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SECOND THOUGHTS

**Some in Silicon Valley
Begin to Sour on India**

**A Few Bring Jobs Back
As Pay of Top Engineers
In Bangalore Skyrockets**

By PUI-WING TAM and JACKIE RANGE
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Silicon Valley has helped power India's outsourcing boom by shifting technology jobs to that country. Three months ago, Munjal Shah reversed a bit of that shift.

Mr. Shah, who leads a California start-up called Riya Inc., had opened an office in India's technology capital of Bangalore in 2005, hiring about 20 skilled software developers. The lure was the wage level: just a quarter of what experienced Silicon Valley computer engineers make.

RETURN TO THE VALLEY

• **The Background:** Small tech firms were leaders in sending work to be done by computer engineers in India.
• **The News:** Demand for India's top computer engineers has driven their pay so high that some other countries are cheaper now.
• **The Upshot:** A few Silicon Valley firms are bringing jobs home. And the rise in costs poses a challenge for a tech-job-fueled Indian economy.

Then Indian salaries soared. Last year, Mr. Shah paid his engineers in India about half of Silicon Valley levels. By early this year, it was 75%. "Taking into account the time difference with India," he says, "we weren't saving any money by being there anymore." In April, Mr. Shah shut down the Bangalore office and offered half of its engineers a chance to move to San Mateo, Calif., with work visas.

Across Silicon Valley, some technology companies, particularly start-up and midsize ones, are beginning to turn away from India for low-cost labor to do sophisticated tech work. Kana Software Inc. of Menlo Park, Calif., eliminated 100 software-development jobs in India in late 2005 and expanded its U.S. hiring instead. Teneros Inc. shut down a 30-member India office and brought 12 of the people to its headquarters in Mountain View, Calif. Some tech start-ups are choosing other low-wage foreign locales, such as Romania and Poland.

Overall, India's tech and outsourced-services industries continue to boom. The industries' revenues rose by almost a third to $39.6 billion in the fiscal year ended in March, says the country's National Association of Software and Service Companies, or Nasscom. U.S. tech companies continue to shift basic work like software coding to India, where big outsourcing companies such as **Infosys Technologies** Ltd. and **Wipro** Ltd., hire tens of thousands of new Indian employees each year. Silicon Valley giants **Cisco Systems** Inc., **Google** Inc. and **Adobe Systems** Inc. are expanding their staffs in India.

They often have other reasons besides pay to be there, such as to be closer to customers. But

even some of the large tech companies are reconsidering India. **Apple** Inc. shelved plans to build a technical-support center in India last year; a spokesman declined to say why. **Intel** Corp. is stepping up hiring in Vietnam -- which has cheaper labor than India -- and says it isn't significantly adding to its Bangalore staff of about 2,400. "The wage inflation rate for engineers in India is four times what it is here" in America, says Intel's chief executive, Paul Otellini.

It's a new twist on the globalization debate. Around the century's turn, when U.S. companies first began flooding to India for its cheap labor, pundits warned that the subcontinent could increasingly rob the U.S. of high-end white-collar jobs. Debate was especially sharp in Silicon Valley, then in a slump, because India annually turns out nearly 500,000 engineering graduates.

Forces of Globalization

Several years on, the forces of globalization are starting to even things out between the U.S. and India, in sophisticated technology work. As more U.S. tech companies poured in, they soaked up the pool of high-end engineers qualified to work at global companies, belying the notion of an unlimited supply of top Indian engineering talent. In a 2005 study, McKinsey & Co. estimated that just a quarter of India's computer engineers had the language proficiency, cultural fit and practical skills to work at multinational companies.

Munjal Shah

The result is increasing competition for the most skilled Indian computer engineers and a narrowing U.S.-India gap in their compensation. India's software-and-service association puts wage inflation in its industry at 10% to 15% a year. Some tech executives say it's closer to 50%. In the U.S., wage inflation in the software sector is under 3%, according to Moody's Economy.com.

Rafiq Dossani, a scholar at Stanford University's Asia-Pacific Research Center who recently studied the Indian market, found that while most Indian technology workers' wages remain low -- an average $5,000 a year for a new engineer with little experience -- the experienced engineers Silicon Valley companies covet can now cost $60,000 to $100,000 a year. "For the top-level talent, there's an equalization," he says.

That means that for a large swath of Silicon Valley -- start-ups and midsize companies that do sophisticated tech work -- India is no longer the premier outsourcing destination. While such companies make up just a fraction of India's outsourcing work, they had been an early catalyst for the growth of India's information-technology business and helped the country attract other outsourcing clients.

Their rethinking of India raises red flags for the country. India's tech industry has been a powerhouse for the economy. Alongside almost 1.6 million Indians directly employed, the industry supports a further six million jobs or so, according to Nasscom, the trade group.

Against a backdrop of rising wages and international competition, it's important for India's economy that its tech giants expand into higher margin business, in order to sustain their growth rates and gain market share. Large Indian outsourcing companies are trying to expand into higher-margin programming and design work, rather than just basic call-center outsourcing and tech maintenance, which now may be done more cheaply in countries such as the Philippines and Vietnam.

Wipro's main tech arm, Wipro Technologies, now does consulting for its clients and can take over a clients' entire IT system -- work that was previously the preserve of companies like International Business Machines Corp. Tata Group's Tata Consultancy Services Ltd. is helping Italy's Scuderia Ferrari design traction-control systems and create software to improve the performance of its Formula One cars.

Yet while India's tech sector has come a long way from basic services such as software coding and tech maintenance and support, the majority of its business still derives from that type of work. At Wipro Technologies, 55% of revenue comes from basic services. At India's other large tech companies, such as Infosys and TCS, 50% to 60% of revenue still comes from such tasks, analysts say.

