



## **Inshoring'-The New Antidote to Outsourcing Beset by defections and idea theft, some outsourcers look closer to home**

**INVESTMENT DEALERS DIGEST-** By Josh Friedlander, July 18, 2005--Some investors and the companies they seed are discovering the downside to offshoring-the process of outsourcing some of a company's operations overseas. They are realizing that for every step forward they take by going to India or China, they may be taking two steps back in terms of disloyalty, defections and theft of ideas. As a result, some are turning to a relatively new phenomenon called "inshoring"-or sometimes "insourcing"-and farming out those operations to areas of the U.S. that offer cheap labor and/or tax incentives.

George Hoyem, a managing director with venture capital firm Blueprint Ventures, has seen the ugly side of outsourcing up close. "One of our companies had a big development center in India, and the market is so hot that the manager came to work one day to find that 15 people had defected and gone to work for Cisco Systems down the street," Hoyem said. "The loyalty of the people is not very strong, and there is a lot of movement in the market."

Employment is one issue. The sanctity of one's products is another. "There's a huge risk of intellectual property loss in China," added Hoyem. "You can end up saving money but also end up creating competitors."

The new alternative, then, to traveling across the sea may be a trip across the country instead. (This form of inshoring should not be confused with the phenomenon, sometimes called insourcing, of foreign corporations basing their outsourcing solutions in the U.S. for use by companies on U.S. soil.)

"An alternative to India and China is outsourcing to low-cost local geographies," Hoyem said. Or even to closer-to-home destinations such as Canada, where one of Blueprint's portfolio companies, Atreus Systems Corp., has received research and development tax credits from the government. Those breaks have allowed Atreus to net a 40% discount over the cost of running certain of its operations from Santa Clara, Calif., where the company had been headquartered.

In the U.S., Hoyem says he has seen efforts to encourage inshoring by such states as Ohio, Oregon and Pennsylvania. The drive has been acute in areas that have lost formerly booming technology industries to foreign shores.

Tracking with certainty the number or economic magnitude of the inshoring movement remains problematic at the moment. "It's very hard to collect data on this because it is company specific," said Robert Scott, director of international programs at the Economic Policy Institute.

Still, even if inshoring increases, offshoring is likely to remain the favored option for U.S. corporations chasing cost savings-at least for the near term. "I think we're still getting our clocks cleaned on the [offshoring] side. We're hearing some stories of [inshoring], and we're also hearing stories of companies that have taken facilities overseas and have been disappointed with the results," said Jeff Finkle, president of the International Economic Development Council.

"But that being said, we've got broad sectors of the [U.S.] economy that are just getting beaten to a pulp."

Rob Finkel, a partner at law firm Milbank, Tweed, Hadley & McCloy LLP, agreed. "The clear trend though is still towards sending business overseas," he said, though he has seen some companies taking a closer view at the true risks associated with offshore savings. "I've noticed that companies are developing an increased awareness of the true costs and risks of going overseas. I wouldn't call it a backlash to offshoring, but I will say you hear talk about how there can be problems with sending work offshore and there are risks."

The lure of offshoring has been its promise of huge cost savings in such areas as customer service, technology and manufacturing. Offshoring vendors will sometimes say there are savings of up to 50%, noted Milbank's Finkel, but these are often more in the 20%-30% range, he noted, and "the cost savings do come with risks."

Added Finkel: "sometimes it makes more economic sense for companies to keep the business in the States or go to Canada or Mexico than ship business overseas. That phenomenon has to do with companies balancing the costs savings against the risks."