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# **US Domestic Labor Arbitrage (DLA)**

***Low-Cost Onshore Sourcing***



*Driving Performance*

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# Is now the Time?

## Assessing US Domestic Labor Arbitrage (DLA)

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With a rapid decade of outsourcing to low-cost geographies, we've seen almost every major firm adding remote offshore operations in locations like India, China, Philippines, Brazil, Poland, etc. More recently, we are seeing the labor arbitrage advantage of these investments being reduced by foreign labor cost escalation, attrition, remote management challenges, reduction in the value of the US dollar, and now - a global recession that is re-balancing world economies.

In this economic environment, a reassessment of US Domestic Labor Arbitrage (DLA) is necessary for both, firms that have offshore operations and firms that may have been slow to the party.

### Key Messages

- With the ongoing transformation of world economies, labor cost spreads are contracting from the 3-4X wage multiple found in 2000 to an estimated 2-3X estimated spread by 2012. This contraction is being driven by the currently increasing shortage of professionals in offshore geographies and the continuing devaluation of the US dollar. With the added overhead of maintaining and managing remote resources in culturally challenging geographies, the time has come for companies to again assess the value proposition of utilizing domestic labor resources vs offshore resources.
- With the build-out of the internet and communication infrastructure in the rural US, DLA is an emerging opportunity for professional services firms currently servicing small/medium clients in niche markets, major offshore firms (primarily Indian) which are already beginning to source resources in US rural areas, and domestic firms who want to differentiate service portfolios by offering rural sourced service options. *(especially for IT, Call Center and Business Process Outsourcing (BPO) activities)*
- Firms of all sizes need to re-evaluate their labor sourcing strategies and plan to incorporate DLA into their labor mix. Vendors must examine their services portfolio offerings, determine if DLA is required to either compete against others offerings, to increase margins, or to meet increasingly common "Buy American" provisions in contracts. RFP/RFQ's are increasingly requesting rural outsourced options and pricing.



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## Assessment

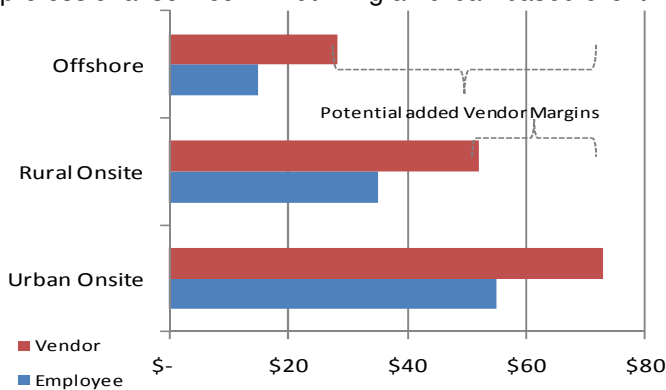
Skill, cost and stability in the labor workforce is critical to the competitiveness of every enterprise. In a flat world, there are multiple models and geographies for procuring the optimum labor mix:

- USA Urban
- USA Rural
- Nearshore (Canada, Mexico, the Caribbean and Central/South America)
- Offshore (India, China, Brazil, Eastern Europe, S.E. Asia, etc.)

Determining the appropriate source of labor requires significant knowledge of global markets, an in-depth analysis to determine tangible and intangible cost factors, and finally a decision to either hire direct or outsource to a vendor(s). If moving existing workforces, additional considerations are required – the ramp up/ramp down of resources, knowledge transfer, transition management, operations/remote management methodologies, vendor management, lead-times, legal ramifications and risk assessments. In performing these assessments, it is always recommended to work with an objective third party knowledgeable in world labor markets and legal jurisdictions.

In performing such assessments, DLA, and specifically, rural sourcing is one emerging source that can reduce labor costs when compared to urban sources, while reducing the risk and intangible overhead costs involved in nearshore and offshore resource sourcing or outsourcing.

The following table demonstrates the scale of labor arbitrage benefits when sourcing labor from three sources – Offshore, Rural US Onsite and Urban US Onsite. The table also demonstrates an employee cost, a vendor cost, and if a vendor, the margin % opportunity when an offshore or rural sourced resource can be sold by a professional service firm utilizing an urban based client rate.



