or business unit.

This stage provides value to customers by helping them to identify which processes are critical and how IT will be used to improve them. Also, depending on the process complexity, the company will decide whether to outsource the entire process, develop the application in-house, implement packaged software (i.e. SAP, Oracle) or hire an Application Service Provider (ASP) that will host the application in a remote location.

Although Pronto Solutions has some experience in providing IT strategy and alignment services, the company has focused most of its resources on the implementation of packaged software.

2.3.2 Enterprise Software Supply

Once a customer has finished the evaluation of its internal processes and decided to implement packaged software, the process of selecting and acquiring the enterprise system begins. In this stage, the software company or the Value Added Reseller (VAR) presents the software's functionality and technological architecture. In addition, the implementation methodology and a high-level implementation plan (roadmap) are presented.

If the sales process is managed directly by the software company, it is considered a direct sale. In this case, the software company leads the sales effort with the support of an implementation partner. In many cases, the VAR is responsible for selling the licenses to the client; this is called an indirect sale. Pronto Solutions, as the
VAR of Oracle for Latin America, sells Oracle licences and also performs the implementation of the software package.

An integrator may also lead the sales effort. An integrator is a firm that acts as the prime contractor for the customers, providing the complete solution and integrating all the components required for the implementation (software, hardware and services). Few firms such as IBM, for example, are capable of providing integration services and assuming the risk of the entire project. Large customers generally prefer to hire an integrator that, in turn, subcontracts all components of IT projects. Therefore, it is common to see alliances and partnerships in the industry with the purpose of delivering an end-to-end solution to customers. A key success factor in the industry then is the ability of a firm to create temporary or long-term alliances (depending on the case) with other vendors, software and hardware suppliers and integrators in order to be able to participate in larger projects and bids.

With regard to marketing activities, these are performed by both the software company and the VAR. Generally, the software company performs marketing activities on a global scale and in the regional market, to large accounts and prospects, while the local partner performs activities oriented to the local market such as lead generation, prospects qualification and industry events.

2.3.3 Hardware Infrastructure Supply

Hardware and equipment vendors sell, lease or operate the required hardware infrastructure (servers, connectivity, routers, etc) to clients.

Technology that is currently available allows firms to outsource their entire hardware and software infrastructure offshore. Companies called "collocation facilities"
provide additional hosting services with specified service level agreements (SLA's). The value proposition of IT infrastructure outsourcing allows companies to share resources with other companies such as security backup, help desk team, etc.

As previously mentioned, Pronto Solutions does not provide IT infrastructure services. In the past, the company created a business unit to host clients’ applications remotely but failed to execute this strategy; therefore, the analysis does not focus on this activity of the value chain.

2.3.4 Project Execution

Once the software and hardware have been installed, the implementation process begins. In this stage, more than one consulting firm can participate; in some cases the client may decide to have one firm provide project management services and another firm perform the implementation activities (parameterization and customization of the application). Pronto Solutions provides both project management and implementation services.

In other cases, the client may prefer to use the consulting practice of the software company in order to implement the software or use an integrator to provide the entire solution. As a result, it is also common to see alliances and joint ventures between participants in this activity of the value chain in order to meet the varied demands of customers.

A key success factor for Pronto Solutions in Latin America has been the company’s certification as an Oracle consulting partner, confirming that, as mentioned in section 2.2.1, industry certification is a key factor for successful competition in the industry. Pronto Solutions, as a certified partner, is recognized by Oracle as a company
with experience and methodologies required for implementing its software applications. This recognition gives Pronto Solutions the credentials required to support its experience in implementing Oracle products, providing a competitive advantage over other consulting firms that do not have such certification.

2.3.5 Change Management and Training

Companies generally need support when preparing the organization to adopt the new technology implemented. Firms specialized in change management provide such support during the project's transition stage.

One component of the transition stage involves training end users to use the new application. Generally, the same firm that performs the implementation creates manuals for the customized application and provides training services.

2.3.6 Post Implementation Services

Finally, the client may require post implementation support and services, including end-users and IT support, upgrades to the application and maintenance, or they may decide to outsource the administration of the system to a third party. A company such as Pronto Solutions constantly sells additional services to its installed base. Further, hardware and software vendors also provide services during this stage.

2.4 Industry Key Success Factors

Building on the previous analysis of the industry's factors and the value chain for the enterprise software segment, the following key success factors have been identified. These factors are presented in order of importance.

1. Cost Advantages:
As section 2.2.1 of the industry analysis indicates, a company cannot compete in the international market for IT offshore services without cost advantages. Although the industry allows differentiation strategies, a low cost advantage compared to other alternatives to outsourcing offshore (local outsourcing, in-house development and technology) is required due to the fact that one of the rationales for outsourcing (described in Section 2.1.4) is cost reduction.

It is important to mention that labour costs are not the only component of the cost structure in offshore projects; the total cost of the offshore proposition must be evaluated, including indirect costs (travel expenses, coordination and alignment of onsite and offshore teams), risk management and productivity.

2. International Certifications and Industry Standards

The industry factors analysis (Section 2.2.1) and the value chain analysis (Section 2.3.4) demonstrate that vendors require international certification in order to be invited to participate in bids. With IT offshore options from vendors of different countries, cultures and business practices, customers need a mechanism that homogenizes different proposals in order to make valid comparisons. Further, international certifications reduce searching costs and information asymmetry.

3. Expertise and Knowledge Management Capabilities

Similar to certification, the industry factors analysis and the value chain demonstrate that the industry has matured and customers demand companies with expertise in specific type of services, technological architectures or industries. For example, if a company wishes to hire offshore implementation services for packaged software, it will look for vendors with significant experience in this type of service (and, in particular, the packaged software to be implemented) as well as in the industry in which the customer competes.
In addition, knowledge management practices are required to reduce inefficiencies and, therefore, cost. The industry is characterized by high turnover; considering the increased demand for skilled employees, the ability of a company to reuse the acquired knowledge is relevant.

4. Country Environment

Section 2.1.6 demonstrates that the political and economical environment of the exporter country influences the customer’s decision to select an offshore provider. Further, section 2.2.4 suggests that a country’s available telecommunications infrastructure is a factor that limits or facilitates the development of its offshore industry.

A country’s political and economical environment is crucial because, in addition to the typical risk associated to IT projects, customers who opt to offshore must manage additional risks such as: management of vendor-employees relationships, business practice consistency, socio-political bias, economical and political risks, among others.

Government support of the offshore industry plays a key role in improving the business environment for offshoring in both the importer and the exporter country. As mentioned in Section 2.2.5, governments of offshore services exporting countries can bolster the industry with industry-specific regulations aimed at improving the country’s competitiveness in the sector. Further, regional or bilateral agreements between nations may create competitive advantages for certain vendors located in the countries involved in such regional trades.

