

Assessing Chile's Position in Winning Silicon Valley
IT Offshoring Contracts

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ABSTRACT

As Chile gains a global reputation for political and economic stability as an emerging economy, world media is trumping this tiny, geographically isolated nation as a new economic tiger in South America. Chile's private sector and federal government are coordinating efforts to publicize the country's technological and knowledge based competitiveness indices as a way of showcasing its advance towards achieving a highly coveted honor – economic emergence as a knowledge economy. This paper attempts to contrast the publicity surrounding Chile's incorporation of IT into its society with this nation's success at winning Knowledge Processing Outsourcing type contracts from Silicon Valley based firms.

INTRODUCTION

Developing nations increasingly rank their success based on their ability to attract and retain IT contracts and jobs. In Chile's case, its desire to focus on high-level IT work has led its businesspeople and government leaders to compete to win offshoring contracts from Silicon Valley based firms. Building on a brief background explaining the rise of modern Chile's economy, this paper will critically examine how Chile is attempting to target one of the most complex and involved types of IT offshoring – Knowledge Process Outsourcing (KPO). Through a sampling of government and private sector viewpoints, the paper contrasts the often euphoric publicity relating to Chile's IT strength and potential to become a Latin American hub of highly technical IT outsourcing work with a more objective examination of the realities still facing this small market economy.

LITERATURE REVIEW

While specific literature about Chile's quest to define itself as a Knowledge Processing Outsourcing hub in Latin America is limited, recent discussions of Chile's struggle to become a player in the broader knowledge economy do exist. The idea that a country as small as Chile (population 17 million) can become a strong and competitive knowledge driven economy is contested by many scholars. Cimoli and DiMaio (2002) argue that Chile's "extraordinary

economic performance has been based on an export-led growth model characterized by an international specialization oriented to natural resources and standardized commodities.”¹ This type of export led growth is not, by itself, conducive to creating a high technology, knowledge-centric economy that can compete with other countries for complex outsourcing contracts. Since money from the sale of natural resources has filled the Chilean central government’s coffers since the late 1800s, it is easy to see why commodities such as copper, salmon and fruits continue to top Chile’s list of exports throughout the present day. As will be discussed, Chile’s history of selling its natural resources has enabled it to obtain financial success despite its geographic isolation.

Cimoli and DiMaio (2002) continue their critical view of Chile’s economic success by suggesting that “Chile is not more an exception with regards to the other developing countries and support the view of the necessity to start a second stage industrialization process to reduce the existing technological gaps and to increase product diversification in order to maintain the catching-up process.”² The Chilean government, through its Fundacion Chile initiative, has been the main proponent of assisting with this diversification process – especially in the IT outsourcing arena. Success so far, however, has involved Fundacion Chile in more of an educator and motivator role in encouraging the expansion and competitiveness of the still unclear IT knowledge economy.

Miozzo and Grimshaw’s (2006) work on IT outsourcing commissioned by large multinational firms in Argentina and Brazil illustrates the fickleness of companies to move around between countries in a geographical region in order to meet its needs efficiency and cost needs. These authors’ results “not only confirm that global service suppliers are ‘footloose’ . . . , but show that outsourcing services to these global services suppliers may contribute to making clients (or segments of the clients operations) themselves more ‘footloose.’”³ This ability to relocate within the region, does not bode well for Chile, given its small size relative to Argentina and

¹ Cimoli, Mario; Di Maio, Michele, Technological Gaps, De-Industrialization and Catching Up: Is the Chilean Case a Paradox,” p. 3

² Cimoli and DiMaio (2002), p. 35

³ Miozzo, M.; Grimshaw, D. Service multinationals and linkages with current firms: the case of IT outsourcing in Argentina and Brazil, p. 24 (<http://www.cric.ac.uk/cric/events/catchup/papers/Miozzo.pdf>)

Brazil. Jain et al (2007) highlight Chile's size disadvantage with respect to its through their findings that the country's market for these services "represented around \$500 million in 2005, compared with more than \$6 billion for IT services in Brazil. The combination of a stable government and a well educated workforce - a beneficial synergy helpful for keeping KPO IT contracts in Chile - may also work to the country's detriment since average salaries are higher in Chile than in other countries in the region. Wages may heavily influence multinational IT service providers which have trouble seeing Latin American offshoring beyond its cost advantages.

