



INFORMATION, COMMUNICATIONS & ENTERTAINMENT

Nearshore Attraction:

Latin America Beckons as a Global Outsourcing Destination

KPMG INTERNATIONAL



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Foreword

As businesses look to create greater efficiencies, the global market for business outsourcing has expanded in recent years. Today, people typically associate outsourcing with India, and, to a lesser extent, China. While those two regions are the market leaders, there has been significant movement elsewhere in the world, especially in Latin America.

Today, leading Latin American countries such as Argentina, Brazil, Chile, Colombia and Mexico are promoting themselves as outsourcing-friendly. Even Costa Rica, Panama, Uruguay and other smaller nations are trying to take part in this market.

For U.S. companies in particular, Latin America can provide a wide range of outsourcing benefits, not the least of which is its geographic proximity. Rather than offshore to a provider halfway around the world, many companies are looking to maintain greater control by creating "nearshore" relationships with outsourcing providers in Central and South America. In many cases, these nearshore associations are designed to complement, not take the place of, Indian and Asian outsourcing relationships.

To advance Latin America's value as a source for IT and business process outsourcing services, governments are providing a range of benefits. Tax and other incentives are making the region more economically advantageous. Telecommunications systems are being improved to ensure stronger infrastructures. Bilingualism is being actively encouraged for a workforce that can be fluent in both Spanish or Portuguese and English.

Yet outsourcing to Latin America is not without its challenges. Slow bureaucracies and regulatory hurdles can still stymie business development in some regions. While the number of bilingual university graduates continues to grow, companies still must often contend with a limited-size labor pool.

This study is designed to serve as a guide for companies considering shifting some of their outsourcing dollars to Latin America and investors considering entering this market. It provides insights into the benefits and challenges these organizations may face, while offering some first-hand perspectives into how some companies are faring. We hope you find it insightful.



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Message from Gary Matuszak and Egidio Zarrella

We are pleased to present this report looking at Latin America's growing importance in global outsourcing. There are a number of trends that are reshaping how companies approach outsourcing and why Latin America is gaining prominence:

Cost savings: The recent global economic crisis is inspiring companies to explore ways to reduce their operating costs and improve efficiencies, and companies are increasingly growing comfortable partnering with service providers in a broader range of geographies, including Latin America.



Gary Matuszak
Global Chair, ICE

Broader global markets: With more companies off-shoring and outsourcing, more countries are looking to participate in this market. Certainly India and China are the leading outsourcing destinations, but a wide range of other regions are looking to find their niche. Latin America's geographic proximity to the U.S. positions it well for this region.

Young, educated classes: Just as outsourcing to India has been driven in part by the education of its workforce, so does Latin America stand to benefit from its growing population of young professionals.



Egidio Zarrella
Global Head, IT Advisory

Increasing influence of BRIC: The rise of the BRIC (Brazil, Russia, India, China) economies is among the most important stories of emerging markets. Latin America's role within BRIC and in support of the BRIC nations is critical to its growth as an important outsourcing center.

With today's economic conditions providing severe challenges for businesses, many companies hoping to position themselves for the eventual recovery are evaluating the effective use of external providers to help them support and expand their IT organizations. Outsourcing offers the technical flexibility and financial practicality that increasingly make it an important business consideration as companies across all industries reinvent themselves to be more competitive.



Key Findings

- Latin America's importance as a provider of global IT and business process outsourcing services is growing given its proximity to the U.S., language skills, telecommunications infrastructure and tax incentives.
- The economic crisis has dampened demand for global outsourcing services, but there are also opportunities as companies look to externalize back office services to focus on core operations.
- As outsourcing companies look to source services in multiple countries, Latin America is seen as a nearshore complement to India, but not all countries offer the same advantages.
- Chile and Colombia lead Latin America in world rankings for ease of doing business and offer incentives for companies to set up outsourcing operations, but they need to increase their number of bilingual professionals.
- Established outsourcing destinations such as Brazil and Mexico have a large workforce but their growth could be limited by a slow bureaucracy and regulatory obstacles.
- Central American countries like Costa Rica, Panama and Guatemala are close to the U.S. and offer bilingual university graduates, but are limited by the size of their labor pools.
- To attract more value-added outsourcing services, Latin American countries need to invest more in English language training in addition to tax incentives and government support.
- Governments should continue to promote their countries in the U.S. and Europe to overcome the negative perception of some clients about Latin America's risks.

Nearshore Attraction

India, China and Malaysia may still be the top three global outsourcing hubs, but they are being challenged by new destinations in Latin America, North Africa and the Middle East.

Certainly the financial turmoil of 2008-09 has taken its toll on the global outsourcing industry as demand for financial and IT services has fallen. But new opportunities have arisen as many companies that never previously considered outsourcing look to cut costs and innovate by externalizing some services.

To the pioneers of the outsourcing business, distance was no obstacle as they searched for low costs in far flung destinations like India and China. But, in the aftermath of the financial crisis, cash-strapped companies and their clients want low risk outsourcing solutions closer to home and may often value quality as much as price.

While India and China are both still able to offer low labor costs, they also have their downsides. Both are a long plane trip from the U.S. and their workers do not always share the same accent, cultural values or even the same time zone. This is where Latin America has been able to leverage its proximity to the U.S. and its similar time zones to grow its global IT and business process outsourcing industry.

Given that Spanish, after English, is the most widely spoken language in the U.S., with a Hispanic population of over 45 million, many U.S. clients prefer to outsource services to companies which offer customer service professionals who speak English and Spanish with a Hispanic accent.

It's true, Latin America's business process outsourcing (BPO) business is only around 4 percent of the global market, forecasted to be worth US\$450 billion annually by 2012,¹ but it is expanding. In fact, Latin America's outsourcing industry is growing faster than any other region in the world. Even in the current economic crisis, Latin America's outsourcing industry is estimated to grow between 5.5 percent and 6 percent in 2009, led by growth of between 10 percent and 12 percent in Brazil, according to Cassio Dreyfuss, vice president of Gartner Research in São Paulo, Brazil.

Latin America's advantages can be summarized as:

- Close physical proximity to the U.S.; similar time zone to the U.S.
- Cultural affinity with the U.S.
- Modern telecommunications infrastructure
- Tax incentives in many countries
- Favorable business environment
- Languages: Spanish and Portuguese with English as a second language.