Finally, as mentioned in Section 2.2.1, some customers are looking for vendors from countries with similar cultural backgrounds and values, allowing for differentiated services in the industry. This cultural factor has allowed companies from Canada,
Mexico and East Europe, for example, to enter the market and compete with Indian and Chinese companies.

5. Labour Pool

Similar to a country’s business environment, the availability of skilled employees in the offshore destination is a factor that determines the selection, as confirmed in Section 2.2.4. Not only is a low cost labour pool required, but it also must be skilled in the technologies to be used in the IT offshore project.

6. Language Skills

English-speaking skills are required in order to reduce coordination activities and improve productivity. As mentioned in Section 2.2.1, although countries with specific language skills can provide specific services for niche customer needs, most international IT businesses speak English; as a result, vendors with English language capabilities have a competitive advantage.

7. Company Size

The consolidation process in the industry described in Section 2.2.1 shows that some vendors are achieving the economies of scale and size required to provide a high volume of IT services at low prices, thereby limiting the entrance of new competitors in the market. Although the offshore industry will continue to grow, its concentration in fewer companies suggests that size will play an important role in vendors’ market entry strategies in order to successfully compete in the industry. Therefore, new entrants must consider size as a key factor for competition in the industry.

8. Alliances and Partnership Capabilities

Frequently, customers are geographically dispersed and have disparate cultural backgrounds. Consequently, vendors must have adequate business development and
partnership capabilities in order to reach potential customers and gain the economies of scale required to keep average costs competitive and retain skilled employees.

As previously identified in the value chain analysis, it is common to see alliances and partnerships in the industry. In this context, offshore companies require an organizational structure that facilitates the process of developing relationships with other firms in order to provide the right solution to customers. Further, companies must develop the flexibility required to execute contracts with entities of other jurisdictions and legal frameworks.

2.5 Rivalry among Existing Competitors

Rivalry in the offshore industry is moderate. On the one hand, factors such as the consolidation of the industry as well as capital requirements and scale effects are significant barriers to entry, thereby reducing competition. On the other hand, industry growth potential and low penetration of offshoring in the traditional outsourcing market attracts new entrants from different countries, consequently increasing competition between existing competitors.

As explained in Section 2.1.3, the offshore IT services industry offers significant opportunities for existing competitors. The estimated market size of US$ 20 billion with an average annual growth of 21 percent makes the offshore service industry very attractive indeed. In addition, the current penetration of offshoring in the outsourcing business is low, providing existing competitors with more room for growth, thereby reducing competition intensity.

In order to reduce the size and scale factor, small and medium-size companies are looking for ways to differentiate their services. The fact that customers are not simply
seeking the lowest rate per hour possible, as confirmed in Section 2.2.3 (Bargaining Power of Customers), but are willing to pay a higher rate per hour in exchange of other benefits (i.e. risk mitigation, cultural compatibility, convenient location and expertise) suggests that the industry offers opportunities for vendors with specific characteristics. An example of this lies in the differentiation strategy of companies in East Europe, Mexico and Canada. Companies from these countries are using the concept of nearshoring to differentiate their services and compete with low-cost providers and large companies, avoiding competition based merely in terms of cost.

Finally, cost pressures can increase rivalry. Although offshore providers do not face strong labour cost pressures, the industry is capital-intensive and financial resources are needed to develop a customer base, obtain certifications, develop a knowledge management process and methodologies, and other operational activities. This capital requirement for up-front investment makes exit costs less viable, increasing the competitive environment in the industry.

2.6 Competitive Analysis

In this section an analysis of Pronto Solutions' competitive environment is presented. Due to the fact that the industry is composed of firms of varying sizes and levels of expertise, which are located in diverse countries, it has been necessary to select two Latin American firms with characteristics similar to those of Pronto Solution in order to carry out a valid comparison.

One of the selected firms is Softtek, a Mexican firm specialized in IT services with operations in several countries. Softtek is a good example of a successful Latin American firm in the IT offshore industry. The other firm is IT Sistemas (ITS), a firm that
competes with Pronto Solutions in the Andean region (Colombia, Ecuador and Venezuela) and is exploring opportunities to enter the offshore market.

2.6.1 The Softtek Case

Softtek is the largest Latin American private IT service provider with operations in 10 countries in North America, Latin America and Europe. The company has more than 3,500 employees and has been providing services for over 23 years. Softtek development centres are located in Monterrey, Mexico City and Aguas Calientes in Mexico. Further, the company has additional project offices in Spain and Brazil.

Total revenue in 2005 was US$ 142 million; of which 55 percent are services provided to U.S. based clients. Softtek expects to increase its revenue generated by offshore services to 70 percent by 2008. (Softtek, 2006) The company took advantage of benefits provided by NAFTA to Mexican companies, in particular the reduction of barriers to obtaining visas for professionals in the U.S.

Softtek, similar to Pronto Solutions, grew thanks to a strong partnership with a software company. As implementation partner of SAP for Latin America, the company built a large customer base in several countries and developed the expertise and methodologies required to provide high quality IT services with geographically dispersed teams. Currently Softtek holds the CMM level 5 certification, the highest level in the industry. Further, the company uses the Six Sigma practices to carry their projects.

The company has three major business units: Application Related Services, IT Infrastructure Support and Business Process Outsourcing. Services provided under each business unit are shown in Table 2-3
Table 2-3: Softtek Business Units

<table>
<thead>
<tr>
<th>Application Related Services</th>
<th>Infrastructure Support Services</th>
<th>Business Process Outsourcing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Application Migration/ Re-Architecting</td>
<td>Security Administration</td>
<td>HR Services</td>
</tr>
<tr>
<td>System Integration</td>
<td>IT Back office Services</td>
<td>Document Processing</td>
</tr>
<tr>
<td>Custom Application Development</td>
<td></td>
<td>Process Improvement</td>
</tr>
<tr>
<td>Business Intelligence</td>
<td>Operational Security</td>
<td>Procurement</td>
</tr>
<tr>
<td>eCommerce Services</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Open Source</td>
<td></td>
<td></td>
</tr>
<tr>
<td>User Support Services</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Softtek Corporate Brochure

2.6.1.1 Offshore IT Services Business Unit

In 1997, Softtek patented the term Near Shore. The term is commonly used to refer to those services provided from an adjacent or nearby country. The strategy underlying this concept is to create differentiation in order to compete against large firms from India that dominate the market. The value proposition of Softtek is that Mexico's proximity to the U.S., its cost structure and international trade agreements (particularly the NAFTA) provide U.S.-based companies with a more convenient alternative.

Softtek has spent more than 8 years creating opportunities for its near shore Business Unit. Currently, the company has five U.S. Fortune 500 firms as clients and are continuing their market development strategy by providing services to European countries by means of a development centre based in Spain (Softtek, 2006).