Mierau's (2007) assertion that "countries such as the Philippines, Chile and Mexico are setting themselves up to provide high-end services at low-end prices as a way to boost employment and help their economies"⁴ may prove to be a difficult strategy for Chile to sustain since constant competition for increasingly complex outsourcing contracts and projects will drive prices down. Since Chile will stand the best chance of differentiating itself based on the high-quality of its IT knowledge processing work, low cost is not a variable that the country wants to compete on – rather it is the quality and value-added complexity of the skills Chilean engineers can bring to Silicon Valley based firms.

Despite the clear sentiment that Chile is not as strong and developed an economy as some pundits claim, scholars have presented suggestions for how Chile can go down a path towards becoming a steady knowledge based economy. A paper by Cimoli and DiMaio (2002) states that Chile must shift and develop its current "natural resources heavy" export strategy: "growth can be maintained if and only if the specialization pattern constantly improves; that is, the country start producing and exporting commodities characterized by higher technological content and ... that differences in the rates of growth of wages between trading partners cannot be modified if the specialization pattern remains unchanged."⁵ This argument is echoed and brought to the forefront of many discussions which dig deeper than the optimistic headlines.

⁴ Mierau, A.; p. 4

⁵ Cimoli, Mario; Di Maio, Michele, p. 35

Kini (2007) discusses the challenges of vendor availability and contractibility as still being a key issue in the Chilean ICT market. This is partly due to the still nascent Chilean IT services sector.⁶ While Kini acknowledges Chilean CIO's understanding of how to evaluate outsourcing opportunities for their local firms, he suggests that it is still unclear if Chile can replicate the success of attracting outsourcing projects to Chile.

Government Support for Knowledge Process Outsourcing

On April 10, 2007, Fundacion Chile, the Chilean government's development agency, held a major conference in Santiago to promote Chile's strength as an up and coming IT offshoring destination for global companies seeking either a Latin American presence or a diversified skill base to complement companies' other IT projects in different parts of the world. Entitled, "Chile Positioned as a Platform for Offshoring Worldwide," this conference praised most aspects of the Chilean economy and showcased AT Kearney's GSLI and other global measures of the country's success at becoming a Latin American IT offshoring hub. Fifteen power point presentations were delivered at this conference. Among the presenters were representatives from Tata Consultancy Services, Evalueserve, iFlex, NeoIT and Synopsys. In six out of fifteen presentations, Chile's stable political and business environment, government support for IT and FDI, and infrastructure were highlighted as the reasons for Chile's distinctiveness as the next IT hub in Latin America.⁷ Online web pages, economic conferences and other government sponsored material are, not surprisingly, overwhelming supporters of Chile's strengths in this arena.

Critics of Government Support of Knowledge Process Outsourcing

The government's support of IT outsourcing is not without its critics. Among them are, Jose Miguel Piquer, the director of the Computer Science department at the University of Chile.

⁶ Kini, R.B., p.1

⁷ Chile Positioned as a Platform for Offshoring Worldwide (also the link to PPT Presentations)
http://www.fundacionchile.cl/portal/page?_pageid=113,232271&_dad=portal&_schema=PORTAL&p_item_id=5246352&p_area_id=96277

According to Piquer, Chile is “‘very well positioned’ in its indices of economic and political stability and in its platforms of electronic commerce...but it turns out that there are no great risk takers or investors ready to enter segments that are not the traditional ones.”⁸ Chile’s strength in base metals, fruit, wine and aquaculture – because of their relative ease of distribution – is hindering Chileans jump towards fully embracing the value added IT outsourcing services arena.