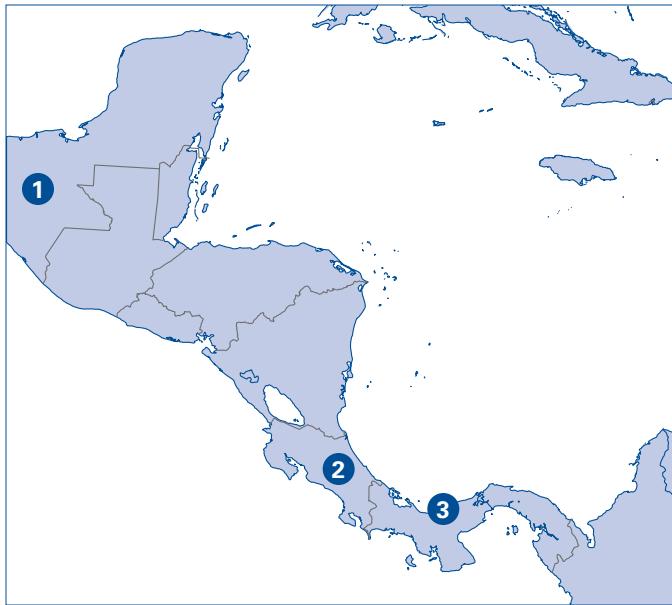
According to the 2009 A.T. Kearney Global Services Location Index, Latin America has six countries in the top 50: Chile (8), Mexico (11), Brazil (12), Costa Rica (23), Argentina (27) and Uruguay (36).² It is little surprise that Chile tops the index in Latin America.

Chile is known for its political stability and favorable business environment, and it is in the same time zone as New York. Its main strengths are in the high-value-added area and

1. Nelson Hall, 2008-2012 forecast

2. A.T. Kearney Global Services Location Index 2009

Central America



South America



1. Mexico

Size of the country	1,964,375 sq km
Population	111.2 million (July 2009 est.)
Capital	Mexico City
GDP per capita	US\$14,200 (2008 est.)
Size of workforce	45.3 million (2008)
Currency risk rating*	BBB+
Ease of doing business rank**	51 (out of 183 countries)

4. Colombia

Size of the country	1,138,914 sq km
Population	45.6 million (July 2009)
Capital	Bogotá
GDP per capita	US\$8,800 (2008 est.)
Size of workforce	21.3 million (2008 est.)
Currency risk rating*	BB+
Ease of doing business rank**	37 (out of 183 countries)

7. Argentina

Size of the country	2,780,400 sq km
Population	40.9 million (July 2009)
Capital	Buenos Aires
GDP per capita	US\$14,200 (2008 est.)
Size of workforce	16.27 million (2008)
Currency risk rating*	B-
Ease of doing business rank**	118 (out of 183 countries)

2. Costa Rica

Size of the country	51,100 sq km
Population	4.25 million (July 2009 est.)
Capital	San José
GDP per capita	US\$11,500 (2008 est.)
Size of workforce	2.1 million (2008 est.)
Currency risk rating*	BB
Ease of doing business rank**	121 (out of 183 countries)

5. Brazil

Size of the country	8,514,877 sq km
Population	198.7 million (July 2009)
Capital	Brasilia
GDP per capita	US\$10,200 (2008 est.)
Size of workforce	93.6 million (2008 est.)
Currency risk rating*	BBB-
Ease of doing business rank**	129 (out of 183 countries)

8. Chile

Size of the country	756,102 sq km
Population	16.6 million (July 2009)
Capital	Santiago
GDP per capita	US\$14,900 (2008 est.)
Size of workforce	7.3 million (2008 est.)
Currency risk rating*	A+
Ease of doing business rank**	49 (out of 183 countries)

3. Panama

Size of the country	75,420 sq km
Population	3.4 million (July 2009 est.)
Capital	Panama City
GDP per capita	US\$11,700 (2008 est.)
Size of workforce	1.4 million (2008)
Currency risk rating*	BB+
Ease of doing business rank**	77 (out of 183 countries)

6. Uruguay

Size of the country	176,215 sq km
Population	3.5 million (July 2009 est.)
Capital	Montevideo
GDP per capita	US\$12,400 (2008 est.)
Size of workforce	1.6 million (2008 est.)
Currency risk rating*	BB-
Ease of doing business rank**	114 (out of 183 countries)

* Standard & Poor's Foreign Currency Risk Rating

** The World Bank Group's 2010 Doing Business Report



knowledge process outsourcing (KPO) activities. Companies such as EDS, IBM, Equifax and JP Morgan have all recently opened service and data centers in Chile.

But not all Latin American countries are as attractive as Chile. The region—with a total population of around 569 million³—is made up of 21 countries, each with different socio-economic and political conditions, labor costs, incentives and tax structures.

Brazil, Mexico and Argentina, with a combined population of 350.8 million,⁴ offer world-class cities like Mexico City, São Paolo, Rio de Janeiro and Buenos Aires, which have hosted shared service centers for multinational firms since the 1980s.

These countries are established outsourcing centers and continue to grow by leveraging the size of their labor pools and domestic demand. But in recent years Chile has led a group of countries including Colombia and Uruguay that have laid down a red carpet for the IT and BPO industries.

Chile, Colombia and Uruguay are not as inexpensive as Argentina and Mexico but, aiming for value-added services rather than call centers, they offer ingredients to attract outsourcing companies including stable governments, good telecommunications infrastructure and tax incentives.

3. The CIA World Fact book, <https://www.cia.gov/library/publications/the-world-factbook/>
4. The CIA World Fact book, July 2009 estimate, <https://www.cia.gov/library/publications/the-world-factbook/>

Changing Perceptions

In the past, Latin America has been regarded as a dangerous or politically unstable place to do business, but attitudes are changing through tourism and education. Today, some countries such Venezuela and Honduras are often in the headlines for the wrong reasons, but Latin America is generally considered safe and secure.

Chile and Argentina are well regarded, but Mexico and Colombia are still perceived as dangerous due to their links to drug trafficking. However, these countries, with the help of the U.S., have made efforts in recent years to clean up their image.

"Cities like Bogotá are becoming increasingly more safe and advanced. It's not that there is political unrest, it's that this is often the client's perception," says Steve Rudderham, IT-BPO outsourcing firm Capgemini's vice president of client engagement for the Americas.

But the client's perception is often in stark contrast to the high rankings obtained by countries such as Chile and Colombia in recent global surveys for ease of doing business, safety and overall business environment.⁵ Moreover, Chile, Brazil, Mexico, Colombia and Peru are all considered investment grade, or close to investment grade, by ratings agencies like Standard & Poor's, Fitch Ratings and Moody's.