2.6.1.2 Strategy

Currently, Softtek has a differentiation strategy. Labour costs in Mexico are higher than those in India. However, Softtek argues that the total cost for the client could
be lower due to other hidden costs such as size of the on site team, travel costs and communication costs.

Table 2-4 summarizes the advantages of Softtek nearshoring as opposed to the offshore model. The information, extracted from Softtek's web page, explains the benefits of nearshoring compared to other offshore services provided by Indian firms.

Table 2-4: Advantages of Near Shoring versus Offshoring According to Softtek

<table>
<thead>
<tr>
<th></th>
<th>Offshore</th>
<th>Nearshore</th>
</tr>
</thead>
<tbody>
<tr>
<td>Project Leaders</td>
<td>2</td>
<td>1 Mobile Project Leader</td>
</tr>
<tr>
<td></td>
<td>One on Site and One Offshore</td>
<td></td>
</tr>
<tr>
<td>On Site Team / Offshore Team</td>
<td>40/60</td>
<td>20/80</td>
</tr>
<tr>
<td>Time Zone Difference</td>
<td>10-13 hours</td>
<td>0 hours for certain U.S. Cities</td>
</tr>
<tr>
<td>Travel Time and Airfare Cost</td>
<td>25 Hours + US$ 2,000</td>
<td>4 Hours + US$ 450 average</td>
</tr>
<tr>
<td>Voice Communication Costs</td>
<td>US$ 0.28 per minute</td>
<td>US$ 0.10 per minute</td>
</tr>
</tbody>
</table>

Source: Adapted from the Softtek web site

2.6.2 The IT Sistemas Case

IT Sistemas (ITS) is an organization with over 100 professionals and offices in Colombia, Venezuela and Ecuador. Since 1999 ITS, has developed many consulting projects for more than 50 customers. Total revenues in 2005 were US$ 5 million.

Services rendered by ITS include: IT Consulting, implementation of packaged software, Business Intelligence, IT Consulting and software development. Although the firm has experience implementing packaged applications, the company is not a certified partner for consulting services; neither does ITS hold any international certification (such as CMMI or ISO) for software development.
Since 2003, the company has been exploring opportunities in the market for offshore services. In 2004, the company won a small contract to provide offshore IT maintenance services to a company based in U.S. Since then, ITS has been developing efforts to improve business volume of business in the offshore market.

2.6.2.1 Strategy

An aggressive low cost strategy helped the company to win contracts in its territories. Their low rates per hour and “push” marketing strategy are the main factors contributing to the company’s modest but rapid growth in the region; it is planning to apply the same strategy to enter the offshore market.

2.6.3 Comparison of Pronto Solutions, Softtek and IT Sistemas

Table 2-5 compares Pronto Solutions, Softtek and ITS against the industry’s key success factors identified in section 2.4. Each company has been compared to industry factors using three qualitative indicators: high, medium and low. The key success factors have been categorised according to level of importance.

<table>
<thead>
<tr>
<th></th>
<th>Itsys</th>
<th>Pronto Solutions</th>
<th>Softtek</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost Advantages</td>
<td>High</td>
<td>Medium</td>
<td>Medium</td>
</tr>
<tr>
<td>Certifications / Methodologies</td>
<td>Low</td>
<td>Medium</td>
<td>High</td>
</tr>
<tr>
<td>Expertise / Knowledge</td>
<td>Low</td>
<td>Medium</td>
<td>High</td>
</tr>
<tr>
<td>Country Environment</td>
<td>Low</td>
<td>Medium</td>
<td>High</td>
</tr>
<tr>
<td>Labour Pool</td>
<td>Medium</td>
<td>Medium</td>
<td>Medium</td>
</tr>
<tr>
<td>Language Skills</td>
<td>Medium</td>
<td>Medium</td>
<td>Medium</td>
</tr>
<tr>
<td>Company Size</td>
<td>Low</td>
<td>Low</td>
<td>Medium</td>
</tr>
<tr>
<td>Alliances / Partnership Capabilities</td>
<td>Low</td>
<td>High</td>
<td>High</td>
</tr>
</tbody>
</table>

The result of the analysis shows that Softtek, even with higher costs and rates per hour, enjoys competitive advantages that offset company limitations in this particular
factor. The company's strong performance in other key factors such as size, expertise and industry certifications, as well as the overall Mexican environment for IT services businesses, places this firm in a competitive advantage difficult for Pronto Solutions and ITS to match.

As a more diversified company with participation in all five segments of the industry (applications, infrastructure, BPO, systems integration and consulting), clearly Softtek has more expertise and knowledge than Pronto Solutions. However, Pronto Solutions' extensive experience implementing Oracle products is its main differentiator over Softtek. Although the Mexican company has extensive experience implementing packaged software, most of this experience is related to SAP products (the main competitor of Oracle in the market for enterprise applications).

Figure 2-6 illustrates two dimensions of the IT applications-related services in which Pronto Solutions and Softtek compete. The vertical dimension represents the size of target customers in the industry (large versus mid-size firms) whereas the horizontal dimension represents the two dominant technologies for enterprise applications (SAP and Oracle).

Figure 2-6 illustrates that the two companies' technological expertise and target customers are different, with a small overlap (Softtek customers that use Oracle ERP and CRM applications). Pronto Solutions can then use these two dimensions of the segment (technology and account size) to differentiate itself from Softtek and improve its market share without having a confrontational competition with a larger competitor.
Finally, ITS does not have another competitive advantage besides cost when competing in the international market for offshore services. The company faces many market entry barriers. Without financial resources and a lack of other key success factors such as certifications and knowledge capabilities, ITS faces a challenging task entering the offshore IT market with a strategy based merely on cost. Moreover, the Andean region is not considered an attractive destination for offshoring. In contrast, although Uruguay is not as attractive as Mexico, it has a stable political and economical environment. The fact that Tata Consulting, one of the largest offshore service providers has installed an offshore development centre in this country, confirms such an affirmation.
2.7 Strategic Alternatives

This section offers strategic alternatives for Pronto Solutions’ offshore business unit and evaluates these alternatives according to the decision criteria listed in Section 1.6 and the company’s market share goal. The proposed strategies reflect the industry analysis and key success factors presented in previous sections.

Pronto Solutions has three strategic options for addressing the future of its offshore IT services business unit. The first option is to apply a diversification strategy, compete in more than one segment of the industry (preferably in the systems integration and IT Infrastructure-related segments) and offer these in several markets. The goal is to take advantage of the industry growth and use the company’s experience in IT application experience in order to execute the diversification process in these two additional segments.

The second option is to implement a segment focussed strategy. By focusing on the IT application-related segment, where Pronto Solutions currently competes, the company can therefore concentrate on what it does best and grow by developing new markets and expanding its presence in the U.S. In such a scenario, the company will only take advantage of a portion of the market opportunities in the offshore industry.