Some Indian outsourcing companies are themselves looking to other countries -- mostly as a response to the globalizing nature of their business, but also to tap new labor pools amid a tight hiring situation at home. TCS recently opened a center in Mexico and is planning to move into Morocco. Wipro has two centers in China and is thinking about adding one in the Philippines.

'Dirt Cheap'

For Mr. Shah, 33 years old, opening a Bangalore office for Riya was a natural move. An Indian native who came to the U.S. at age 7, he had led another tech start-up in 2001 that had engineering and customer-service operations in Bangalore. "It was dirt cheap," he says. "It completely worked for us."

Riya is a "visual search" company, building technology to search through images and identify faces or other features. The company has launched an online photo site and a visual-search engine called Like.com and will change its name to that later this month. Mr. Shah opened a Bangalore office in early 2005 to help find the engineers he needed.

It was a challenge. Riya, which remains closely held, was unknown in India, while global tech giants were staffing up there and competing for talent. Cisco, for instance, is building a million-square-foot Bangalore campus that will hold 10,000 workers. U.S. venture capitalists have flooded in as well, looking to fund engineers who want to turn entrepreneur.

Mr. Shah spoke to the local Bangalore news media to try to get the company name out. His vice president of engineering, Azhar Khan, held recruiting sessions where he asked candidates to take a technical test to weed out unsuitable applicants. To hire Riya's first six engineers, Mr. Khan says he had to interview 50 to 70 people.

Riya approached Navneet Dalal, who was about to graduate with a doctorate from a computer-science research institute in France, INRIA Rhone-Alpes. Mr. Dalal says he was also talking with Google and Microsoft Corp. about jobs. Riya felt it had to move fast. After interviewing with Google in Mountain View early last year, Mr. Dalal met a Riya executive at a coffee shop. Riya quickly offered him a lucrative package for a job in India.

"The initial incentive was good enough for me not to think about Google, in terms of stock and salary," says Mr. Dalal, now 29, who declines to disclose his pay. (Someone with his experience and qualifications typically earns around $75,000 in India.) Mr. Dalal joined Riya as a computer-vision researcher in Bangalore in May 2006. Within a year, he says, he got a better stock-options deal and a 25% raise.

Increases like that have spurred a lot of job-hopping in India. Pervasive Software Inc. of Austin, Texas, opened a Bangalore unit in 2004 and hired 45 people. But soon its turnover was more than 25% a year, says the company's CEO, John Farr. The company kept having to invest in training workers, only to see them leave. A year ago, it shut its Bangalore unit.

Hidden outsourcing costs surfaced for other tech companies as well. To bridge the geographic and time gaps, some have found they need to hire more U.S. managers to handle their Indian teams. Kana Software in Menlo Park has one engineering manager for every 25 to 50 engineers, but it found it needed one for every five to 10 engineers it employed in the Indian city of Chennai. In December 2005, Kana decided to close its Indian operation.

Mr. Khan, Riya's California-based vice president of engineering, says he often stayed up until 4 a.m. so he could talk with the team in Bangalore. Mr. Shah, the chief executive, flew to India six times a year to make sure things were running smoothly.

Straddling time zones slowed development work. Sometimes a researcher gets stuck on a problem. "It's not really a good thing to keep bugging people at midnight every day, so that introduces some delays," says Mr. Dalal. He also felt cut off. "For us sitting here in India, it's hard to get the business aspect of the problem," he says.

Mr. Shah commissioned a yearly survey of salary trends among top computer engineers in Bangalore. They showed wages jumping 30% a year. To keep people, "we needed to match the increases." In January, Riya gave its Bangalore crew raises of 25% to 40% each.

But it was also having trouble filling open job slots. "I realized price expectations were too high," Mr. Khan says. "I thought, "Wait, why are we paying a junior guy $50,000 or $60,000 over there when I can get a guy [in California] for $80,000?"

In April, he and Mr. Shah decided to shutter the Bangalore operation and bring key staffers to the U.S. After getting board approval, they flew to Bangalore and assembled the 20 engineers to break the news. "They were all upset," says Sowmya Karnad, Riya's human-resources director in Bangalore. But given the soaring wages, it didn't come as a surprise. Messrs. Shah and Khan offered 10 engineers a chance to move to Riya's U.S. office. Eight, including Mr. Dalal, accepted.

Few Job Worries

Those who stayed behind have few job worries. Sandeep Gain, a 28-year-old lead engineer for Riya, declined a U.S. transfer, partly to stay close to his family but also because he likes his opportunities in India. He says he has received two offers, from a large U.S. conglomerate and from a Nasdaq-listed company. Both involve pay increases.

Shutting down in India isn't cheap. Teneros, which closed a 30-person operation in New Delhi in late 2005, says it spent $2 million to do so. It had to get out of contracts, and it brought 12 of its Indian workers over to the U.S. on work visas, incurring immigration fees. Teneros left partly because of wage inflation and a lack of information-technology infrastructure that was slowing its work, says its CEO, Steve Lewis. Mr. Shah says Riya's shutdown costs, such as immigration charges and a broken lease, will be in six figures.

He has cleared eight desks in San Mateo for the eight Indian engineers coming over and is

waiting for their paperwork to clear, hoping they'll be in Silicon Valley by the end of the year. "I thought I understood India," Mr. Shah says, "but now I know it's so much more effort to have a remote office as a start-up."

--Don Clark and Vibhuti Agarwal contributed to this article.

Write to Pui-Wing Tam at pui-wing.tam@wsj.com[1] and Jackie Range at jackie.range@dowjones.com[2]

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