The Relevance of Two Chilean Economic Highlights

To understand why the Chilean government, people and the world media are attracted to the idea that the country can become an international player in IT outsourcing, it is important to examine two key economic highlights from Chile’s pre-World War I history. From the 1870s to the beginning of World War I, Chile had the world’s largest supply of naturally occurring sodium nitrate. This compound accounted for a key component in gunpowder and, in turn, weapons production. Since these years were pivotal in the military build up of various countries, Chile became extremely wealthy. From 1890 to 1914 nitrate represented 80 to 90 percent of Chile’s exports.⁹ During this time, the Chilean government invested proceeds from nitrate sales towards public education, transportation, infrastructure and city beautification.¹⁰ Chile’s fortunes, however, took a turn for the worse in the second decade of the twentieth century. The invention of synthetic ammonia (through the Haber-Bosch process), rendered Chile’s natural supply of sodium nitrates much less relevant to the world’s warring nations and weapons producers. While its honeymoon with sodium nitrate proved ephemeral, this experience illustrated the advantages of being connected to the world economy much the same way as Chile currently views IT outsourcing as the new ticket to connectedness and prominence within the global economy.

Another reason for Chile’s economic strength prior to WWI was that its coastal city, Valparaiso, was a major port for trans-pacific vessels which were “in-transit” to Atlantic and

⁸ Information Technology in Chile: Still Awaiting Take-Off, Published: January 22, 2004
<http://knowledge.wharton.upenn.edu/article.cfm?articleid=902>

⁹ Rector, J., The History of Chile, p. 128

¹⁰ Sicotte, R, et. al, <http://community.middlebury.edu/~kwandsch/FertilizerSHORT.pdf>

European destinations.¹¹ By acting as a hub for trans-pacific and trans-atlantic commerce, Chile gained an edge in Latin America in that it was influenced by both American and European traders. Apart from boosting Chile's economy, Valparaiso served to remind Chileans that there were ways to become recognized on a global scale. A decline of Chile's sea trading strength occurred with the completion and opening of the Panama Canal in 1914.

Emergence of a Market Economy

To understand Chile's current geographic isolation from established and emerging knowledge driven economies, it is helpful to examine the country's position in the 20th century. With foreign ammunitions makers and international shipping lines no longer as interested in what the country had to offer, the Andes mountains, dry northern deserts, cold Antarctic southern regions and vast Pacific Ocean coastline made for an island like existence. The human rights abuses of General Augusto Pinochet in the 1970s would bring Chile back into the world spotlight but for very different reasons. With U.S. support, Pinochet staged a coup against the popularly elected Salvador Allende, and in his eyes, tried to make Chile less of a fertile breeding ground for Communism. The torture, physical abuses and deaths committed by the regime during this process devastated the nation and shocked the world. Ironically, it was Pinochet's realization that he and his staff knew little about market economies that led to Chile's rise as an emerging market economy. This lack of knowledge on the part the commander in chief led him to ask for help.

As part of his reorganization of the Chilean economy, Pinochet sent a group of 30 Chilean economists, known as the "Chicago Boys," to study economics at the University of Chicago and invited a group of American economists from the University of Chicago to teach and work with economists at the University of Chile to develop a market-oriented economy for the country. While Chile had a long history of engaging with outsiders, the 1970s Chicago Boys program would be a significant event in the formation of Chile's modern, decentralized, free market economy – one built on free trade agreements and liberal economic principles.¹²

¹¹ Rector, J., p. 127

¹² <http://www.cambridge.org/us/catalogue/catalogue.asp?isbn=0521451469>

Current Economic Trends

Buoyed by the exports of copper, wine and salmon, (each accounting for US\$27 billion¹³ (in 2006), \$962.5 million¹⁴ (in 2006), and \$660 million¹⁵ (in 2006), respectively), Chile has contributed increasing amounts to its government coffers. These record setting export levels are helping to fund the Chilean Digital Agenda. This agenda attempts “to convert Chile into a digital country by 2010” by moving “into a new phase in the inter-operability of public services, putting special emphasis on the needs of companies and citizens.”¹⁶