The third strategy is a market focussed strategy. Instead of developing new markets, the company can focus on developing more services to be offered in Latin America only (the market in which the company currently operates). This strategy implies that the company’s available resources will be mainly employed in developing other business units and not in the offshore business unit. The grow/share matrix presented in section 1-2 shows that the company has other "question marks" (business units with a low share in high growth markets); therefore, a valid option is to invest the
available resources in developing other business units and offer them only in Latin America.

2.7.1 Evaluation Criteria

Each of the alternatives has been evaluated against the decision criteria described in Section 1.6 and other company's goals. The first step of the evaluation process was to determine the importance of each criterion for the company's partners. The second step consisted in assigning a rated value to each criterion for each strategic alternative. The values rank from 1 to 5, where 1 is a low value and 5 is a high value. For instance, a criterion rated with a value of 5 implies that it is five times greater than a criterion rated with a value of 1.

Table 2-6 summarizes the results of the evaluation performed with information provided by Pronto Solutions. The first column shows the six criteria described above; the second column shows the weighted value of each criterion; and the subsequent columns shows the rating and weighted value for each strategy.

2.7.2 Analysis of Results

The evaluation suggests that the most viable option for Pronto solutions is to implement a segment-focus strategy and concentrate in the IT applications-related services segment. The following is an analysis of the results for each strategic option.

1. Option 1: Diversification

Although the diversification strategy provides the option of improving the company's market share in the long run and resulting in greater profits (due to higher market size and lower penetration rates of other segments), the levels of investment required, combined with the financial return horizon, makes this option less attractive.
The company will need to invest a significant amount of resources in order to develop the expertise, capabilities and certifications necessary to enter other segments. Considering the company’s size, financial resources and lifestyle preferences, such a strategy will not be feasible.

Table 2-6: Strategic Alternatives

<table>
<thead>
<tr>
<th>Weight</th>
<th>Option 1</th>
<th></th>
<th></th>
<th>Option 2</th>
<th></th>
<th></th>
<th>Option 3</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Market and Segments</td>
<td>Financial</td>
<td>Investment Requirements</td>
<td>Financial Return Horizon</td>
<td>Potential Profits</td>
<td>Management</td>
<td>Autonomy Level</td>
<td>Impact in Lifestyle</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Rating</td>
<td>Weighted Value</td>
<td>Rating</td>
<td>Weighted Value</td>
<td>Rating</td>
<td>Weighted Value</td>
<td>Rating</td>
<td>Weighted Value</td>
<td></td>
</tr>
<tr>
<td><strong>Market</strong></td>
<td>20%</td>
<td>4</td>
<td>16%</td>
<td>3</td>
<td>12%</td>
<td>1</td>
<td>4%</td>
<td>20%</td>
<td>100%</td>
</tr>
<tr>
<td>Improve Market Share</td>
<td>20%</td>
<td>4</td>
<td>8%</td>
<td>4</td>
<td>16%</td>
<td>3</td>
<td>12%</td>
<td>20%</td>
<td>100%</td>
</tr>
<tr>
<td><strong>Financial</strong></td>
<td>18%</td>
<td>2</td>
<td>7%</td>
<td>4</td>
<td>14%</td>
<td>3</td>
<td>11%</td>
<td>12%</td>
<td>100%</td>
</tr>
<tr>
<td>Investment Requirements</td>
<td>12%</td>
<td>4</td>
<td>10%</td>
<td>3</td>
<td>7%</td>
<td>2</td>
<td>5%</td>
<td>10%</td>
<td>100%</td>
</tr>
<tr>
<td>Financial Return Horizon</td>
<td>10%</td>
<td>2</td>
<td>4%</td>
<td>3</td>
<td>6%</td>
<td>4</td>
<td>8%</td>
<td>20%</td>
<td>100%</td>
</tr>
<tr>
<td>Potential Profits</td>
<td>20%</td>
<td>2</td>
<td>8%</td>
<td>4</td>
<td>16%</td>
<td>5</td>
<td>20%</td>
<td>20%</td>
<td>100%</td>
</tr>
<tr>
<td>Autonomy Level</td>
<td>100%</td>
<td>16</td>
<td>29%</td>
<td>21</td>
<td>38%</td>
<td>18</td>
<td>33%</td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>

2. Option 3: Market Focus

A market focussed strategy does not appear to be sustainable for Pronto Solutions in the long run. Latin America is a small market compared with those of Europe and North America, the target markets for offshore services. This option does not impact the partners’ lifestyle; however, neither does it offer relevant market share improvements.
3. Option 2: Segment Focus

A segment focussed strategy appears to be the most viable option for Pronto Solutions. This strategy best satisfies two important decision criteria: the levels of investment required and the financial return horizon.

Although the segment of IT applications-related services is characterized by higher penetration (31 percent of the total IT applications outsourcing market), it appears that it is the only segment in which Pronto Solutions has competitive advantages in order to compete and improve its market share without incurring significant investment levels and changes to partner preferences.

2.7.3 A Differentiation Strategy for Pronto Solutions

The segment focussed strategy proposed allows Pronto Solutions to specialize in a specific set of services and compete with vendors such as Softtek. As mentioned in section 2.6, the expertise of Softtek in the IT applications segment is largely related to implementation services of SAP products; by contrast, Pronto Solutions has extensive experience with Oracle products. Both software companies (SAP and Oracle) have an extensive global customer base, providing the opportunity for consulting partners to specialize in one of these two technologies. The proposed strategy (Option 2) also allows Pronto Solutions to differentiate from Softtek. By focusing in Oracle products, the company may continue accumulating knowledge in this technology, grow in this portion of the market segment and position itself as the best nearshoring option for Oracle consulting and post implementation services.
Further, Pronto Solutions, as is the case with Softtek, can differentiate itself from mid-size offshore vendors from other regions by exploiting the benefits of nearshoring. Figure 2-7 illustrates the differentiation strategy for the company.

Figure 2-7: A Differentiation Strategy for Pronto Solutions

LOCATION

Nearshore

Pronto Solutions

Softtek

Oracle

SAP

TECHNOLOGY

Mid-Size Offshore Providers

Offshore
3 INTERNAL ANALYSIS

The next step is to analyze Pronto Solutions' managerial preferences, resources and organizational structure in order to determine whether the company has the internal capabilities required to successfully execute Option 2, the strategy suggested in Section 2.7. The objective of this section is to identify the company's internal capabilities and compare them with those required by the industry, previously identified in the key success factors.

