



Picking the Winners Among Tier-2/3 Cities – An Offshoring Perspective

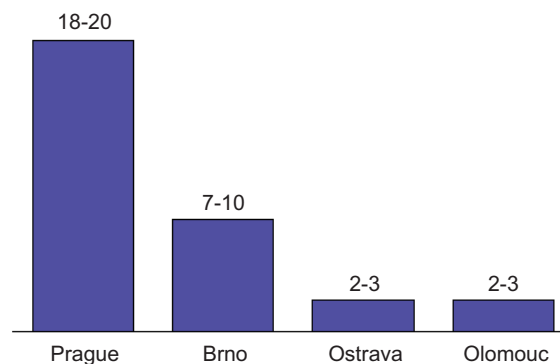
The offshore BPO industry has grown by more than 35 percent over the last three years to reach revenues close to US\$28 billion in 2007. A large portion of this growth, however, has been restricted to Tier-1/1.5 cities (metropolitan regions) in established offshore destinations. Across geographies, large cities such as Bangalore and New Delhi in India, Metro Manila in Philippines, and Prague and Budapest in Eastern Europe supported the bulk of this rapid growth. As a result, some of them have started showing symptoms of saturation including high attrition levels and steep increases in wages and other operating costs.

EXHIBIT 1

Delivery centers of global suppliers and buyers are concentrated in Tier-1 cities

Number of global IT and BPO players
2008

CZECH REPUBLIC EXAMPLE



Sources: Everest Research Institute analysis, CzechInvest

In the recent past, Tier-2/3 cities (cities with lower population and relatively less-developed infrastructure facilities, compared to Tier-1 cities) have started to emerge as viable alternatives for captives and third-party suppliers. These lesser known and typically smaller cities, with their lower operating costs and untapped labor pools, are increasingly becoming attractive to investors. For example, Indian Tier-2/3 cities provide a 15-30 percent reduction in operating costs compared to Tier-1 cities and are also instrumental in meeting the Indian BPO industry's growing demand for talent.

However, these cities are constrained by risks such as the availability of quality social and physical infrastructure, management reluctance to shift to these cities, and lower employability of the labor pool. The diversity of talent in these cities is lower when compared to a Tier-1 city.

Collaborative efforts by industry players and local governments are essential to unlocking the potential of Tier-2/3 cities and enabling the continued growth of the BPO industry. A twofold approach of identifying niche areas that the city can focus on and creating a suitable BPO-support "ecosystem," is likely to lead to effective and sustainable results.

Initiative 1: Development of "BPO hubs" for specific verticals or domains

Everest defines "BPO hubs" as centers where BPO activity focuses on a specific function or vertical. Identification and development of provincial (regional) BPO hubs can be an effective way to leverage a Tier-2/3 city's inherent strengths and better utilize the talent available.

Everest's recent analysis of Tier-2/3 cities in India identified 15 cities in priority segments such as finance and accounting (F&A), financial services, pharmaceuticals and logistics, which have the potential to become BPO hubs. Everest ranked these cities based on multiple parameters including overall and segment-specific talent availability and employability, current and planned presence of domestic industry, addressable BPO market potential, and presence of third-party vendors and captives.

