South Asia

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The Bangalore experience goes Baltic

By Indrajit Basu

KOLKATA - Whenever Scott Livermore, the Boston-based engineering manager at Pilot Software, a United States-based strategy management software company, runs short of programmers and needs outsourcing, he turns not to what has been obvious so long to many of his competitors: an Indian information-technology (IT) outsourcing service provider. Instead, he hops on to a flight to Moscow to seek the services of Auriga, a boutique software-services vendor in Russia that has 250 software programmers.

According to Livermore, he had to look away from India not just because Pilot's experience with offshore programmers in India didn't work for his company, but also because "Russian programmers work just as well as their American counterparts, and come up to 40% cheaper".

To all the fans of India IT outsourcing talent, Pilot Software (a subsidiary of the German software giant SAP) may appear one of the few cases where the India experience went sour. But Pilot is not an isolated example. Even as many Western companies continue to turn to India for their IT and business services needs, a growing number of large as well as smaller outsourcing services-seekers from Western Europe and the United States have realized that "Bangalore" lies not just in India, but also in Central and Eastern European countries such as the Czech Republic, Hungary, Poland, Russia, Ukraine and Belarus.

"Central and Eastern Europe has established itself as a prime location for offshore and near-shore services, particularly for clients based in the United States and Western Europe," said the global research outfit IDC in a recent report. And although the IT outsourcing market of the region is still tiny - about 1% of the nearly US$386 billion global outsourcing market - IDC estimated that the value of IT services-related exports from Central and Eastern Europe to the onshore location (eg, the United States and Western Europe) for expenditures by a third party had exceeded $1 billion.

Moreover, if the value of captive services operations, such as specialized research and development centers or dedicated back-office functions, is included, the revenue numbers could far exceed that estimate.

India has shown the way and the Eastern Europe and Central Asia region, as its economy tries to quickly integrate with its more affluent Western neighbors, is trying to become not only the extended workbench of high-cost companies, but also their back office.

"There has been a significant shift in the outsourcing strategies that many companies are adopting lately," said Alexei Miller, executive vice president of Data Art, a provider of high-end software outsourcing services for small and medium-scale enterprises. Although Data Art is headquartered in New York, it runs its development center in St Petersburg, Russia, and also maintains an office in London, a market that according to Miller contributes almost 50% to his company's total revenues because Data Art can serve from Eastern Europe.

"Outsourcing from India has been the mainstay for many smaller and medium companies

globally. And in the last five years there have been many success stories, but many negative stories as well," said Miller. "The current realization is that if you want to strike value out of an outsourcing relationship, you have to think deeper and look beyond India to get something else. And that something else cannot come from one location but from many locations and from many vendors."

What is unusual about this trend is that even as costs in Eastern and Central European countries are relatively high and human resources are still scant compared to their Asian counterparts, something other than cost savings is driving companies to the region.

"While price is what initially drives organizations to consider using nearshore and offshore resources, companies are realizing that it must be balanced by other considerations," said the IDC report. These include things like the stability of the relationship (ie staff turnover on the project) and shared management values. Take the instance of Hermes Software, a 600-employee, $55 million revenue IT services company with its headquarters in Slovenia and development centers in Croatia, Serbia, Vienna, Stuttgart, Dublin and Sarajevo.

"Our edge over Indian companies is proximity to our customers," said Hermes chief executive officer Peter Testen. "We address customers which are close to their territories, and being pretty much of the same cultural background, it gives us some specific advantages like a better understanding of their problem, faster, and most importantly being able to offer appropriate solutions to customers that have problems connected to time-to-market."

Western companies see other factors such as time zone differences, a similar work ethic, and the clear understanding of business issues as important criteria that drive many companies to Central and Eastern Europe instead of India.

Indeed, a smaller time zone difference makes communication easier, and "this means that vendors are much more likely to throw something over the fence and get something back that they want without having to send project managers at very step of the way, and without having to craft super-detail technical and design specs [specification documents]", said Steve Keil, CEO of Sciant, another boutique IT services vendor with headquarters in Zug, Switzerland and its main development center in Sofia, Bulgaria.

Nevertheless, outsourcing to Central and Eastern Europe is not an easy decision and there are still a few challenges that confront those choosing to do so. "The companies face difficulties scaling," said Peter Schumacher, founder of the international strategy consultancy Value Leadership Group. "This is a weakness. For example, in Ukraine, setting up a 200-person team would require up to nine months. In addition, the work would have to be split across multiple locations, perhaps as many as four. These are important constraints that make it difficult to shift large projects to nearshore locations."

The other problem is attrition, according to a Value Leadership study as in many of the Central European and East European countries attrition levels are increasing; rates of 10% to 15% are not uncommon. This has resulted in a problem that India also faces. "Since these states are partly driven by the small size of the talent pools in each country, compensation levels across nearshore markets are increasing rapidly too," said Schumacher. "In some countries, for example Slovenia, there is a shortage in IT professionals. Other countries are experiencing a brain drain. For instance, about 1 million people have emigrated from Poland these last years to seek opportunities and take up positions in the United Kingdom and other countries."

The moot question, therefore, is what then? Should it be India or the European upstarts? This is a tricky. According to experts, while there are similarities across the region as a whole, buyers must address each country individually when assessing its appeal and viability as an outsourcing destination. For instance, said Alexis Sukharev of Auriga, "Even though the Central and East European IT export industry is still [relatively] small and fragmented, it has

some unique features, like strong engineering talent and programmers who show more flexibility than some other offshore locations."

Moreover, added Schumacher, the nearshore firms offer a unique positioning because the economics of offshore projects favor larger projects. "The cultural proximity of the nearshore firms allows for an efficient start-up process and gives nearshore firms a productivity edge with small projects," he said. Many smaller and medium-sized IT services-seekers in the Western world see this as a benefit as they need vendors who can provide high-impact small teams on short notice.

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