The partners of Pronto Solutions expect that investments in the IT offshore business unit will improve the company's market share. Their concern is that the company is not fully exploiting its internal resources and capabilities in order to develop opportunities in the market for offshore services. Moreover, they are concerned that their current strong position in Latin America in the IT applications segment may be threatened by new development centres recently installed in Brazil, Mexico and Uruguay by other firms. As mentioned in section 2.6 Tata Consulting, a large consulting firm from India, has opened a development center in Uruguay to serve clients in Latin America and the U.S. This firm can easily compete with Pronto Solutions in the Latin American market in terms of cost and quality.

Table 3-1 summarizes the status of Pronto Solution's internal resources and capabilities for successfully implementing Option 2. Further, the table shows a proposed strategy to improve those areas where Pronto Solutions is weak.

The analysis suggests that while Pronto Solutions has strong operational resources and capabilities required to implement Option 2 (such as knowledge,
expertise and skilled labour pool), it lacks marketing, sales and business development capabilities. The recommendation is a combination of internal investment, organizational restructuring and development of a partnership to strengthen weak areas. Also, due to the fact that Uruguay is not perceived as one of the most attractive destinations for offshoring (compared to Mexico and Brazil), the partners need to evaluate the utilization of the company's facilities in Mexico or Brazil as the main development center with the office in Uruguay acting more as a support centre.

Table 3-1: Summary of Pronto Solutions internal Capabilities and Resources

<table>
<thead>
<tr>
<th>Internal Capabilities</th>
<th>Status</th>
<th>Mitigation Strategy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Management Capabilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Project Management</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Business Development</td>
<td>X</td>
<td>- Invest to improve</td>
</tr>
<tr>
<td>Management Preference</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Location of the Offshore Development Center</td>
<td>Δ</td>
<td>- Consider Brazil or Mexico as development centers</td>
</tr>
<tr>
<td>Resources</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Financial Resources</td>
<td>Δ</td>
<td>- Consider an alliance</td>
</tr>
<tr>
<td>Labour Cost</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Labour Pool</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Language Skills</td>
<td>X</td>
<td>- Consider an alliance to improve</td>
</tr>
<tr>
<td>Certifications</td>
<td>Δ</td>
<td>- Invest to improve</td>
</tr>
<tr>
<td>Knowledge Management Capabilities</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Project Execution and Expertise</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Customers References</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Alliances and Partnership Capabilities</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Marketing and Sales Capabilities</td>
<td>X</td>
<td>- Invest to improve</td>
</tr>
<tr>
<td>Sales Capabilities</td>
<td>X</td>
<td>- Restructure marketing organizational structure</td>
</tr>
<tr>
<td>Organization and Culture</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Organizational Structure</td>
<td>Δ</td>
<td>- Invest to improve</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Improve synergies between business units.</td>
</tr>
<tr>
<td>Culture and Values</td>
<td>✓</td>
<td></td>
</tr>
</tbody>
</table>

Strong ✓
Medium Δ
Weak X

3.1 Management Capabilities and Preferences

The analysis of Pronto Solutions' management capabilities shows that the organization lacks the managerial expertise required to develop business opportunities
in the target markets (particularly the U.S.). Although the company has strong managerial experience in executing complex projects related to Oracle products (therefore, capable of successfully delivering services under Option 2), it seems that one of the company's managerial weaknesses lies in its business development size. In order to mitigate this skill gap, Pronto Solutions should consider investing in the recruitment of an executive to perform the role of business development manager for the offshore business unit.

With regard to management preferences, the partners' inclination to locate the majority of offshore activities in Uruguay also limits the company's ability to execute Option 2. Due to the fact that Uruguay is not perceived as one of the most attractive destinations for offshoring, the company has the challenging task of not only promoting itself in the market, but also of selling Uruguay as an interesting destination. With the company's managerial limitations in business development capabilities, this task appears difficult. In this context, the partners of Pronto Solutions should consider locating the offshore development centre in Mexico or Brazil (countries where Pronto Solutions currently operates) with the Uruguay office acting as a support centre.

3.1.1 Management Capabilities

Pronto Solutions is a partnership owned by five partners, all of Uruguayan origins. The five partners have extensive professional experience and are responsible for specific activities in the organization. Partner A, a systems engineer, supervises the company's operations in Brazil and Uruguay. Partner B, an accountant, is responsible for operations in Mexico; he resides in Miami, Florida. Partner C, a systems engineer and MBA, is responsible for operations in Argentina, Colombia, Peru and Chile as well as for the relationship with Oracle at a high level. Partner C resides in Buenos Aires, Argentina.
Partner D, a systems engineer and accountant is responsible for the financial management of the company. Finally, Partner E with a master’s degree in Economics is responsible for all aspects of quality, process improvement, and the preparation of the organization for obtaining international certifications. This partner also supervises the operations of the offshore business unit.

Pronto Solutions also has 5 country managers with extensive knowledge of the business environment in their respective territories.

3.1.1.1 Project Management Capabilities

With regard to project execution, the company has strong capabilities in project management, risk management and project control. These capabilities are required to implement Option 2.

Project managers are certified by the Project Management Institute (PMI) and have several years of experience in the industry as well as extensive knowledge of the technology and functionality of Oracle products. Further, the company has practices for risk identification and mitigation from proposal to project closeout.

3.1.1.2 Business Development Capabilities

The company lacks the expertise to develop business opportunities in the U.S. None of the partners and country managers (the second managerial level in the organizational hierarchy) have international business experience beyond Latin America. There is a clear gap between the company’s expectation of entering in the U.S. market and its managerial capabilities for developing this market. This is a weakness that must be addressed in order to execute Option 2.
One alternative to mitigate the lack of business development capabilities is to recruit an individual to perform this role. Another alternative is to develop an alliance with a company located in U.S. (or Canada) with knowledge of the target country. The recommendation is to recruit an executive to perform this role and keep it as an internal activity instead of assigning it to a third party. The reason is that this role is crucial for the successful execution of Option 2.

3.1.2 Preferences and Interests

Lifestyle is important for the partners and country managers of Pronto Solutions. Three of the partners currently reside in Uruguay while the other two reside in Argentina and Miami, Florida, and travel frequently to Uruguay. This lifestyle and emotional attachment to the hub country are the reasons for locating the offshore development center in Uruguay and not in any other countries in which the company operates.

Clearly, Uruguay is an attractive country for locating an offshore development center due to the country’s political and economical stability and geopolitical location. However, Brazil and Mexico (countries in where the company currently has offices) are the only two Latin American countries perceived as attractive destinations for offshoring. Another limitation facing Uruguay is the gap between the projected demand for offshore services and the number of students who graduate in systems engineering per year in this country; an average of only 270 engineers graduate from Uruguayan universities. However, Tata Consulting is expecting to hire 300 employees per year over the next two years in Uruguay. In this context, the company is in a weaker position in terms of executing Option 2.