Chile has the lowest foreign currency risk of any country in the region, rated A+ by Standard & Poor's. But other countries are catching up. In fact, Moody's Investors Service recently raised Brazil's sovereign debt ratings to investment grade and indicated the rating could be raised again, as it cited the resilience of Latin America's largest economy to the global financial crisis.

5. Various surveys including A.T. Kearney Global Services Location Index 2009, World Bank's 2010 Doing Business Report, Black Book of Outsourcing 2008 Report

Case Study

HP Enterprise Services: A Broad Latin American Presence

As the global outsourcing industry moves towards multiple sourcing locations as a way to tap talents and benefits in different regions, multinational outsourcing companies with a global footprint are able to offer specialized solutions from nearshore in Latin America.

One such company is U.S.-based HP Enterprise Services (formerly EDS, an HP company), a global technology services leader that knows a thing or two about sourcing from multiple locations. EDS began providing IT services in Brazil and Mexico in 1985 and today is present in nearly every country in the region with centers in Mexico, Brazil, Argentina, Chile, Colombia, Costa Rica, Panama, Peru and Puerto Rico.

In 2008, EDS was purchased by HP for US\$13.9 billion and is now called HP Enterprise Services, which is a business unit of HP Enterprise Business—but it still focuses on creating specialized skill sets at centers in Brazil, Costa Rica, Panama and Argentina, says Eduardo Araujo, vice president and general manager of HP Enterprise Services in Latin America.

For example, HP Enterprise Services operates BestShore Centers in Cordoba, Argentina and São Paulo, Brazil, with specialized resources in air transportation and health care. “It’s an issue of using the best capabilities in the best place and at the best price,” says Araujo, who hails from Brazil himself but is based in Texas.

Cordoba, for example, offers a pool of graduates seeking entry-level work while Brazil offers a “different skill set” more suited to the health sciences/medical area, said Araujo.

HP Enterprise Services also has operations in India where labor costs are lower, but Araujo

sees Latin America “not as an alternative but as complementary to India.” And, for some of HP Enterprise Services’ clients, the proximity of Latin America and the cultural affinity is an important attraction. “There is a very flourishing market for outsourcing in Latin America partly because it’s on the same time zone as the rest of the Americas so it’s a natural connection,” says Araujo.

In July, HP Enterprise Services closed a US\$90 million technology infrastructure management agreement with Chilean financial services firms Nexus, Redbanc and Transbank. To serve these clients, HP Enterprise Services will design and build a new data center near Santiago, Chile in addition to its global delivery centers in Argentina and Brazil, says Araujo.

Araujo admits the lack of trained professionals and English fluency may be a constraint in some countries, but HP Enterprise Services gets around this by giving its employees language training internally. HP Enterprise Services also gets involved in the education process while its future employees are still at university. In Cordoba, for example, HP Enterprise Services offers graduates internships and opportunities to work in other countries as part of its training program.

Education is important because one of the main challenges for HP Enterprise Services in Latin America is its need to hire more people to meet rising demand for services, says Araujo. “Our clients in Latin America are telling us they want more services and resources, and the challenge for us is how to meet this demand,” says Araujo.

Araujo is optimistic that the strong growth seen in Latin America’s outsourcing business will continue. He bases his estimations of growth of 8% annually within the next

five years in the outsourcing industry on his experience in this market, as well as recent studies from IDC which state that Latin America will have the highest growth rate of any region in the world.

Complementing India

Latin America has further benefited from companies' plans to diversify their outsourcing centers. In an effort to avoid risk, companies are opening multiple outsourcing centers spread throughout the globe. This may include so-called "nearshore" destinations such as Latin America and offshore destinations such as India and China. As a result, clients no longer see Latin America as an alternative to India, but as complementary.

Latin America's nearshore proximity to the U.S. means most countries in the region are only a few hours by plane from Atlanta, Houston or New York. In many cases, this allows clients to visit often and feel connected to their service providers. "There is a very flourishing market for outsourcing in Latin America partly because it's on the same time zone as the rest of the Americas so it's a natural connection," says Eduardo Araujo, vice president and general manager of HP Enterprise Services (formerly EDS, and HP company) Latin America.

This complementary strategy has even been embraced by Indian outsourcing companies. Evaleserve, a provider of KPO services to global financial companies, has been able to leverage Latin America's time zone advantage to provide services to its U.S. clients. Evaleserve opened a KPO service center in Chile in 2006 to complement its centers in India, China and, since 2008, Romania (see case study, page 16).

"We can do research in any language, serving any location, in any industry, at any time," says Evaleserve's Chile country manager Mohit Srivastava.

And being in the same time zone, means Evaleserve can provide real time support to U.S. clients from Chile, which is an important advantage.

Chilean companies have also found that time zone is important in serving U.S. clients.

"The demand for offshoring services is highly concentrated in the U.S. and Chile is uniquely positioned to benefit from geographical and economic advantages to compete in that market," says Carlos Fernandez, chief executive of Coasin, a Chile-based IT consulting firm with headquarters in Chile and Argentina.

Buenos Aires (Argentina), Rio de Janeiro and São Paulo (Brazil) share the same time zone and are only one to three hours ahead of New York, depending on the season, which is also convenient.

Case Study

Evalueserve: A Warm Reception for Chile

Five years ago, when Mohit Srivastava, the Chile country manager for global KPO company Evalueserve, was deciding where to set up operations in Latin America, he applied what he calls "the dipstick test."

"If you speak to five lawyers in a country and they all give you the same story, you know it's a good place to do business," says Srivastava.

Srivastava got five different stories from lawyers in Argentina, but the same story from all five lawyers in Chile, so the choice was made.

Evalueserve opened an office in Chile's coastal city of Valparaiso in 2006, provided rent-free by the government investment agency CORFO, and Evalueserve now employs 150 professionals in the country and plans to triple in size in the next five years.

"I know we made the right decision, Chile is a great country for us," notes Srivastava, adding that the main benefits of Chile are: it is the same zone as the U.S.; the ability to provide services in Spanish and Portuguese to the rest of Latin America; and overnight Asia coverage.

Evalueserve also has operations in India, Romania and China allowing the company to provide real time financial support services to any location in the world 24 hours a day, five days a week. "We can do research in any language, serving any location, in any industry, at any time," says Srivastava.

In addition to Argentina, Evalueserve considered Mexico, Brazil and Costa Rica to set up operations, but chose Chile because although its labor costs were more expensive than Argentina or Costa Rica, it was cheaper than Mexico and Brazil and offered other

advantages. "What really works for Chile is the business environment, it's got the most stable social, political and economic environment in the region, it's by far the best," says Srivastava.