EXHIBIT 2

Everest Group's ranking of potential BPO hubs in India

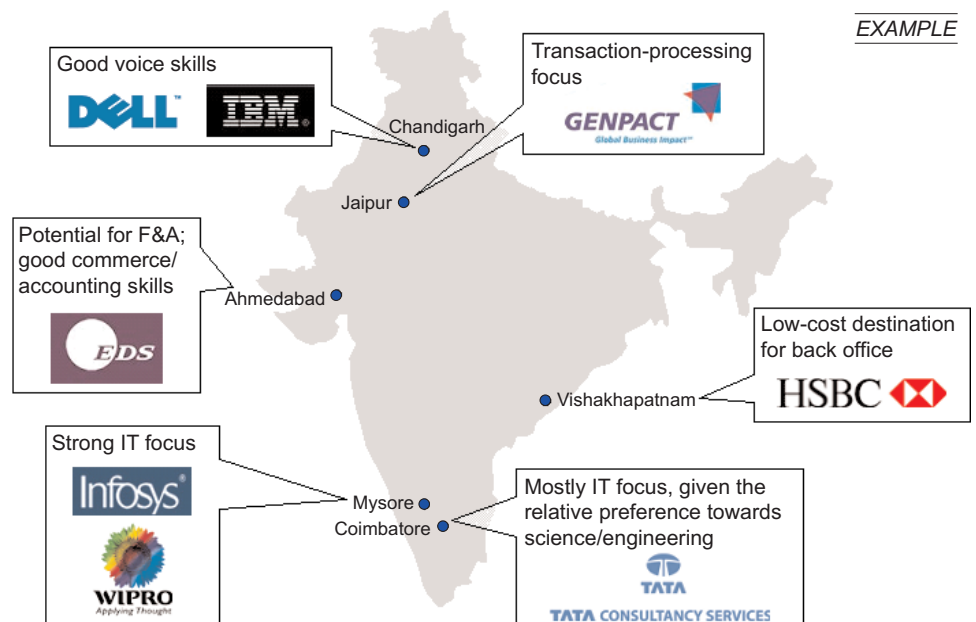
Everest Group's ranking of potential BPO hubs in India			
Multi-sector hubs Bangalore, NCR, Mumbai, Pune, Chennai, Hyderabad, and Kolkata			
Finance & Accounting 1. Ahmedabad 2. Nagpur 3. Jaipur 4. Indore 5. Nashik	Financial Services 1. Ahmedabad 2. Jaipur 3. Nagpur 4. Vadodara 5. Chandigarh	Pharmaceuticals 1. Ahmedabad 2. Vadodara 3. Aurangabad 4. Nashik 5. Ludhiana	Logistics 1. Nagpur 2. Vishakhapatnam 3. Ahmedabad 4. Coimbatore 5. Mundra

Ahmedabad ranked first in segments like financial services and F&A primarily due to a large pool of graduates from Finance and Commerce programs, a large pool of qualified accountants, and the presence of financial institutions (e.g., banks). Aurangabad and Nasik scored high in the pharmaceuticals segment primarily due to the large presence of pharmaceutical players in these areas. Nagpur emerged as a hot favorite in the logistics segment because 17 percent of the city's working population currently work in the transportation sector and because of its increasing emergence as a central logistics hub for India.

A similar approach would be applicable for emerging cities in other countries (e.g., Brno in Czech Republic, Cebu in Philippines, and Curitiba in Brazil).

EXHIBIT 3

Tier-2/3 cities are attempting to carve specific niches in the offshoring space based on their distinctive leverage points



Initiative 2: Creation of an ecosystem conducive for BPO operations

Local governments in these cities will need to make investments to develop the supporting infrastructure required for BPO operations. Development of the appropriate physical infrastructure (e.g., air and surface connectivity, telecom, local transportation, and housing) and social infrastructure (e.g., healthcare, education, security, hotels, entertainment, and shopping) is important to both attract initial investments and sustain operations in the long run.

A compelling proposition is for players in the BPO industry to potentially co-invest with government to make the initial forays into these cities. In India, there are instances of players partnering with the local government to set up large campuses and service delivery centers, thereby seeding the ecosystem for further growth. For example, in India, the Mahindra Group along with the Rajasthan State Industrial Development and Investment Corp. has set up a township with world-class infrastructure facilities in Jaipur, which has attracted investments from global companies. In other instances, state governments have made the initial investments to set up infrastructure and facilities ahead of demand, as illustrated by the city of Indore in central India.

In many cases, players will need to make the initial training investments to ensure that the skills of the local labor pool are upgraded to be suitable for offshore BPO services.

Key lessons include:

- Local governments need to proactively identify and initiate plans to develop BPO hubs. For example, the government of Gujarat (a state in India) plans to develop the Ahmedabad-Gandhinagar area (a region in the state) as a financial services BPO hub to exploit the region's inherent strengths in financial services.
- Players will need to carefully assess skills available in Tier-2/3 cities and build their capabilities accordingly. Focusing on cities for specific skills or domains helps create future BPO hubs. For example, while Jaipur has about 29,000 graduates per year, only ~1,700 are actually employable for voice-based BPO. However, Chandigarh, with an annual graduate pool of 25,000, has a more employable workforce of about 4,500 graduates for voice-based BPO.
- Players need to be aware that some Tier-2/3 cities will require training investment. However, much of this is likely to be offset by the benefits of accessing an untapped labor pool, lower cost of operation, tax benefits through location in an SEZ, etc.

Conclusion

Offshoring's first step was moving work across great distances. Ironically, the next major move is much closer to home but potentially more challenging to find the appropriate management, infrastructure, and labor pools. Those companies and countries that venture into the next wave of locations must proceed firmly and thoughtfully to ensure that offshoring's maturation is as smooth as possible.

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