In such a context, the company must evaluate whether it will be more beneficial to utilize offices installed in Brazil and Mexico and position itself as a nearshoring
provider with development centers in Mexico, Brazil and Uruguay, instead of positioning Uruguay as an attractive offshore destination.

3.2 Resources

The analysis of Pronto Solutions' resources suggests that while the company has cost advantages, a skilled labour pool, knowledge management capabilities and some of the industry's required certifications, there is a gap with regards to English language skills, marketing and sales capabilities for implementing Option 2.

Pronto Solutions' limited financial resources suggest that the best alternative for the company is to develop a partnership with a North American company that has sales capabilities and a team of English-speaking consultants that can act as the front-end team. With the company's experience in developing alliances and a flexible organizational structure, the possibility of implementing an alliance appears viable. Other options such as developing the front-end internally are considerably more cost intensive.

One area in which Pronto Solutions definitely needs to invest is in improving its marketing capabilities with regard to the strategic option to be implemented. Although the current status has worked for the internal Latin American market, it does not contribute to promote the company's capabilities for offshore services, nor does it provide a clear message about the company's value proposition for offshoring.

3.2.1 Financial Structure

Pronto Solutions does not have long-term debts and holds the equivalent of 10 percent of annual sales in cash reserves. The company's financial situation is healthy; however, the company is small compared to other competitors in the industry (Softtek,
for example, is ten times larger in terms of annual sales) and does not have sufficient resources for large investments.

Since Pronto Solutions began, it has been financed with capital provided by the owners or reinvested gains, without incurring long term bank loans and other financial instruments. In general, the partners prefer low risk and predictable revenues and profits rather than high risk and potentially high profits. Therefore, the required investment should be financed by profit created by the company's operations, by funds provided by new investors, by developing an alliance with another company or a combination of any or all of these alternatives.

A conservative financial structure combined with the company's limited size reduces the availability of financial resources to implement strategic Option 2. Pronto holds the equivalent of 12 percent of its annual sales necessary to execute the selected strategy for the offshore IT business unit. The remaining funds, if needed, should come from private investors or through an alliance with another company with a similar interest in the offshore market.

3.2.2 Labour

3.2.2.1 Labour Cost and Pool

Pronto Solution's labour costs are, on average, 30 percent higher than those of others competitors from India; however, they are a third of the average labour costs in the U.S.

The company has highly skilled employees specialized in the implementation of Oracle products. These 400 employees are distributed throughout the company's offices in Latin America, as shown in Figure 3-1. Clearly, the company has a strong team,
capable of executing Option 2. The average experience of the company's consultants is in the range of 8 to 9 years. Figure 3-1 also shows that Mexico and Brazil are the offices with most employees, followed by Uruguay and Argentina. This distribution of labour supports the option of utilizing the offices in Mexico and Brazil as development centres.

Figure 3-1: Distribution of Employees by Office

It appears that Pronto Solutions does not only have a strong team of experienced consultants, but is also able to retain them. With a turnover ratio of 5 percent, Pronto Solutions has a good performance record in this aspect (the average ratio in the industry is 15 to 20 percent). This low turnover ratio has contributed to maintain the company's direct costs low and, at the same time, to retain the accumulated knowledge of its human capital.

The company has been able to retain talent due to its open door culture, flat organizational structure and a combination of a flexible job environment and professionalism. Further, employees are attracted to the company due to travel opportunities and professional growth.
Training programs are also available. For example, the company has recently provided support for obtaining the Project Management Professional certification, an internationally recognized accreditation provided by the Project Management Institute. In addition, salaries are above average when compared to those in the consultants’ home countries.

3.2.2.2 Language skills

Although Pronto Solutions has a highly experienced team of consultants and low turnover ratio, the English language capabilities of the company are weak, limiting the company’s ability to execute Option 2. Despite the fact that around 80 percent of the total Pronto Solutions’ labour force can understand written and spoken technical and business English, less than 5 percent is fluent in this language. As mentioned in the industry analysis, offshore projects require that 20 to 40 percent of the implementation team work on site (at the client’s facilities) to facilitate interaction between the client and vendor. This implies that a similar percentage of Pronto Solutions consultants must constantly interact with English-speaking clients.

Pronto Solutions can either reduce this gap of English-speaking consultants by taking different measures such as: hiring consultants in the countries where the company currently operates (Latin America); hiring them in the target markets and opening an additional office that will serve as the front end office to U.S. based clients or it may develop an alliance with a company that could provide the front end team and related services while Pronto Solutions provides the development activities.

Developing an alliance appears more viable in terms of levels of investment required (a decision criteria stated in section 1.6). By developing an alliance with a company based in the U.S., Pronto Solutions can rapidly access the front-end team,
without incurring significant investments in installing an office in North America. Moreover, hiring English-speaking consultants in Latin America implies frequent business travel to the U.S. as well as visa issuance for such employees.

Pronto Solutions can provide its experienced team of consultants at competitive rates per hour to the other partner. Further, by combining customer references and knowledge, both companies may form an attractive supplier with experience implementing packaged software in different industries and countries.

Such a partner may benefit from the alliance in several ways. First, it will gain access to skilled consultants at a low cost and, in turn, offer lower rates per hour to its clients. Rates per hour for IT services have been declining during the last six years due to the availability of offshore providers. Therefore, by farming part of the production of its services offshore, the partner will remain competitive and, at the same time, maintain its margin per hour. Second, the partner will be able to balance its headcount of consultants and match its labour supply to service demand, resulting in lower fixed costs (related primarily to the process of recruiting, selecting and retaining talent) and an improved utilization ratio (the ratio of total available hours to labour to billable hours).

Finally, in order to minimize the fear of losing customers who may approach Pronto Solutions and pay for its services directly, the partner may act as the prime contractor and own the relationship with the client. Pronto Solutions may then act as a subcontractor for the other company, with contractual limitations in order to provide services directly to end customers.

This type of alliance is common in the IT services industry. Several consulting firms located in developed countries outsource part of their services abroad. The
purpose of such alliances is to improve per hour margins and, at the same time, offer customers a good mix of competitive rates with a local presence.

3.2.3 Industry Certifications

In 2002, Pronto Solutions adopted ISO 9001, the international certification for IT projects development, implementation, maintenance and administration. Further, the firm created the position of Quality Manager to which a senior executive was appointed. The role of the Quality Manager is to develop quality standards suggested by the Project Management Institute (PMI) and the ISO organization in order to ensure that these standards are applied in all project offices. International certification (required by customers) as well as the company’s improvements in quality management capabilities reduce barriers to entry and facilitate the implementation of Option 2.