As was the case during the 1870s, when Chile invested profits from the taxing of its natural resources into national projects relating to education, transportation and civic improvements, earnings from Chile’s current leading exports are also being used to boost the nation’s infrastructure. Unlike in the late nineteenth century, the country is now investing to attract foreign investors and to promote IT business which focus on providing outsourcing services to Silicon Valley based companies. The Digital Agenda will develop the country’s IT infrastructure.

To develop its outsourcing capabilities, Chile, much like it did in the 1970s, is looking to foreign help to learn how to become an effective offshorer. This time, instead of relying on the market advice of American economists, Chile is turning to India’s most successful outsourcing firms to develop a national concentration of niche IT services focused on Knowledge Process Outsourcing.

¹³ <http://www.bloomberg.com/apps/news?pid=20601103&sid=aX9ELYngdg68&refer=news>

¹⁴ <http://www.reuters.com/article/economicNews/idUSN0242367920070202>

¹⁵ <http://www.globefish.org/index.php?id=3101>

¹⁶ <http://knowledge.wharton.upenn.edu/article.cfm?articleid=902>

Knowledge Process Outsourcing and its Relevance for Chile

Defined as “a process of creating, structuring, storing, synthesizing, protecting and monetizing knowledge,”¹⁷ Knowledge Process Outsourcing represents one of the most advanced types of offshoring in existence today (Figure 1).¹⁸