Chile is not cheap. Labor is 30-40 percent more expensive than Argentina or Costa Rica but Evalueserve's KPO services require a small number of highly skilled workers rather than a large number of employees. Chile offers a small, but well-educated talent pool of bilingual graduates from local universities. Evalueserve employs 80 professionals focused on investment research in Chile, including 35 providing complex financial analytic services to Evalueserve's global banking clients in New York and elsewhere.

With offices in India, Chile and the U.S., Evalueserve has created what Srivastava calls a "golden triangle" which allows the company to provide a high level of service to U.S. clients at considerably lower cost than providing the service 100 percent onshore. Most of the "heavy lifting" research work is done in India, some key services are provided from Chile and only a small part of the work is done 'onshore' in New York, says Srivastava.

When Evalueserve arrived in Chile it had to bring in financial managers from Europe, the U.S. or Asia due to the lack of local professionals with experience. But this was not hard given Chile's efficient immigration process that facilitates green cards to foreigners quickly, says Srivastava. "You can get a green card in a couple of weeks, it's really amazing," he says.

Evalueserve is training managerial talent locally now so it does not need to bring managers from abroad, but the ability to bring in foreign professionals when needed is a big

plus for Chile. Labor laws in Latin America are strict in terms of hiring and firing workers but Chile has an "employer friendly environment" compared to other countries in the region.

If Evalueserve was to decide where to set up operations in Latin America today, Srivastava says he would add Colombia to the list but would still pick Chile. Colombia has lower labor costs than Chile, a bigger talent pool and has made "quantum leaps" in terms of reducing risk and offering incentives for outsourcing companies, says Srivastava.

"Colombia is a very attractive right now and it will be the biggest competitor for Chile in the next few years, but it still has a way to go to match Chile's business environment," says Srivastava.

Language Skills

English is not spoken as widely in Latin America as it is in India, but that is changing as more young university graduates are bilingual or even trilingual with Spanish, Portuguese and English as a second or third language.

Spanish is the second language in the U.S., spoken as a first or second language by an estimated 45 million Hispanics⁶, and U.S. clients are frequently more comfortable on the phone with a Hispanic accent than an Indian accent. Still, accents within Latin America also vary greatly from one country to another, which is why Colombia and Central American countries with their neutral accent are often popular destinations for customer service centers.

As for English, it makes sense that the further north you go in Latin America the better the level of English. Mexican cities such as Monterrey and Queretaro offer a good supply of bilingual graduates, while Central American countries including Costa Rica, Panama and Guatemala have aggressively promoted English language training for young professionals. As a result, Costa Rica and Panama have become attractive for companies such as Intel and Dell to set up customer support centers employing local talent on the same time zone as the U.S.

As Latin America evolves from a center for call centers and entry-level outsourcing services to a center for IT and value-added financial services, English language training will be increasingly important, says Capgemini's Rudderham.

India already produces 3-4 million graduates a year with high-level skills in areas such as accounting who are more cost effective than their U.S. counterparts. But Latin America is catching up with what Rudderham calls a "second wave" of highly skilled workers who speak English as well as Spanish.

But some South American countries may need to invest more in English language training. In Brazil, for example, where Portuguese is the main language, many young people speak English but they will not be entering the workforce for another five years. In the meantime, there is a shortage of bilingual professionals. Even Colombia, which has a large call center operated by Allus Global BPO, suffers from a lack of bilingual professionals.

In Chile, despite government efforts in recent years to improve the level of bilingual professionals, only about 8 percent of the technical graduate population speaks English. That means companies such as Capgemini may prefer to use Chile as a center to serve Spanish-speaking clients.

For companies like India's Evalueserve which hire a small number of highly skilled workers, Chile's small labor pool is not a problem. But U.S.-based software company Oracle, which opened a sales center to provide technical support to customers back in the U.S., struggled to find 400 engineers who speak English.⁷

"If Chile, Argentina and Brazil want to open to the U.S. market they need to invest in English," says Rudderham.

6. Cervantes Institute, *Encyclopedia of Spanish in the United States*

7. Amcham magazine *Business Chile*, October 2007, "English Teaching in Chile: A Failing Grade"
<http://www.businesschile.cl/portada.php?w=old&id=526&s=0&lan=en&q=main>

Infrastructure

When companies choose a location for outsourcing, factors such as labor costs, the availability of talent, and quality of life are considered, but modern telecommunications and transportation infrastructure are also critical to export their services and bring clients to visit.



Given that most outsourced services are provided by phone or over the Internet, the availability of high-speed broadband connections and mobile Internet services are crucial. Most countries in the region score well in this regard. Chile, for example, is Latin America's most e-ready market, with the highest broadband and mobile telephony penetration rates in the region (11.9 percent and 80.4 percent respectively).⁸ Chile is connected to three international fiber optic networks, has high speed ADSL and cable modem internet access along with LMDS technology.

In a ranking of the best cities to do business in Latin America, published in 2009 by the *AméricaEconomía* business magazine, Santiago was judged to have the most competitive telecommunications infrastructure in the region.

Mexico and Brazil also offer solid infrastructure in their main cities, while Panama is a hub for transport and telecommunications services in the region, attracting multinational banks including HSBC and Citibank that have set up regional offices in Panama City.

"There is a correlation between telecommunications infrastructure and competitiveness in the region," according to the president of a leading Latin American telecommunications provider during a presentation at the Americas Competitiveness Forum III. But there is "still much work to do" in this regard as some countries are better connected than others, he notes.

Countries that face infrastructure challenges include Costa Rica and Colombia. Costa Rica's telecommunications infrastructure is controlled by the state-owned company ICE, which has limited broadband Internet services available to companies in recent years. But thanks to the CAFTA free trade agreement, U.S. companies have started to offer Internet services in the capital San Jose in recent years.

As for Colombia, its telecommunications infrastructure is improving but the country still suffers from a low rate of broadband Internet and mobile phone penetration. This could be a drawback when companies are choosing between Chile and Colombia, for example.

8. AméricaEconomía magazine, May 2009

Government Incentives

The global outsourcing business is very competitive and, in the current uncertain economic environment, companies are looking for locations with low costs, low risk and added value. Labor costs in Latin America, especially for skilled workers, cannot compete with proven offshoring destinations such as India or China, so governments need to offer investors something extra.

When choosing a location for an outsourcing center, companies consider various factors including the talent pool, size of the workforce, language abilities, geographic location, time zone and taxes. Tax incentives are usually not the main driver of the decision, but they could tip the balance just as higher taxes could make a country less attractive.