Currently, the company has initiated the process of obtaining the CMMI – Capability Maturity Model Integration - developed by the Carnegie Mellon institute. The objective is to achieve the CMMI – Level 3 certification in 2007 and continue moving toward higher maturity levels in software development. Due to the fact that this certification is widely recognized in the industry and sought by customers, Pronto Solutions is at a disadvantage with other competitors in this aspect, limiting the implementation of Options 2. The recommendation in this case is that the company should continue to invest in the Level 5 certification.

3.2.4 Knowledge Management

During the past 4 years, the company has been moving toward a knowledge-sharing organizational culture. External forces such as global competition and new technologies have pushed the organization to adopt a knowledge management initiative and capitalize on the intellectual capital of its consultants. Due to the fact that services
are delivered to clients on a project-based approach, Pronto Solutions’ interest in knowledge management practices seems rational; however, knowledge is still viewed more as a way to replicate, use and access information rather than as a tool for transforming organizational culture, especially in project offices.

Pronto Solutions has been managing knowledge for many years. Consultants have been sharing knowledge related to their discipline in each individual office or business unit, yet rarely do so on a global scale. The problem lies in the fact that that in many cases, project teams have had to reinvent the wheel in order to solve problems that have been previously solved in other projects. Transfer of learning and experience has been limited primarily to what each employee brings directly to each new project assignment.

At this point, following four years of concentrated effort, Pronto Solutions has successfully developed a technological platform that allows consultants to access important information such as documentation from previous projects, best practices, methodological manuals, and other relevant information, through the internet. The company is now able to execute projects with geographically dispersed teams and, as a result, able to implement of Option 2. The company must now initiate a cultural change in order to continue improving its ability to share knowledge.

3.2.5 Project Execution, Expertise and customers References

The company’s ability to successfully implement packaged software lies in three main factors: (1) its extensive knowledge of Oracle’s products, (2) its ability to estimate project costs and schedules in the early stages, and (3) its methodologies for implementing packaged software. Without a doubt, Pronto Solutions’ expertise in
implementing Oracle products is an important strength for the successful implementation of Option 2.

Figure 3-2 shows the distribution of the Pronto Solutions’ customer base by industrial sector. With over one hundred implementations in companies across Latin America and clients in baking, retail, manufacturing and service companies, Pronto Solutions has accumulated significant knowledge related to Oracle applications. The company has developed an extensive customer base and is continuously selling post-implementation services due to high levels of customer satisfaction. Key accounts are willing to provide references and invite prospects to their facilities in order to share their experiences in implementing an enterprise system. Moreover, as a certified consulting partner of Oracle, the company has the credentials required by the industry to participate in bids, improving its odds to successfully execute Option 2.

Figure 3-2: Distribution of Clients by Industry

- Banking, 35%
- Retail, 10%
- Manufacturing, 20%
- Government, 12%
- Telecom., 17%
- Other, 6%

The second factor involves the firm’s ability to mitigate risks related to implementation during the early stage of projects. Experienced project managers and pre-sales consultants provide early input regarding the number of hours, staffing requirements, scheduling and scope for each commercial opportunity. This is crucial, as
rates per hour have been decreasing in the industry while competition has increased, thereby reducing the margin per hour yield with each project. Moreover, clients are demanding lump sum contracts over traditional time and materials contracts, transferring a significant portion of the implementation risk to the consulting firm.

In order to improve its market share and develop a customer base in the U.S., Pronto Solutions may have to bear a considerable portion of the implementation risk, especially in the initial projects awarded. Strong estimating and scheduling capabilities, as mentioned above, allow Pronto Solutions to assume this risk and earn the credibility and customer base required for the proposed strategy.

An additional strength of Pronto Solutions relates to methodologies and practices developed by the company. Pronto Solutions has predefined documentation templates for each phase of the methodology as well as for each module (enterprise systems are typically modular and each module covers a specific business process; i.e. accounts payable, purchasing, order management, etc). These pre-defined documentation templates improve productivity by reducing the time required to implement a module; therefore, the company can increase the margin per hour, especially in lump sum contracts.

3.2.6 Alliances and Partnerships Capabilities

As mentioned in the value chain analysis, the technological solution requested by the client requires the integration of other products (software or hardware) and services; therefore, it is common to see alliances and partnerships between companies in the industry.
At Pronto Solutions, the partners define global alliances and partnerships at the corporate level and each project office determines which other regional alliances are necessary to win contracts and execute projects in their respective territories. Successful relationships with large software companies and integrators, as well as with small, local service firms indicate that Pronto Solutions has the organizational flexibility necessary to work with other firms for long term or short term goals, as required. As a result, the offshore business unit may benefit from the collaborative nature of this type of business culture when implementing alliances in the targets markets for the execution of Option 2.

3.2.7 Marketing and Sales Capabilities

With regard to marketing, the company has not created a formal role for the position. In brief, each country manager is responsible for the generation of its marketing strategy. There is no corporate marketing strategy that serves to standardize the company’s message and its positioning across regions and business units.

Sales executives lead the sales process and are responsible for marketing and sales activities, including lead generation, qualification of prospects, marketing campaigns and the design of the best solution for customers. Sales executives are supported by pre-sales consultants whose their role is to present the product’s functionality and provide a preliminary assessment of how the implementation should be performed. Further, such consultants provide support by answering RFP’s and preparing technical proposals.

While this approach has been successful in the Latin American context, it has done little to improve the customer base and market share of the offshore IT services business unit. Pronto Solutions has neither the marketing capabilities nor the sales structure required to promote its expertise and knowledge in implementing packaged
software within the target markets for offshore services, a significant weakness for implementing Option 2. As demonstrated in the next section, this is due in part to the fact that no organizational structure exists to allow access to customers in these markets. Further, the marketing position is oriented toward reinforcing its presence in Latin America, yet says little about the company's vision for offshore services. The company's webpage is a case in point: clearly, Pronto Solution's web page reveals the firm's focus on successful projects in Latin America while the offshore business unit section does not offer a clear message regarding the benefits of hiring Pronto Solutions for such services.

Pronto Solutions must invest in improving its marketing in any of the three options in order to achieve the goal of increasing the company's market share in the offshore IT services market.

3.3 Organization

The organizational structure of Pronto Solutions must be restructured in order to improve areas such as marketing and business development. Also, the company requires an individual capable of leading the offshore business unit to achieve the market share goal and execute the selected strategy.

The decentralized and flexible structure of Pronto Solutions has not been fully utilized to improve the offshore IT business unit current situation. The company's international business experience and contract management capabilities could be better utilized in order to develop business opportunities and alliances in the target markets.

Finally, the company's human capital management practices and values have contributed to its low rates of employee turnover. Due to the fact that employee turnover is a factor that leads to increased labour costs for offshore suppliers and, as a result,
yields to an increase in the bargaining power of employees, Pronto Solutions’ culture is an internal strength that facilitates the implementation of Option 2.