Estimated Hourly Rates	Employee	Vendor	Vendor Margin
Urban Onsite	\$ 55	\$ 73	25%
Rural Onsite	\$ 35	\$ 52	32%
Offshore	\$ 15	\$ 28	48%

*Assumes Hrs 1,480*

*Assumes Infrastructure or Intermediate Java/.Net - 5yrs experience*

Estimated Annual Cost	Employee *	Vendor	Vendor Margin
Urban Onsite	\$ 81,400	\$ 108,000	25%
Rural Onsite	\$ 52,000	\$ 77,000	32%
Offshore **	\$ 22,000	\$ 42,000	48%

*\* Salary & Benefits*

*\*\* Offshore Employee is Captive*



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## Intangible DLA Benefits

Although more difficult to quantify, the following benefits of rural sourcing are business imperatives when making key decisions concerning labor acquisition and geography.

### DLA Benefits

- **Management** - Greater management control of remote operations
- **Culture** –Cultural adaptability, sensibility & learning lead time reduction
- **Data Security** – Statutes & enforcement of intellectual property laws
- **Buy American** – Meets government and corporate dictates for local labor
- **Social Responsibility** – Meets Corporate Social Responsibility policies
- **Green** – Supports new “Green Laws” requiring reduced carbon footprint
- **Cost** – Competitive when assessing offshore hidden costs & Urban costs

## US Rural Destinations

US rural destinations can be placed in three broad categories:

**Tier 1** – Major urban areas and highly developed suburban locations

**Tier 2** – < 100,000 population, with either a university, regional airport, or both

**Tier 3** - < 50,000 population, >60 miles from a university, airport or major city

Within these categories, definition exceptions exist. One example: Detroit, a major urban area, but with a large displaced labor pool of highly skilled resources, and a depressed wage market. With this said, there are several key success factors requiring assessment prior to determine the optimum location(s):

- **Proximity** – Location of airports, roads and related infrastructure
- **Communications** – Availability/dependability of broadband infrastructure
- **Community** – Local acceptability, incentives and support
- **Cost** – the fully burden cost of skilled resources
- **Skills** – Availability and stability of required skills
- **Scale** – Size of available resource pool
- **Sustainability** – Labor migration risk, ongoing infrastructure development

Leading manufacturing firms have been performing such analysis and locating in rural areas for decades. In the '80's automotive firms such as Toyota, GM, BMW, Hyundai and others located in small town USA where they could find sufficient labor pools, labor wage differentials and adequate transportation infrastructure to lower costs, maintain productivity and compete globally. Today, with the build-out of the internet and communications infrastructure, the expanding US service economy has the same opportunity to make the rural move. This opportunity has recently been enhanced with the US Congress in 2010 allocating \$7 billion to further invest in broadband infrastructure in rural areas.





### Emerging early players

- |   |                                   |   |
|---|-----------------------------------|---|
| ■ | <b>Rural America Onshore Inc.</b> | <a href="http://www.ruralamericaonshore.com">http://www.ruralamericaonshore.com</a> |
| ■ | <b>Rural Sourcing Inc.</b>        | <a href="http://www.ruralsourcing.com">http://www.ruralsourcing.com</a>             |
| ■ | <b>Saturn Systems</b>             | <a href="http://www.saturnsys.com">http://www.saturnsys.com</a>                     |
| ■ | <b>Alpine Access</b>              | <a href="http://www.alpineaccess.com">http://www.alpineaccess.com</a>               |
| ■ | <b>Technisource</b>               | <a href="http://www.technisource.com">http://www.technisource.com</a>               |
| ■ | <b>Cross USA</b>                  | <a href="http://www.cross-usa.com">http://www.cross-usa.com</a>                     |
| ■ | <b>Ciber</b>                      | <a href="http://www.ciber.com">http://www.ciber.com</a>                             |



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### Advisory

- Domestic Labor Arbitrage is a credible option when requiring and assessing acquisition of direct labor or vendor resources
- A detailed business case is recommended to determine appropriate business models and service delivery options. This plan should include all direct and indirect expense components along with a comprehensive financial, management and geography risk assessment
- It is recommended that a third party individual or Advisory Service with direct global labor expertise across world markets be engaged to guide the decision process when comparing DLA, Nearshore or Offshore options, as well as defining build/buy Outsourced vs Captive options
- If the decision affects a core segment of the enterprise, full board and executive buy-ins are critical in guaranteeing success



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