Tax incentives can range from co-funding for pre-investment studies, income tax discounts for service exporting companies, tax exemptions for purchase of goods used for exporting services, subsidies for human resource training, real estate subsidies and government funding for R&D and innovation projects.

Costa Rica, Panama and Uruguay have also created special tax free zones near major cities where IT and business process outsourcing companies can set up operations, find the support services they need, and export services without paying taxes.



Argentina

Argentina has a large pool of graduates in its major cities—Buenos Aires, Rosario and Cordoba—and low labor costs following the devaluation of the peso in 2002.

In recent years, Argentina's government has prioritized the software industry and offers special benefits to IT and software companies including reduced tax rates.

Incentives include:

- Tax exemption of 60 percent of the total amount of income tax
- Fiscal stability for 10 years as from 2004
- Reduction of employer contributions up to 70 percent
- No restrictions on foreign currency wire transfers for imports of goods and services
- Other benefits derived from the recognition of software as an industrial activity.

A wave of Indian companies has recently acquired Argentine outsourcing operations looking to take advantage of the low labor costs and educated workforce. Cities like Rosario and Cordoba in particular offer low-cost, bilingual graduates able to work in contact centers. But cost arbitrage is not everything, and Argentina's political risk is still an obstacle in outsourcing services. Argentina has a deserved reputation for arbitrarily changing the rules for companies, which has hurt investment in recent years.

Argentina is also bureaucratic and in some cases inefficient, which is why foreign companies often seek out a local partner to help smooth the way before opening a new office in the country.



Brazil

With its political stability, talent pool and reliable telecommunications infrastructure, Brazil has been emerging as a key IT-BPO destination with exports of US\$2.2 billion in 2008, and employing more than 1.7 million people.⁹

Brazil's national software organization Brasscom is promoting the country's strong domestic base of IT clients to global companies like Accenture, Atos Origin, CPM Braxis, EDS, HSBC, IBM, Intel, Microsoft, Siemens, Softtek, Sun, Tata and Unisys.

And the future looks bright. With new incentives for IT companies at a federal, state and local level, Brasscom aims to produce thousands more IT professionals with IT services exports expected to reach US\$5 billion by 2011.¹⁰

Incentives include:

- Reduction in social security contributions up to 50 percent
- PIS/Cofins tax exemption for products purchased for export
- Spending on staff training and development, and research and development can be deducted against income tax
- Tax exemption on the import of software development materials
- Tax deductibility on technology transfers, licenses and royalties.



There are also state and municipal incentives. Among major cities, São Paulo and Rio de Janeiro offer local tax incentives for IT firms to set up offices there. For example, Rio offers incentives for companies that provide services to oil and gas firms working on large offshore oil fields near the coast.

For this reason, outsourcing services are usually located in the southeastern part of the country in and around São Paulo and Rio de Janeiro. But there is also huge potential for growth in northeastern Brazilian cities like Salvador and Manaus with their large, untapped labor pool and good communications infrastructure.

With a population of around 198 million and a workforce estimated at 93.65 million¹¹, Brazil leads Latin America in terms of people skills and availability.¹² Brazil offers plenty of potential to grow in the outsourcing industry, particularly in the IT and business processing area, but its high export taxes and labor regulations can be a drag.

Brazil's outsourcing industry was launched 30 years ago with the arrival of firms like IBM and EDS and has evolved from an industry focused on low costs in the 1990s to a focus on performance improvement and IT-BPO innovation today.

With its low wages, culture of customer service and a high level of English fluency amongst young people, Brazil has over one million people working in call centers in cities like São Paulo

9. Brasscom, Brazilian Association of IT and Communication Companies, www.brasscom.org.br, various pages

10. Brasscom, Brazilian Association of IT and Communication Companies, www.brasscom.org.br

11. The CIA World Fact book, 2008 estimate, <https://www.cia.gov/library/publications/the-world-factbook/>

12. A.T. Kearney Global Services Location Index 2009



and Rio de Janeiro owned by Atento, Contax and Teleperformance amongst other local and international firms.

Spanish firm Atento has been providing BPO and call center services to its clients—mainly telecommunications and financial services firms—from nearly all Latin American markets for 10 years. “Latin America has big potential for growth, in particular Brazil,” says Diego Lopez, Grupo Atento’s strategy director.

Atento has about 100,000 employees in Latin America providing services to local clients as well as multinational clients, but Lopez admits it is a challenge to retain employees in call centers. “The people are the main resource of the company. Atento strives to select the best and then to provide ongoing motivation and training,” says Lopez.

But part of the challenge for companies is that, while wages in Brazil are lower than other countries in the region, its strict labor laws can be a burden with social security benefits increasing the total labor cost by 60-70 percent. The cost of having workers on the payroll is high so outsourcing companies often hire workers as ‘independent advisors’ off the payroll, and then let them go after a short period, rather than hire them formally. As a result, there are numerous lawsuits brought against companies from former employees, which can result in unexpected costs.

Another obstacle is Brazil’s notoriously slow bureaucracy. Opening a local office often requires permits from municipal, state and federal governments, which can take months.

And then there are the high taxes and restrictions on services exported from Brazil that inhibit the growth of the outsourcing business.

For Brazil to compete with India and China as a global outsourcing destination, the government will need to address these issues going forward. One option is to create free trade zones exempt from export taxes as Colombia, Costa Rica and Panama have done.

Overall, Brazil has huge potential as an outsourcing destination given its talent pool and the growing demand from local companies, but more incentives are needed to offset the drawbacks of high labor costs and bureaucratic headaches.

Like a naturally gifted footballer, Brazil offers plenty of raw talent, but the rules of the game could be more favorable for outsourcing firms.

Chile

Leading the way is Chile, which is aggressively trying to promote itself as a services platform for Latin America. The Chilean Economic Development Agency (CORFO by its Spanish initials) runs a program called InvestChile that provides various incentives for investment in high technology fields. The incentives are equally available to local and foreign investors for projects with a minimum value of US\$1 million.



InvestChile's incentives include co-funding for:

- Pre-investment studies
- Project launch
- Human resources
- Real estate leases
- Investment in fixed assets.

Chile also has numerous free-trade agreements with the U.S., Canada, Australia and China, as well as double taxation agreements that make it possible to export services without paying taxes in both countries.

Companies report that CORFO is a great partner, smoothing the way for doing business.

"CORFO is our friend, mentor and guide... they have been there for us when we needed them," says Evalueserve's Srivastava.