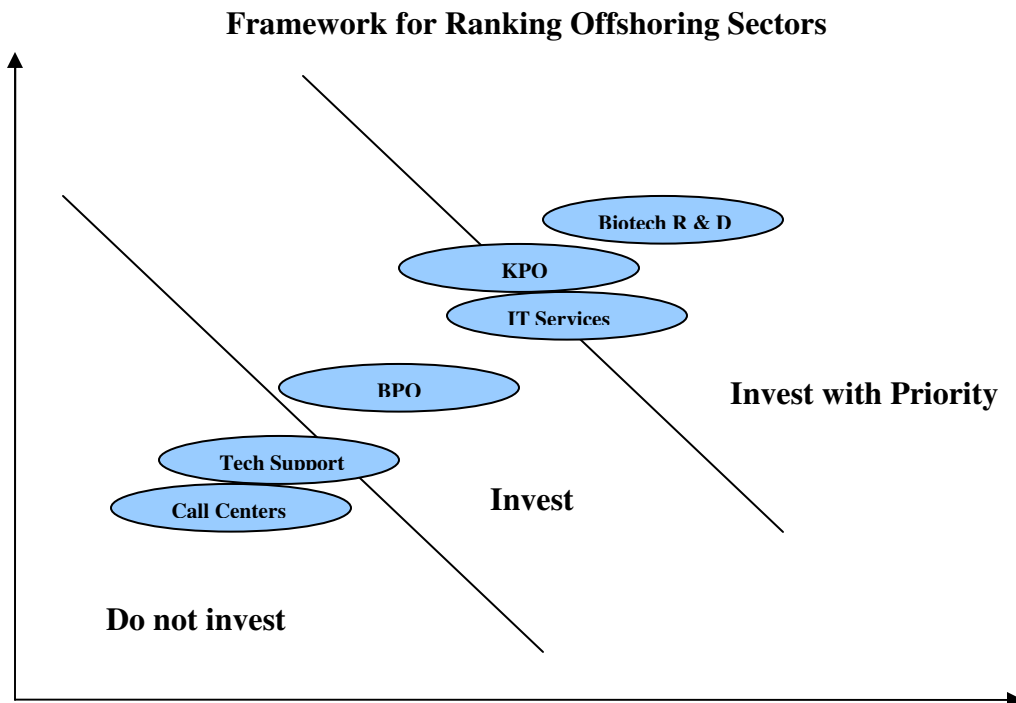


Figure 1

Figure 1 illustrates the range of services that span the needs that can be satisfied by outsourcing and suggests that Chile should invest and focus on KPO as a way of ascending the global outsourcing competitiveness rankings. Adapted from an A.T. Kearney slide show presented at an Outsourcing Conference entitled, “Chile and the New Offshoring Industry: How do we take advantage of the Opportunity?”¹⁹, this figure shows that KPO work fits neatly with Chile’s need to play “catch-up” in the global outsourcing area. Since countries like India and China have dominated the Back office, Call Centers and Business Process Outsourcing

¹⁷ Evaluserve Power Point Presentation, “Chile and the New Offshoring Industry,” Delivered on April 10, 2007 in Santiago, Chile, Slide #5

¹⁸ AT Kearney Power Point Presentation, “Leveraging Chile’s Strengths to become a Preferred Location for Remote Services,” Delivered on April 10, 2007, Slide #25,

http://www.fundacionchile.cl/portal/page?_pageid=113,232271&_dad=portal&_schema=PORTAL&p_item_id=5246352&p_area_id=96277

¹⁹ Ibid.

(BPO) segments of outsourcing for many years and since Mexico and Brazil have used their market size and proximity to the U.S. to provide affordable staffing for American based IT needs, Chile, according to AT Kearney, seems best-positioned to focus its efforts on high-end, difficult to emulate design and research centers for Silicon Valley based IT companies such as Oracle, Synopsis and Yahoo.

Rankings and What Really Matters: A Critical Look

The A.T. Kearney Global Services Location Index (GSLI) has become a standard by which developing countries rate their success at improving their standing as offshoring service providers to the global economy. The 2007 GSLI report, concluded that Chile ranked #7 in the global ranking of leading offshoring destinations. (An improvement from its #8 rank in 2005.) More than its rank, the status of countries who appear to climb this index, is enhanced because of the importance the world places on development based on IT funding and capabilities. As Kini (2007) emphasizes, the importance that the GSLI plays in countries' developments plans and strategies: "using the scores on these indicators as benchmarks, countries, especially the developing countries are reallocating their resources in gaining on these rankings as measures of gain in the race to knowledge economy."²⁰

While these rankings may encourage emerging economies to work hard to develop their IT infrastructure, they do not necessarily represent the success that the country has had as an overall winner in competition for lucrative IT outsourcing contracts. Based on the literature, presentations and popular articles reviewed by the author, the main factors contributing to Chile's high rankings in the AT Kearney GSLI index and in World e-Readiness indices for Latin American and the Caribbean (Figure 2) relate to the country's political, economic and social stability and not on the number or dollar amount of IT contracts won. To date, Chile and its government seem to enjoy the praise associated with these high rankings, while actual tactics towards winning complex IT outsourcing contracts from Silicon Valley based firms have not increased dramatically in recent years.

²⁰ Kini, R.B., p.2

Figure 2 - Latin American and the Caribbean Country e-Readiness indices Country Rank
(Dec. 2005)

Country	DOI Rank	EIU e-readiness 2005	DAI Rank	World Bank ICT Index (World Rank)	Knowledge Economy Index (KEI)	Network Readiness Index (NRI)
Chile	1	1	3	1	2	1
Costa Rica	N/A	N/A	11	10	4	6
Argentina	2	4	8	2	5	11
Bolivia	N/A	N/A	29	16	12	19
Mexico	3	2	14	3	6	5
Venezuela	4	6	17	7	10	13
Colombia	5	7	21	8	11	8
Brazil	7	3	15	4	7	2
Peru	6	8	22	13	9	15
Number of Countries Included	7	9	33	21	20	20

