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## Attracting Offshore R&D Centers: Insights from Indian High-tech Companies



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# Background



As governments understand the link between technological innovation and economic prosperity, they are not only enabling domestic firms to excel, but are also aggressively trying to attract foreign R&D. Governments believe attracting foreign R&D in short-term will create domestic employment, but also help the country to grow technologically in long-term. Ageing population, lack of enough qualified professionals in particular fields, limited higher education professionals and bias in domestic education systems, paths of industrial development policies pursued and their limitations are all forcing the governments to pursue attract foreign R&D strategy. On the other hand, foreign firms setting up R&D centers believe a market presence will help them to gain a foothold in a new geographic market, or increases their access to key consumers. In industries such as IT some countries because of their high internet penetration may be the ideal ground for foreign firms, especially if their domestic IT market is weak or emerging. To attract foreign R&D, governments are offering financial assistance, talent pool assistance, business intelligence and ease of rules and regulations. Governments are offering soft loans, tax benefits and concessional infrastructural support on the lines of soft landing program, etc. Browne & Mohan looked at policies pursued by different governments and expectations of the R&D firms, and present insights through this whitepaper.

## What different Governments offer?



The R&D incentives provided by Hong Kong under the Special Tax treatment control Program consist of over US\$10 million fund that offers direct cash grants will be given if a R&D center is forecast to have significant economic impact even if it does not hire a set number of new researchers. The Hong Kong government also provides cash amounting to 10 percent of total investments if a laboratory hires more than 10 researchers with master's degree or above. The other benefits provided by the Hong Kong government are in terms of infrastructural support like rent support to foreign laboratories that set up operations at dedicated R&D buildings.

Under the Special Tax treatment control Program Germany offers the highest possible levels of support for investment within the European Union. Large companies can receive grants up to 30% of their total investment medium sized up to 40% and small companies up to 50%. In contrast to some eastern European countries, where in some cases support is provided in the form of tax breaks, these are cash grants that are paid as initial investment expenses are incurred and therefore have a significant impact in the early phases of the investment project. Foreign investors can also make use of a series of additional support programs, which, in addition to investment cost subsidies, also include R&D funding, low interest loans, and subsidies for wages and employee training.

Italy provides attractive R&D investments schemes under its Non-resident Italian research scheme. Under these schemes the startups enjoy the benefits like 3 years, 90% tax exemption for personal tax and total exemptions of regional taxes for all R&D labs established by non-residents in any part of Italy. Mexico has introduced an unique landing program that ensures free office space in a University, helps companies locate software engineers and managers, and helps firms navigate Nuevo Leon's state government procedures. The Soft Landing program also includes assistance with housing for expat executives and managers new to Monterrey and provides information needed to minimize culture shock. Singapore also offers attractive R&D incentives under the IDA Program like 50% reimbursements of salary cost of R&D professionals or development engineers hired at Singapore office. Tax exemption scheme for new start-up companies can claim for full tax exemption on the first \$100,000 of normal chargeable income (excluding Singapore franked dividends) for each of its first three consecutive Years. Starting from YA 2008, a further 50% exemption is given on the next \$200,000 of the normal chargeable income (excluding Singapore franked dividends) for each of the first three consecutive YAs. Tax deduction of cost is limited to 100 per cent where the expenditure is incurred outside Singapore.

Canada offers a permanent 20% flat R&D tax credit and also many provincial governments offer various incentives (e.g., refundable credits) for R&D activities conducted in their provinces. In China, a R&D center, designated as high and new technology enterprise can enjoy a 15% reduced tax rate, instead of the 25% corporate income tax rate, and potentially a tax holiday of 2-year tax exemption and 3-year 50% deduction if located in the prescribed areas. Also a 50% super deduction is allowed in expense deduction for R&D expenses that are not required to be capitalized as intangible assets. South Korea offers tax holidays up to 7 years, etc to attract high-technology businesses. Korea is planning to offer cash grants if the R&D centre is forecast to have significant economic impact even if it does not hire a set number of domestic researchers. It also offers rent support for dedicated R&D buildings and infrastructure.

# Indian ICT companies perceptions and want?



Till recently, Market perspective outweigh other considerations for Indian ICT companies while selecting offshore R&D or development centers. Large domestic market skewed their decision towards USA and UK primarily, while access to strategic market determined their preference of Mexico and Canada. Post economic downturn, the companies are seeking newer destinations that also offer significant advantages and incentives. Countries endowed with quality research-intensive universities and institutes and availability of highly skilled manpower attracts interests from enterprise application companies.

Special tax exemptions, tax holidays, export and import based incentives, losses against future profits and accelerated capital depreciation are also determining the choices of new offshore R&D destination. Startups and innovative SME's prefer direct support for infrastructure set up, provision for business intelligence, and easy rules and regulations. Countries that facilitate programmed University-industry linkages such as Mexico and Italy are preferred destinations by vertical product firms.

While South Korea and Japan rank highest on the minds of Gaming and Social Media companies, lack of immersion programs and targeted campaigns is hindering their international plans. Startups look for easy establishment of office (plug and play) and also for recruitment assistance. They also look for the tax incentive for fixtures and fittings, foreign tax credit for foreign sourced income, overseas talent recruitment scheme and equity remuneration incentive scheme.

## **Governments attracting Indian ICT may benefit from:**

- ❖ Promoting offerings in select business and technology platform and creating program champions.
- ❖ Offering direct infrastructure support and immersion programs (if business language is non-English) to attract startups and young SME's should offer.
- ❖ Improving Indian firms appreciation and understanding of host countries capabilities can enhance their interest and understanding of the R&D being carried out and culminate in useful partnership.
- ❖ Targeting specific foreign ICT companies to participate in the national program and over period wean them to host development R&D offices on their soil.
- ❖ Designing programs that involve domestic Universities and Indian ICT firms in key research areas.
- ❖ Creating entrepreneurial programs around world class universities and involving targeted ICT company executives as adjunct faculty could accelerate investments in social media and gaming sector.
- ❖ Targeting Micro-finance, Saas players, Social networking, Gaming, Mobile VAS, payment ICT players

# Conclusions



Increasing globalization and technological flows across boundaries implies Governments cannot sustain competitive advantage by focusing on domestic R&D alone. The experience of developed countries such as USA (which has the highest inbound R&D entrepreneurs) underscores the point that success depends upon attracting and assimilating technological ideas from all borders.

Governments need to innovate on assimilation programs, incentives and linkages to attract talent and entrepreneurs from India to establish R&D centers. Pursuing policies that only ensure local employment may be counterproductive. Programs that tie up domestic universities research capabilities, national R&D programs and the foreign firm R&D can accelerate the technology development and technology led entrepreneurship.

Support for intellectual property protection, improving legal and administrative requirements may also be required to attract talent.

In the final analysis, success of attracting R&D depends on each country's willingness to take measured risks, and implement changes.

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