CORFO furnished Evalueserve with a modern office building near the port city of Valparaiso rent free for five years. "That was a very attractive value proposition for us, because we were competing with India in terms of costs," says Srivastava.

Chile has a talent pool of close to 85,000 engineers, and approximately 10,000 more are added every year. Some of the largest IT companies present in Chile include Atos, Origin, EDS, TCS, IBM and Accenture.¹³

And then there are homegrown companies such as Chilean IT services company SONDA. Founded in Chile in 1974, SONDA, with annual revenues of US\$671 million, is focused on Latin America with main service centers in Chile, Brazil, Mexico and Colombia and other facilities in Argentina, Uruguay, Peru, Ecuador and Costa Rica. Its 5,000-plus clients include Petrobras, Embraer, Telmex, Movistar, Walmart, McDonald's and Coca Cola. "We are not

13. InvestChile, CORFO program, <http://www.todochile.cl/>

convinced that India or China will have cost advantages in the long term. We are physically closer (to Latin America); we speak the same language, we share the same culture, and we are in the same time zone," says Alberto Merino, commercial development manager for Latin America at SONDA.

In 2008, Chile's global services revenue was US\$843 million, with more than 20,000 people employed in the BPO, KPO and IT sectors.¹⁴ Of these services, around 50 percent were exported to Latin America, 21 percent to the U.S. and the remainder to Europe and the rest of the world.

Exporting these services also brings "immediate and clear benefits" for Chile including employment opportunities and training for workers in the best practices of multinational companies, as well as opportunities to gain work experience abroad, says Carlos Álvarez, executive vice president of CORFO.

In addition to IT and BPO services, Chile aims to leverage its good business environment and telecommunications infrastructure to capture a greater share of the value-added Innovation Outsourcing business, says Álvarez. But he admits Chile needs to improve its English language skills first. "If we really want to take advantage of this opportunity, we need to make sure we have qualified, bilingual professionals," he told a panel at the Americas Competitiveness Forum III held in Santiago in 2009.

Colombia

Chile is not the only country in the region marketing itself as a business-friendly location for IT services. Colombia has made quantum leaps in the past decade and is now one of the safest and most politically stable democracies in the region, offering companies various incentives to set up operations there.

In fact, in the World Bank's Doing Business Report 2010, Colombia ranks top in Latin America for ease of doing business (36th in the world), ahead of Chile.¹⁵

Incentives for investors in Colombia include:

- Free Trade Zones offering up to a 50 percent tax break on sales into the local market
- Legal stability contracts
- 40 percent tax deduction on the cost of purchased machinery
- Service exporting companies can import capital goods exempt from custom duties and sales tax (VAT).¹⁶

Bogotá alone generates US\$250 million annually in the call center/outsourcing industry, employs over 30,000 people in contact centers and has a big and modern economy with over 500,000 graduates entering the workforce annually.¹⁷

14. IDC Chilean Global Services Industry Observatory, May 2009

15. World Bank: Doing Business Report 2010, <http://www.doingbusiness.org>

16. Invest In Colombia,
<http://www.investincolombia.com.co/free-trade-zones-and-other-incentives.html>

17. Invest In Bogotá, <http://www.investinbogota.org/english/?m=nodo/115>

"Colombia is very attractive right now... but it still has a way to go to match Chile's business environment," notes Evalueserve's Srivastava.

Costa Rica

With its stable government, good business environment and proximity to the U.S., Costa Rica has become an important destination for IT and business process outsourcing companies since computer chip maker Intel set up manufacturing operations there in 1998.

Costa Rica has special Free Trade Zones (Zona Franca in Spanish) in capital San José from which companies can export services to the U.S. paying little or no corporate income tax. Goods used for export services can also be purchased tax free and there are no restrictions on foreign currency management.¹⁸

IBM, HP, Proctor & Gamble and Saint Jude Medical have set up outsourcing operations in Costa Rica, taking advantage of the country's educated, bilingual workforce and the fact it is only two hours by plane from Miami.

Indeed, Costa Rica is a hot tourist destination and is leveraging its location, promoting itself as a global services hub for companies doing business in China, the U.S. and Europe.

But Costa Rica does have some drawbacks. Its labor pool is small (around 2 million), and access to telecommunications infrastructure is limited by the state-owned firm Instituto Costarricense de Electricidad (ICE), although Internet access is starting to improve. In addition, it can be difficult for companies to get permits to open a local office or export services, which can increase operating costs. However, there is new legislation before Congress to move some of the paperwork online, which would improve efficiency and cut red tape.



Mexico

Employing the 'Maquiladora' concept, which Mexico successfully used to attract foreign investment in its manufacturing industry, the government is trying to apply the same incentives in the global services area.

Mexico's outsourcing industry has developed in the last 10 years leveraging the country's proximity to the U.S., the NAFTA free trade agreement and its large pool of bilingual workers. In the past, Mexico has focused on being a base for banks such as Santander, HSBC and Bank of America to provide services to their branches in the rest of Latin America. But today, Mexico's software development program (Programa para el Desarrollo de la Industria del Software, or PROSOFT) is promoting Mexico to IT clients as a world-class nearshore alternative.

Emerging cities in the IT and business process outsourcing sector include Queretaro and Guadalajara, in addition to established locations like Mexico City, Juarez and Monterrey. These cities have attracted companies such as India's Tata and Spain's Telefonica by offering cash grants of up to 50 percent of the total investment and tax credits of up to 30 percent of R&D expenses.

18. Costa Rica Investment Promotion Agency (CINDE),
<http://www.cinde.org/en/incentives-and-costs>

Top Offshoring Locations

Where Latin America ranks among the 50 countries in the 2009 A.T. Kearney Global Services Location Index

Chile	8
Mexico	11
Brazil	12
Costa Rica	23
Argentina	27
Uruguay	36
Panama	43
Colombia	Not ranked

But despite its large talent pool and proximity to the U.S., Mexico ranked only 60 out of 144 countries in the Global Economic Forum's 2009-2010 Competitiveness Report.¹⁹ Part of the problem is that Mexico is still a very bureaucratic country. In addition, important labor and energy reforms are stalled by political wrangling in Congress and the unions are powerful, which can cause problems for companies.

Finally, although Mexico is a top tourist destination, like Colombia it has an international reputation for drug-related violence, which reduces the perceived level of safety and may put some companies off setting up operations there.

Panama

Panama's service-oriented economy is based on the Panama Canal, which is an important international shipping lane and is currently undergoing an expansion. With its stable government, proximity to the U.S. and its currency (the U.S. dollar), Panama is also a natural choice for companies like computer manufacturer Dell, which has set up a regional customer service center there.