Chart Reference: <http://www.eclac.cl/socinfo/publicaciones/xml/8/24228/w73.pdf>

Figure 3 – Explanation of e-Readiness Indices²¹

Acronym	Explanation
DOI	<i>Digital Opportunity Index</i> - measures digital opportunities of Information Society in progress and use of ICTs.
EIU	<i>Economist Intelligence Unit e-readiness Index</i> - allows for country comparison of e-business environments and outlines the degree to which a market is favorable to Internet-based opportunities
DAI	<i>Digital Access Index</i> - ranks Information and Communication Technology (ICT) access
WB ICT	<i>World Bank Information and Communications Technology Index</i> – a “pure” ICT sector index - does not include non-ICT indicators. The index uses 15 indicators divided into 5 categories (access, quality, affordability, sustainability and applications)
KEI	The <i>Knowledge Economy Index</i> seeks to assist client countries in understanding their strengths and weaknesses in transitioning into a knowledge economy...the KAM provides a preliminary knowledge economy assessment of a country
NRI	The <i>Network Readiness Index</i> measures the extent of preparation of a country or community in order to participate in and benefit from ICT developments

While Chile ranks within the top three positions in each of the indices in Figure 2 (in a comparison of Latin American and Caribbean countries) the country at this time is still considered to be a *potential* hi-tech leader.²² This assertion, from a United Nations Human Development report, confirms that Chile is still in the process of enabling itself to be a serious IT offshoring services provider. An emphasis on internal IT and human capital training must first be a priority in this country in order to move Chile from its current “high-accolade” position amongst developing IT service providers to that of a significant contributor to IT offshoring in Latin America. The findings in this paper have determined that the media attention surrounding Chile’s current status as an emerging IT offshoring hub in Latin America is still more hype than reality.

²¹ Minges, Michael, Evaluation of e-Readiness Indices in Latin America and the Carribean, prepared for the UNECLAC. <http://www.cepal.org/socinfo/publicaciones/xml/8/24228/w73.pdf>

²² <http://hdr.undp.org/reports/global/2001/en/pdf/pr3.pdf>

A comparison of several high-level factors in Argentina and Brazil serve to place Chile's ability to attract Silicon Valley funding into perspective. The Argentina-Brazil-Chile chart (below) clarifies the clear advantage Brazil has in becoming a Latin American hub for outsourcing. Even though Portuguese is the national language of Brazil, this country's proximity to most of the Spanish speaking countries in Latin America, coupled with its excellent engineering schools, make Brazil a formidable opponent to Chile in its quest to serve as an IT services hub in Latin America.

“ABC” Comparison Chart^b

	Argentina	Brazil	Chile
Potential Market Size (# of people)	38 million	184 million	17 million
\$ Value of IT Activities in 2005	~\$2 billion	\$6 billion	\$500 million
Proximity to Sizeable Spanish Speaking Populations	Close to Chile	Borders 7 Spanish Speaking Countries	Close to Argentina, Peru and Bolivia

The Language Issue – Spanish or English or Both?

In July 2003, President Lagos and his Education Minister announced that the Chilean government was committed to making Chile a bilingual country by 2010.²³ While most Chilean college graduates speak English in varying degrees of fluency, an increased emphasis on teaching English conversation skills would promote Chile's attractiveness as an offshoring destination for US multinational corporations.

^b Chart material adapted from Roshi etl al, “How Chile can win offshoring,” McKinsey Quarterly; 2007 Special Edition, p. 10-12.

²³ Exporting Services to Chile <http://www.buyusa.gov/chile/en/121.html>

Even though Chile may wish to market itself as a Latin American hub for Spanish language business needs, mastery of English in a professional setting, will show prospective American companies that Chileans have an international and global business mindset. Exposing local workers to a more international approach of management ideas is one of the key motivators for increasing offshoring services employees' readiness to work for multinational corporations.²⁴

Similar Time-Zones:

Many advocates of Chile's rise as the future IT services offshoring hub of Latin American cite Chile's time zone as being critical to being better able to serve multinational corporations' needs. For most of the year, Chile shares identical time as the East Coast of the United States and Canada. (Santiago is actually further *east* than New York City and Washington, DC). This temporal equality usually ranks at the top of many Chilean government presentations on why Chile is so well positioned to do business with American multinationals. Furthermore, because daylight savings times in the Northern and Southern hemispheres creates time changes in the opposite directions, during the North American spring time, the Silicon Valley west coast of the United States only has a two hour time difference with Chile. For these reasons, Chile's location and be useful for serving a variety of North American client needs.

