

Executive summary

NASSCOM – KPMG Study 2004:
Choosing a location for offshore operations in India

May 2004

NASSCOM™

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India's success with off-shoring is expected to continue over the next few years with expected growth of 30 – 40 per cent and an increase in the share of off-shored services from 25 per cent currently to 40 per cent.

What is lost in this evolution is where this growth is going to come from. While it could partially come from existing activities moving to the higher end of the value chain, it will also require expansion or entry of new players.

Most new entrants and existing players are faced with the lack of information or a framework to guide on the choice of location for their off-shoring operations. Should it be in the currently attractive locations that are encountering salary increases of 10 – 20 per cent and attrition jump to 30 – 40 per cent? Or, should it be in locations where costs could be 30 – 50 per cent lower in comparison but availability of necessary infrastructure / people skills may be an issue? How would the positioning of these locations change in the future (two – three years)?

The NASSCOM-KPMG study is aimed to address this gap and to guide the systematic evaluation of location choice for companies' ITeS requirements.

The study indirectly addresses the needs of three broad categories.

- Firstly, potential investors who have no clear understanding of operating out of India or even about specific location choices and are looking at an overall assessment as well as the experience of other players.
- Secondly, players with off-shoring operations in India that are evaluating expansion or relocation options driven by customer or competitive pressures and cannot keep track of changes across different locations.
- Thirdly, local or state government and regulatory authorities that are often very intent on attracting ITeS investments and generating employment but lack an understanding of how companies choose locations.

The report covers 13 city clusters across ten states that account for over 85 per cent of the country's IT / IT-enabled Services (ITeS) exports. Other states too are now attracting interest for ITeS but these were not considered for the current study at this stage, either due to lack of significant ITeS activity or information available within the resource constraints.

A typical approach to choice of location by companies for ITeS could involve multiple stages of information gathering and analyses or negotiations.

The evaluation during the process is based on a changing set of

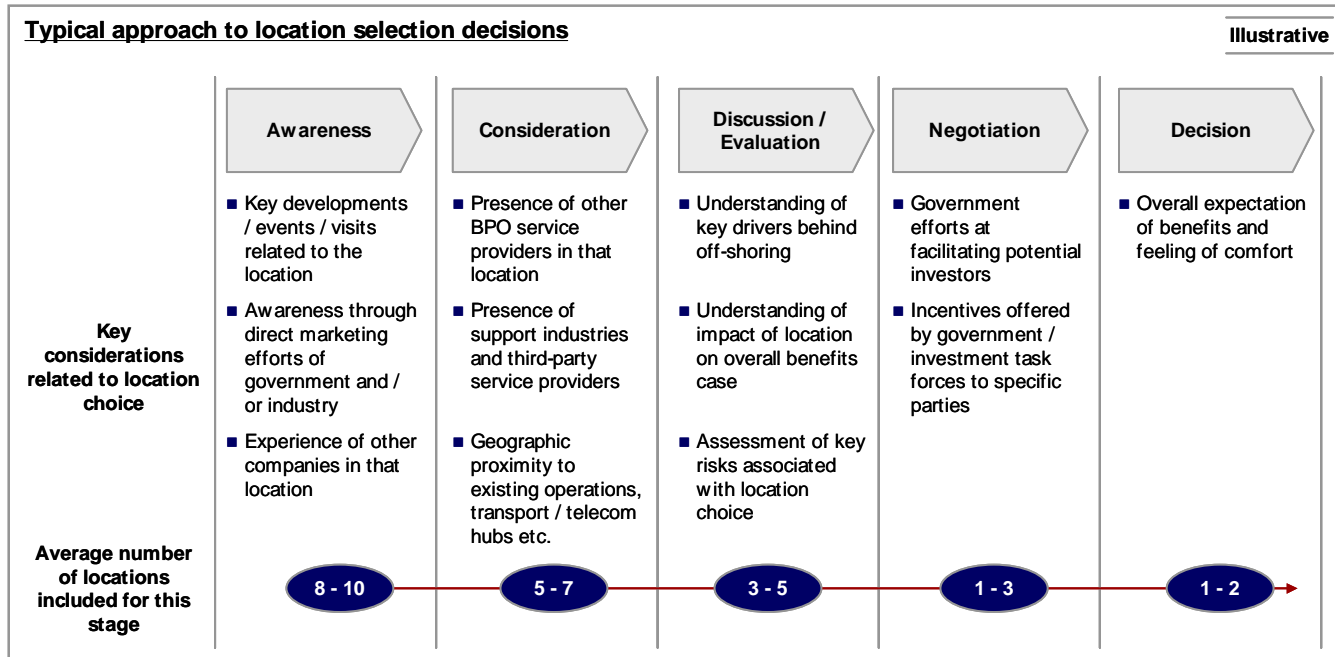
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parameters, from 'a buzz about the location' to 'quantitative aspects of key factors like salary costs, bandwidth availability etc.' to 'qualitative and experiential aspects of flexibility and special concessions'.

Attractiveness of a location would thus be driven by a mix of qualitative and quantitative factors and the importance that a company attaches to the different criteria based on its specific characteristics.