In the late 1990s, the Panamanian government passed legislation to create tax incentives for outsourcing companies and in 2007 it added more incentives for shared service centers.

19. Global Competitiveness Report 2009-2010,
<http://www.weforum.org/en/initiatives/gcp/Global%20Competitiveness%20Report/index.htm>

Like Costa Rica, Panama offers Free Trade Zones where companies can set up operations and export services to the U.S. paying no or little corporate tax on their income. The government has also created the 'City of Knowledge' next to the Panama Canal that offers tax and immigration benefits to attract IT firms.²⁰

But Panama's bureaucracy can be cumbersome and there are restrictions on bringing foreign workers into the country. Panama also has a small talent pool (around 1.5 million) and is struggling to produce enough English-speaking graduates to meet the demand.

Uruguay

Tucked between Brazil and Argentina on the River Plate estuary, Uruguay is often overlooked by multinational companies focused on its larger neighbors, but not by IT firms looking for skills professionals, low costs and a tax-free place to export services to the rest of the world.

Uruguay's government has made the local software industry a priority, offering tax discounts for local and foreign companies that set up shop in Montevideo's tax free Business and Technology Park known as Zonamerica. Although English is not widely spoken in Uruguay, it has a small, but well-educated pool of bilingual IT professionals.

In 2002, Indian software producer Tata Consulting Services installed its regional offices in Zonamerica, and U.S. based travel services company Sabre Holdings operates a call center there. Services exported from Zonamerica to the U.S. are tax free.



Emerging Players

In addition to the countries covered in this report, there are a number of new outsourcing destinations in Latin America including Guatemala, El Salvador and some Caribbean islands.

Guatemala, for example, has a labor pool of 4.3 million, which is larger than either Costa Rica or Panama, and its key advantages include a large number of bilingual workers, a neutral accent and the proximity of Guatemala to the U.S., according to Capgemini's Rudderham. In addition to Capgemini, prominent companies operating in Guatemala include ACS, Atento, Digitel, Transactel and 24/7 Customer.

Among Caribbean islands, the Dominican Republic and Barbados have established outsourcing centers.²¹

20. City of Knowledge, <http://www.ciudaddelsaber.org/en>

21. A.T. Kearney Global Services Location Index 2009

Case Study

Capgemini: Searching for English Speakers

When Steve Rudderham, Capgemini's VP of Client Engagement for the Americas, first visited Colombia his parents were worried. "They didn't know where I was going or if I'd come out alive," he recalled.

That was many years ago and, today, Bogotá is a safe and modern city. But the perception that U.S. clients have about risk and political unrest in Latin America is still a problem, he says. As the new wave of emerging countries enters the global outsourcing business, the challenge, according to Rudderham, is how to get people comfortable with Africa, Russia and some Latin American countries like Colombia.

For Capgemini's Americas Business Process Outsourcing business unit, part of the answer is hiring English-speaking workers in Guatemala, a country that is unknown to many Americans but is on the same time zone and just a few hours away by plane from Houston, Dallas, New York or Atlanta. "There's a lot of education needed in the U.S. about what is happening in Latin America, but there's no substitute for bringing people down on a plane and showing them the city as well as the center," says Rudderham.

Central American countries including Guatemala, Costa Rica, El Salvador, Honduras, and Panama, as well as Colombia, have made a big push to teach English as a second language, which is helping produce more bilingual graduates. "Americans tend to associate much better with the Hispanic accent versus the Indian accent, and they want to be on the same time zone," says Rudderham.

Capgemini has had operations in Latin America for ten years but its BPO segment in Chile, Argentina and Brazil (São Paulo and

Campinas cities) has "taken off" in the last few years, reports Rudderham. Capgemini serves the rest of Latin America from Chile and its Portuguese-speaking clients from Brazil, but there is potential for these countries to serve U.S. clients as well if they invest more in English language training, maintained Rudderham.

Guatemala is key to Capgemini's outsourcing operations in the region because labor is less expensive and more people speak English than in Chile. It helps that the Guatemalan government, with the help of Capgemini and other companies, is promoting English courses in local universities, says Rudderham. Capgemini also gives its employees flexible shifts so they can continue studying while they work and later move up into better positions within the company, which also helps reduce turnover, he adds.

Latin American labor is low-cost but when it comes to skilled professionals such as accountants, India is still less expensive. "The cost differences get a lot bigger when you go up the scale and India is much cheaper, they are pumping out 3-4 million graduates a year," says Rudderham.

To reach U.S. clients, countries like Chile, Argentina and Brazil need to have "this second wave of educated, bilingual people fuelled and ready to go," says Rudderham. Chile, for example, offers good incentives and a welcoming business environment but the main benefit to Capgemini is through increased productivity rather than lower labor costs. "Tax incentives are good but governments should be investing in education as well so we can hire educated, English speaking graduates," says Rudderham.

The differences between countries like Guatemala, Chile and Brazil is the reason companies including Capgemini, IBM and Accenture have centers in various countries and regions, "which allows providers to tap into the right talent in the right region," says Rudderham.

Capgemini calls this kind of selective outsourcing *rightshoring*.

"We have to go after different markets because of the language... we're trying to leverage where the talent is to put the BPO centers," says Rudderham.

The Impact of the Financial Crisis

The global financial crisis has stunted growth in the global outsourcing industry as governments have reduced investment in infrastructure while companies have cut budgets for IT and financial services. As a result of the crisis, governments in the region are strapped for cash and some have scaled back incentives to investors in a bid to collect more tax revenues.²²

The weak U.S. dollar and strong appreciation of Latin American currencies, including the Brazilian real and the Chilean peso, while good for consumers in these countries, is a blow to service exporters who receive payment in dollars.

On the other hand, the crisis is an opportunity for Latin America as many IT and financial services companies that would never have considered outsourcing five years ago are now looking to outsourcing as a solution.

"We're tapping into clients who didn't think of outsourcing five years ago when the Citibanks and GE's of the world were at the forefront doing it," said Capgemini's Rudderham.

Rudderham noted that this is part of the "next wave" of smaller, more risk-averse companies entering the outsourcing business in recent years that is not necessarily related to the economic crisis.

Still, in hard economic times Latin America is a natural source of labor for companies moving their services away from more expensive regions of the world like Europe and North America.

"Companies are more cautious in their spending, but there is an opportunity for our clients to reduce their costs by outsourcing services while maintaining a good level of service," says José Roberto Sierra, president of Allus Colombia.

