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HEADLINE: VCs Encourage Companies to Move Offshore

BODY:

India is set to establish its grip at the core of the US IT industry in coming years, as growing numbers of Silicon Valley start-ups use less costly offshore professionals from the country to help develop their new products.

In fact, US-based venture capital firms are encouraging their charges to use, or at least investigate offshore facilities in India, and other countries such as China, according to several reports in local US newspapers this week.

"There isn't a board meeting that goes by that we don't ask, 'Why aren't you being more aggressive (with software development) in India and China?'," Jim Breyer, a managing general partner of Palo Alto based Accel Partners, told the San Francisco Chronicle. "25% of the staff at Accel's portfolio companies are employed overseas - this is up from 5% five years ago."

John Ludwig, a partner at Bellvue, Washington-based VC firm Ignition Partners told the Seattle Post-Intelligencer: "Venture capital dollars are tighter than they were three or four years ago, so these entrepreneurs are looking at everything they can to do to make a dollar last. And if they can extend the life of their company by a multiple by doing some work offshore than that is probably a good thing to do."

Almost 15% of Ignition's portfolio companies have an offshore strategy, while Seattle, Washington based OVP Venture Partners claim that 10% of the new business plans that arrive on their desks incorporate an offshore component. "This is something that everyone in our industry is thinking about," said Bill Miller, a partner at OVP.

But the risks associated with offshore development are significantly higher for small start-ups. Although India provides a high level of skilled programmers, skills in packaged software are lower, and Silicon Valley still provides the best software designers and "ideas people" that are crucial to the development of a product for an early stage software company.

Miller used the example of AskMe, a portfolio company of OVP that tried to move core product development work offshore a few years ago. The company ultimately dropped the idea because the overheads of managing a global team were too much for such a small company, and the quality of services faltered. The challenges of offshore usually outweigh the cost benefits for young companies, said Miller.

However, there are a number of US and Indian offshore services companies that are increasingly focusing on product-specific software development, and providing offshore services to smaller US-based companies.

Palo Alto, California-based Symphony Services is one such firm that targets packaged software companies and start-ups for offshore services. It is part of the Symphony Technology Group, a venture capital firm that has companies such as Agilisys, Counterpane and Industri-Matematik International on its books.

Another company, Sierra Atlantic, a Fremont, California-based software developer that uses a hybrid onshore/offshore model to provide product development services for software vendors such as Oracle, Siebel, and PeopleSoft. Its executive vice president Marc Hebert told ComputerWire that a third of its revenue (about \$ 8m annually) already comes from software product-related work.

Hebert said his company is increasingly seeing demand for offshore services from smaller software companies and start-ups, but that these type of clients typically need a much higher onshore focus to reduce risk, making the offshore cost-reduction argument somewhat defunct.