3.3.1 Organizational Structure

Figure 3-3 shows the organizational structure of Pronto Solutions. Each partner is responsible for operational activities; managers report directly to these partners. The diagram also shows that the offshore business unit is managed directly by one of the partners and does not have a person specifically assigned as unit head. This clearly indicates one of the reasons why this business unit has underperformed in the offshoring market and, as a result, has a poor market share.

Figure 3-3: Organizational Structure of Pronto Solutions
This organizational structure has functioned well for operations in Latin America and provides the flexibility required to execute projects in several countries with different legislation and business practices. Once a contract is awarded, the firm is able to quickly mobilize resources to clients' facilities in order to deliver its services. This is possible primarily due to the company's decentralized organizational structure, which facilitates project execution in geographically dispersed areas. In addition, the availability of documentation, practices and other resources through the Internet also permits timely service delivery. Further, this type of organization allows the firm to work closely with its customers and provides access to skilled consultants; headcount is efficiently managed by transferring consultants from other offices according to business activity levels in any certain country.

Moreover, due to the fact that the firm has legal entities in several countries, it is able to reduce uncertainty to those customers willing to hire local companies. Such is the case of government agencies in countries that require contractors to have local operations. In addition, Pronto Solutions is competent in managing its global taxes. Head office works closely with project offices in order to coordinate compliance with local entities and, at the same time, improve the company's overall tax burden.

Although such an organizational structure has contributed to Pronto Solutions' growth, it has not been fully exploited in order to improve the market share of the IT offshore services business unit. This is largely because the company does not have a clear strategy for this unit, nor does it have an executive assigned to accomplish the market share goals. The company's organizational flexibility and legal and taxes capabilities could be also used for its expansion to other markets. Pronto Solutions has considerable experience in international business and managing contracts with clients from different countries, an advantage that may be used to execute Option 2.
3.3.2 Culture and Values

Pronto Solutions considers itself to be a knowledge organization where originality and collaboration among members are values promoted by the company. The company also places significant emphasis on its human capital and recognizes that an adequate working environment has contributed to the development of the potential of its consultants as well as to the company’s intellectual capital. Such values have contributed to the company’s ability to retain talent and reduce turnover of skilled employees (one of its strengths mentioned in Section 3.2.2) and, as a result, facilitates the execution of Option 2.

Pronto Solution’s organizational culture is rooted in customer service and in developing long term relationships with clients. The company believes that one of its most important assets and the source of its international expansion are the referrals and testimonials of its satisfied clients (as mentioned in Section 3.2.3).
4 RECOMMENDATIONS

The analysis of the offshore IT services industry and Pronto Solutions' internal resources and capabilities suggest that the best alternative for the company is to implement a market development strategy with a focus on IT-applications related services, particularly those services related to Oracle products. The proposed segment focus strategy allows Pronto Solutions to specialize in what it does best: providing services related to Oracle products. By focusing on a specific set of services, the company can avoid barriers to entry and improve its market share without incurring considerable levels of investments.

The suggested strategy is supported by the following arguments:

- **Offshore IT industry growth is attractive**
  
  Despite the fact that the industry has become more consolidated and barriers to entry have increased, the offshore IT services industry offers significant opportunities. The estimated market size of US$ 20 billion with an average annual growth of 21 percent is a very attractive financial lure.

- **Pronto Solutions has cost advantages**
  
  Although Pronto Solution's labour costs are higher than those of competitors from other countries, its rates per hour are nevertheless still attractive. Further, the industry analysis has demonstrated that customers do not only seek the lowest rates per hour available; rather, other factors are also taken into account when selecting an offshore vendor.
- Pronto Solutions has extensive experience implementing Oracle products.

With a considerable amount of implementation projects in different industries, the company has accumulated significant knowledge and expertise related to Oracle applications. Pronto Solutions has also developed long-term relationships with key accounts willing to provide references about their experiences working with Pronto Solutions, therefore improving the company reputation as an experienced supplier of implementation services. Finally, the company is backed by its certification as Oracle consulting partner.

- Pronto Solutions has a skilled labour force.

With a strong team of consultants averaging 8 years of experience as well as the company's ability to retain talent, Pronto Solutions has a skilled labour force able to execute complex projects in the IT-applications related segment.

- Pronto Solutions has some of the certifications required by the industry

Pronto Solutions has already obtained the ISO 9001 certification, one of the required certifications in the industry, and is in the process of obtaining the CMMI certification. The company's progress toward becoming a full certified offshore provider, added to the company's certification as Oracle consulting partner and its experience implementing packaged software, makes Pronto Solutions an attractive offshore vendor.

- Pronto Solutions has knowledge management capabilities.

Currently, the company has knowledge management capabilities that allow it to execute projects with geographically dispersed teams. Pronto Solutions has developed a technological platform to store, reuse and transfers documents and practices and is in the process of improving its knowledge management capabilities beyond the technological level.
• **Pronto Solutions can successfully differentiate itself from other vendors by focusing on nearshoring services for Oracle customers.**

Pronto Solutions, similar to Softtek, can differentiate itself from vendors in countries such as India by reinforcing the benefits of nearshoring in its value proposition to customers located the U.S. Further, the company can avoid direct competition with larger vendors such as Softtek by focusing only on services related to Oracle products with mid-sized accounts. As confirmed in the industry analysis, the IT offshore industry has become more specialized, providing opportunities for companies with significant experience and knowledge in specific services / technologies.

• **Pronto Solutions is a small company with limited resources and a conservative financial structure.**

This factor limits the ability of the company to enter in other segments of the industry, confirming that the company should focus on investing its limited financial resources in the portion of the IT-applications related segments where the company can successfully compete.

The company must improve the current organizational structure in order to allow the offshore business unit to grow. A head for the offshore business unit and a business development manager must be appointed in order to achieve the company’s goal of improving its market share in the offshore industry. In addition, the company must invest in improving its marketing capabilities. The current decentralized structure and non-unified marketing positioning does not contribute to the company’s positioning as an attractive offshore vendor for IT-applications related projects.

Finally, due to a limited availability of financial resources, the best alternative for Pronto Solutions in terms of cost/benefit is to develop a partnership with a North American company that has sales capabilities and a team of English-speaking
consultants to provide on-site service delivery. With the company’s experience in
developing alliances and its flexible organizational structure, such an alliance is a viable
alternative. As mentioned in section 3.2.2, these types of alliances are common in the
industry.

Risk Assessment of implementing the Recommended Strategy

The risk of implementing the suggested strategy is low. The level of investment is
even lower when compared to that in Option 1. In addition, by focusing in
implementation services related to Oracle the company also reduces risks, due to the
fact that (as confirmed above) the company has the resources and capabilities to deliver
satisfactory results to customers. Moreover, some risks may be shared with the partner
selected to provide on-site service delivery.
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