SONDA's Merino agrees that despite cutbacks in expenditure on technology by governments and firms, there are opportunities. "The clients are focusing all their resources—both human and technical—towards their core business, so we can help them by freeing their assets, decreasing their headcount, and making their cost structure and expenses more predictable," says Merino.

22. Colombia has eliminated some tax exemptions for capital goods (KPMG)

Case Study

Allus Global BPO: Maintaining Cultural Values

In 2008, a group of foreign investors led by U.S.-based Eton Park Capital Management saw an opportunity to buy leading call center operations in different Latin American countries and unite them under a single brand: Allus Global BPO. The group's first acquisition was Argentina's biggest call center ActionLine Córdoba in the city by the same name. This was followed up with the purchase of Colombia's leading call center, Multienlace, in Medellin.

Multienlace's then general manager José Roberto Sierra, who is now president of Allus Colombia says the acquisition was aimed at offering more specialized, value-added services to U.S. and European clients in addition to basic customer support services. "Our focus is to offer high value services for our clients in Europe and North America, not just call centers, we also offer services to support specialized processes at a regional and local level," notes Sierra.

With 14,000 employees in Colombia and Argentina, Allus provides specialized business process solutions to various industries including telecommunications, banking, health, media and retail, and its list of clients includes Telefonica, Movistar, American Express and the Miami Herald. Allus expects revenues in 2009 of around US\$145 million and is in the process of opening a new center in Peru, which is expected to start exporting services to Spain in the next few months, says Sierra.

More than the cost arbitrage, Sierra says his clients in the U.S. and Europe are looking for a high quality service. "Cost is important but the quality of service is more important... particularly in terms of the quality of our professionals," says Sierra.

And U.S. clients prefer to work with Hispanic professionals in the same time zone given the 45 million people of Hispanic origin in the U.S. who share similar cultural values. "Latin America's political stability and clear rules for investors have made countries like Colombia and Argentina a good alternative to India for BPO outsourcing," adds Sierra.

Countries such as Peru, Colombia and Argentina offer a large labor pool for call centers and basic services like telemarketing but also for value-added services such as customer support, technical support and specialized services. "The big cities of these countries have a pool of bilingual graduates from many local universities who are able to provide these value-added services," says Sierra.

It also helps that the governments of Colombia and Argentina offer tax incentives for outsourcing companies to set up operations and export services. Sierra admitted the international perception of Colombia as dangerous is an obstacle for outsourcing companies, but he maintained governments could work to change this by aggressively promoting their country's brand image abroad. "When people come to a country like Colombia or Argentina, they realize how developed the country and the outsourcing industry really is," says Sierra.

Overall, Sierra is excited about the future. "We have the product, the people, the talent and the infrastructure to be very competitive... Latin America will become a very important player in the coming years," he concluded.

Challenges Going Forward

Latin America has made huge progress in the last five years, laying the groundwork for nearshore outsourcing services to thrive. In general, the region is no longer considered a dangerous or risky place to do business, and tax incentives have attracted multinational companies to set up operations in the region.

But as regions such as the Middle East and North Africa expand their outsourcing industries, Latin America will face increasing competition and governments must work harder to leverage their nearshore advantage by offering incentives and improving the business environment.

Of course, each country faces different challenges in minimizing risk and attracting more investment, but they can be summarized as follows:

- Maintaining tax incentives (even in hard economic times)
- Cutting red tape that can slow down investment and increase costs
- Investing more in English language training
- Increasing the size of the talent pool
- Modernizing telecommunications infrastructure
- Marketing the region's image abroad.



Chile's SONDA, for example, has not encountered obstacles in Chile, but has occasionally in other countries, such as "the variety and complexity of tax and labor laws, disparity in the quality and penetration of telecommunication services, mistrust in the outsourcing of services and governments or companies who are not very well disposed to outsourcing," says Merino.

Ironically, the strong demand for services from Latin America is also a challenge as the small size of the talent pool in the region is a concern. Cousin's Fernandez, for example, says he worries about the small size of Chile's talent pool, but added that the government could invest more in education to produce more graduates with specialized training in IT and other areas.

Other companies also are concerned about the limited size of the labor pool in the region. "The labor supply is finite, our services are increasingly complex and there is a lot of competition," says Atento's Lopez.

To ensure a good supply of educated workers going forward, Lopez says governments in the region need to invest more in education and job creation.

Rudderham also stresses the importance of English language training for countries hoping to become a platform for services to U.S. clients.

Some countries in the region like Chile and Colombia rank highly in terms of the ease of doing business, but others like Brazil, Argentina and Costa Rica have some work to do reducing red tape. Moving processes online and speeding up approval times would help these countries attract more high-tech investors.

Another challenge for countries like Colombia, Mexico and Guatemala, is educating U.S. clients about their countries and overcoming the perception of danger and mystery that limits growth. Outsourcing companies like Capgemini and Allus are helping to change this image, but it takes time and government involvement.

As for the economic crisis, the temptation of protectionist measures is strong as governments look to get their economies on track to recovery quickly, but they should resist this temptation as increasing export taxes or duties could have a negative impact on the outsourcing industry.

Conclusion

Latin America's rising importance in global outsourcing is undeniable. With its proximity to the U.S., language skills, infrastructure and tax incentives, Latin America has emerged as a favorable destination for IT and business process outsourcing.

In addition to traditional outsourcing destinations such as Mexico, Brazil and Argentina, rising stars including Chile, Colombia and Uruguay are catching the attention of companies by offering generous incentives and government support.

To date, most of the investment in Latin America has been in customer service centers, taking advantage of low labor costs and good infrastructure. The challenge now is for Latin America to move up the IT value chain, attracting more investment in innovation outsourcing, by investing in education and English language skills as India and China have done.

In this way, Latin America will be able to leverage its proximity to the U.S. by offering more value-added services to U.S. and European clients. After all, Latin America has all the ingredients to succeed.

"We have the product, the people, the talent and the infrastructure and to be very competitive... Latin America will become a very important player in the coming years," says Allus' Sierra.

Latin America may not replace India as the main driver of the global outsourcing business, but it is well positioned to tap this demand offering advantages such as a similar time zone and cultural similarities that are valued by U.S. clients.

The bottom line is that if Latin America can build on its advantage as a nearshore destination while offering more value-added services and producing more bilingual professionals in the IT area, the region's outsourcing industry will continue to grow in leaps and bounds.

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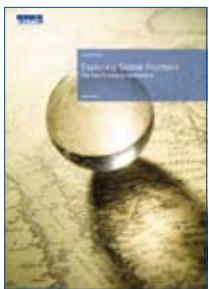
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