Future Projections

In examining the future of Chile's potential to become a hub for IT offshoring services for multinational corporations several factors will continue to limit Chile's ability to become *the* next Latin American offshoring destination. Based on the primary research and personal interviews conducted for this paper, the following chart ranks the major challenges Chile faces as it seeks to gain prominence and attain success in the IT offshoring services arena:

²⁴ Farrell, D. et al., *McKinsey Quarterly*; 2007 Special Edition, p. 6

Major Challenge Factors Facing Chile's IT Offshoring Sector as of 2007

1. Limited number qualified human resources^a
2. Limited size of Chile's home market
3. Geographic isolation from Asia and Europe
4. No major neighboring Spanish speaking markets
5. Diversify IT service locations within Chile

- Qualified human resources refer to employees who have both the computer/technical and English language abilities to conduct high-level IT service work such as research on how to create a faster, more efficient search function for a large corporation's intranet. Estimates vary, but by some accounts, Chile graduates between two thousand and ten thousand science, engineering or other technical university graduates per year. This small talent pool is one reason that Ricardo Baeza-Yates, Director of Yahoo Research for Europe and Latin America, believes that this human capital factor poses the biggest challenge to Chile's growth in this field: "the main challenges are human resources...we do not have a critical mass of CS researchers or in some areas, engineers."²⁵
- Due to the limited size of Chile's home market, an increase in international technical exchange programs for promising students appears to be one straightforward way of overcoming Chile's limited population base. By sending students abroad to get trained in IT services, KPO and computer science research, the next wave of Chilean technical employees, scientists and entrepreneurs can think of their market more on a continental level (excluding Brazil) as opposed to just a limited national level. Peru's and Argentina's populations of 28 million and 40 million, respectively represent the two most populous countries in Latin America (after Mexico). Focusing on sales and expanding business ties

^a "Qualified Human Resources" pertains to employees who have technical computer/programming knowledge and English proficiency.

²⁵ Personal Communication, November 21, 2007

and relationships with these neighbors would enable Chile to better position itself as an IT services hub for the region.

- Geographic isolation from Asian and European markets and companies, while an important factor now, will diminish in importance over time. The reasons for this include the increased use of communications technology to provide IT service functions. A more immediate problem facing Chile's potential to stand out in this field is the centralization of most of Chile's IT service providers in the greater Santiago metropolitan region. Like many small to medium sized, developing countries, most of Chile's educated workforce, employers and modern infrastructure are located in its capital city. Efforts to develop secondary IT service hubs in other parts of Chile have been limited to date. The engineering departments at the Federico Santa Maria Technical University in Valparaiso and at the Universidad Austral in Valdivia might one day be potential locations for future IT offshoring services start-up companies.

CONCLUSION

Until the technical and business skills of Chile's people increases in a sustainable way, Chile will remain geographically isolated from other knowledge based economies. While the country's nitrate boom and pre-Panama Canal strengths in the shipping have given the country an adventurous and wealthy mystique, the realities of transforming Chile into a knowledge economy in the twenty-first century, will require more concentrated effort towards the development of the country's human capital. Apart from some limited instances, KPO has a long way to go before Chile can become competitive in the sector of IT outsourcing. Further areas of research on this topic can explore the relevancy of nearshoring and the types of human capital that are necessary to enable Chile's graduation from its high IT readiness rankings to becoming a true added value IT offshorer.

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