The framework adopted was based on the platform of five input factors:

- human resource costs and availability (for example, number of graduates, starting salaries, attrition rates)
- infrastructure availability (ITeS facilities, telecom and power supply, quality of life)
- the dependence of the location on ITeS



- the presence of support groups (for example, industry expertise, venture capital, education, industry associations)
- the physical features (for example, geographic location, climate)

Source: KPMG Analysis

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The efforts to enhance attractiveness for ITeS were considered in terms of announced initiatives related to improvements (e.g. business environment, resource availability), incentives (e.g. policy support) and investments (e.g. public / private sector).

One key finding is that the choice of location for companies planning to establish or expand their off-shoring operations in India is influenced by the underlying objectives. Without these differences in criteria, companies would have all chosen the same location or set of locations for ITeS although the current spread of ITeS operations in India is contrary to that hypotheses.

Of course, not all of these objectives are exclusive but one or two of them may be dominant.

Companies that had an established base, either in terms of facilities (own or parent company's), a brand (to attract talent) or top management teams, chose to operate and expand their ITeS operations in the same location.

Companies that were focused ITeS players, chose to expand presence in India based on where they could meet specific productivity requirements in terms of the right base of skills (i.e. trained professionals in IT, financial services or engineering design) and the right costs (i.e. lower salaries with low cost of

recruitment and low attrition).

Other companies may have been driven more by the need to meet business continuity requirements through parallel operations in multiple locations that have different geo-political, ecological and social risk profiles.

And then there are companies that may have been driven to a location spread based on their acquisitions and alliances.

The study suggests that most locations swing between a focus on infrastructure development (for example, providing facilities for ITeS, providing telecom and power supply, improving the quality of life) and a focus on HR development (for example, providing specialized skills training, generating a pool of educated resources).

The cities may be currently based across the spectrum but are making efforts to move into one particular direction as shown by the arrows.

Based on current assessment, the team from KPMG identified four key clusters or groupings for the different cities:

Firstly, there are the 'business centers' like NCR that have benefited from the availability of business infrastructure and a pool of employable people to attract ITeS investments. Their initial success has however led to increased pressure related to

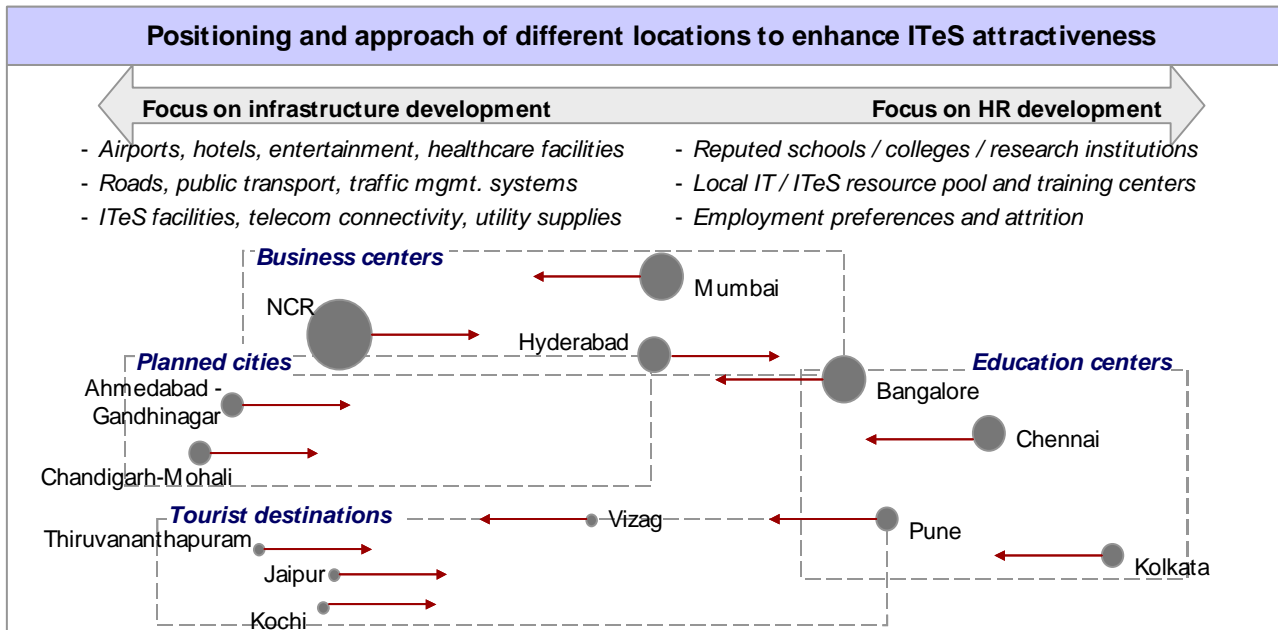
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supplying manpower or managing urban infrastructure for further growth.

Then there are the 'education centers' like Kolkata or Chennai that have invested in a robust education / institutional infrastructure but have traditionally seen skills migrate to other locations for ITeS.

These locations are now investing in infrastructure and marketing efforts to attract ITeS investments.

There are 'tourist destinations' like Jaipur and Kochi that can leverage a global service orientation and relevant infrastructure (like hotels, transportation services) because of their tourism



background. The challenge for these locations is to develop or attract the ITeS skills required by larger MNC ITeS players. The fourth category is that of 'planned cities' like Chandigarh that are systematically investing in attracting investments based on their ability to provide telecom, power, building infrastructure. Their biggest challenge is to attract anchor investors while developing a pool of skilled resources.

Source: NASSCOM. KPMG. 2003 – 2004.

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Interestingly, the number of ITeS companies at a location shows a strong correlation to the category in which it falls. More importantly, however, for companies that have chosen to operate out of multiple locations, their choice has often been restricted to locations within a category – for example Mumbai and NCR, Bangalore and Pune or Chennai and Bangalore.

Each of these categories show different levels of appropriateness as a location for ITeS. For example, business hubs and education centers could make very good sense for those companies looking out for a sophisticated workforce with niche or high-end skills. Planned cities with the relevant infrastructure for ITeS would make good sense as a cold/warm-site disaster recovery center.

Implications for key stakeholders

Potential investors into India

- Costs of some infrastructure support services (e.g. power, telecom) are **not substantially different** across locations – **availability** is often more important
- CSFs and entry **barriers vary across locations** and are more suited to specific requirements of **select companies**

Existing Indian ITeS players

- Choice and revision of location is driven by **client requirements, growth aspirations** and **margin pressures**
- Expansion choices are normally restricted **within the same category** of locations (even as the locations themselves migrate across categories)
- New **locations may become attractive** with change efforts as well as internal objectives

Local / state government and officials

- **Policy incentives** by themselves are **not adequate** for attractiveness
- States will need to **continuously** balance their **efforts across HR and infrastructure** development areas
- States must adopt a **positioning** based on **relevant strengths** with specific investors (e.g. niche skills, high-end services, shadow locations, low-cost locations)

The study also provides a more detailed assessment on the various parameters for around 13 city clusters across the ten states with the aim to represent the strengths of the city for ITeS, based on parameters chosen, rather than to compare one against the other.

The study has some key implications for all the key categories of intended audience.

ITeS companies entering India or planning to expand operations in India need to view location spread as an integral part of their off-shoring strategy. This could be

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driven by client pressures to offer business continuity, aspirations to enter new growth opportunities requiring niche skills or competitive pressures leading to a need for lower cost of skills.

Companies can systematically gauge improvement efforts across locations. They can assess attractiveness by assigning weights that would depend on specific organizational characteristics and objectives behind off-shoring.

The state governments must recognize that ITeS policies by themselves will not be sufficient to attract ITeS. These must be supported by near-term business improvement efforts as well as longer-term infrastructure development initiatives.

Also, they will need to recognize their key strengths and limitations to appropriately position locations for ITeS rather than an aggressive sales push directed, very often at a common list of clients. This will help position India as an agglomeration of attractive clusters to meet specific requirements of ITeS players.

Lack of adequate information in the past about the current and potential future attractiveness of specific clusters as well as about the experience of other companies in those clusters may have led companies to defer investment plans or to choose sub-optimal

locations in terms of cost and availability of skills.

This document provides the relevant information required and can act as a decision-support guide, based as it is on multiple sources of information and interactions.



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NASSCOM

National Association of Software and Service Companies

The National Association of Software and Service Companies (NASSCOM) is the apex body and umbrella organization of IT services and IT-enabled services organizations in India. It was formed in 1988 with the primary objectives of being a catalyst for the growth of the software-driven IT industry in India. NASSCOM is a non-profit organization and is registered under the Societies Act, 1896. It currently has over 850 member companies who collectively contribute to more than 95 per cent of the revenues of the IT services and IT-enabled services industry in India.

NASSCOM's aims and objectives include facilitating trade and business in IT services, IT-enabled services and the e-commerce industry; encouraging the advancement of research, facilitating the education, employment and growth of the Indian economy. NASSCOM works with the Government of India and various state governments to formulate policies and procedures in the IT services and IT-enabled services industry.

NASSCOM organizes conferences, seminars, workshops and exhibitions in India and abroad. These events focus on areas such as Internet, e-commerce, e-governance, IT-enabled services, ERP, networking and banking. It also organizes specialized export promotion events in various countries of the world where overseas companies are encouraged to interact with Indian companies.

www.nasscom.org

KPMG

KPMG is the global network of professional services firms whose aim is to turn understanding of information, industries, and business trends into value. With nearly 100,000 people worldwide, KPMG member firms provide audit and risk advisory, tax and legal, and financial advisory services from more than 750 cities in 150 countries.

The Indian practice of KPMG was established in 1993, where it operates out of its offices in Mumbai, Delhi, Chennai, Bangalore, Hyderabad and Kolkata. KPMG India gives its clients full access to the resources and infrastructure of KPMG's global network of professional service firms. KPMG in India offers a range of services that include assurance, tax and regulatory, financial advisory and business advisory services.

The firm has access to the resources of Indian and expatriate professionals with diverse educational backgrounds including business administration, economics, accountancy, law, engineering, computer science and other disciplines. Many of its professionals are internationally trained.

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