

Russia: From the Lab to the Back Office

Russia has been a high-value tech destination, sometimes preferred even over India. But now, it wants to get out of that label and do more. Financial services is the first target

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It may not exactly be an alien name, but the story of Russia, by and large, remains unsung in the world of offshoring. And this, despite the fact that in 2004, the country exported \$560 million of IT services to the world, primarily the US. And by that measure, the country is next only to India, China, and Ireland, and far bigger than top-of-mind locations such as the Philippines, Mexico, and all the other Eastern European nations combined.

Yes, it still looks tiny compared to leader India's export of \$17 billion of IT and what the Indians call IT Enabled Services (BPO) in the same year.

Yet, that is not what is worrying the Russians. After all, India started out much earlier and has a huge manpower base. And what is often hidden in the top level statistics is the fact that the entire export of Russian IT industry were generated by a workforce of mere 30,000 people. That kind of realization is comparable only with that of top Indian IT companies. In other words, Russian IT work is of higher value than that of India.

And the Russians have never been tired of pointing it out. Talk to Russoft, the largest IT industry association. There is every possibility that you will hear how Russia has 20 times as many scientists on a per capita basis, as compared to India; how a vast majority of Russian software engineers and computer programmers have MS or PhD degrees in mathematics or physics; and how Russia is the first destination for research and innovation, where India is the choice for standard IT jobs, with lots of coding requirements. And the fact is—minus the standard exaggeration that you expect in any marketing statement—what the Russians claim is more or less right. Russia has indeed been a destination for research and development, especially in areas like aerospace, engineering, and product design.

So What is the Problem?

Good business is a mix of value and volume. For a new destination like Russia, what is of paramount importance is growth. And that has of late been a cause for worry.

In 2004, Russians IT exports grew just about 17 per cent. This was in comparison to 60 per cent growth registered a year before. Though Russoft projects a somewhat better 32 per cent growth in 2005, it is still not impressive, especially at this small base. A country like India, with its size, still grows at 40 per cent or so.

Russia's New IT Labor		
Labor force	2002-03	2003-04
IT engineering graduates	42,138	45,994
Math and physics graduates	21,777	22,132
Non-IT engineering graduates capable of entering IT Workforce	69,072	76,435
Graduates (other discipline) capable of entering IT workforce	70,631	81,270
Total fresh IT labor force	203,418	225,831

Source: Auriga Research

It is not the best of situation, but hardly surprising. The Russians so far have been successful at bagging the high-tech development and design work. Look at Russia's captive

"development" centers that give a better idea of the companies' commitment to a location, at least initially. Those who have been to Russia with love include Intel, Boeing, IBM, Cisco, Motorola, Dell, Siemens, HP, and Microsoft. In contrast, look at the India list. All the companies above are of course there, but so are AOL, AXA, ABN AMRO, AIG, Bank of America, Butler, Citibank, COLT Telecom, Goldman Sachs, HSBC, JP Morgan Chase, Lehman Brothers, Lufthansa, McKinsey & Co, Morgan Stanley, Prudential, P&O Nedlloyd, Reuters, Standard Chartered, Tesco, and Unilever, to name a few.

And now, you can see the difference. Whereas Russia's IT game is restricted to the hi-tech industry, India's is far wider, spanning retail, telecom, energy, logistics, and financial services. And as a discerning reader, you may not have failed to notice that even in India, the majority is from what can broadly be called financial services industry-BFSI, as they are together called in India-the biggest outsourcing community globally.

Without tapping into that segment, it is difficult to grow beyond a point. The good news is: the Russians have finally realized it.

The Lure of the Money Men

According to a Deloitte Research report, *The Titans Take Hold: How offshoring has changed the competitive dynamics of global financial service institutions*, released in May 2004, as much as \$144 billion will be spent by financial services industry in offshore operations which will increase to \$261 billion by 2010. In a recently released report, *Better, Cheaper, Faster: Business process transformation in financial services*, Economist Intelligence Unit (EIU) has found that this will happen across the sub segments of financial services, such as wholesale banking, retail banking, asset management, insurance, and investment banking. As many as 62 per cent of bigger financial services companies (revenue in excess of \$1 billion) either outsource, or plan to outsource in a maximum of three years to a third party in an offshore location. Add the captive centers and the percentage would rise dramatically.

The same EIU report also notes that on being asked where they intend to outsource their business processes (including IT), India predictably featured on top among offshoring destinations. But it was followed by new EU states, and rest of Asia Pacific, with Russia and CIS just making it with less than two per cent preferences in back office, and enterprise services, and zero in front-office services.

Theoretically, Russia could try at least what is intended to go to new EU states. And that is what they have realized.

When we spoke to Russian companies, majority of them wanted to talk about their capability in financial services, reflecting what occupies the mind space of the top marketing people in Russian outsourcing companies.

But Can They Succeed?

Well, they certainly believe they can-and wants everyone to believe that they can-even though the idea of developing financial software systems still evokes a jittery response among industry insiders. There is a popular saying in the financial IT community, "It can only work well when a programmer is literally sitting next to a trader or analyst." However, slowly, but surely, this mentality is giving way as companies are adopting more structured project management practices. Most outsourcing vendors address this issue by offering hybrid on-site/offshore models. But the real question is how well can remote groups understand specific requirements and adapt to the fast paced environment of financial institutions?

Well, the answer lies with the highly trained Russian project managers. While Russian project managers might not be as savvy as in-house personnel, they are strong contenders. Many young people with MBA degrees abroad worked in US companies, and then have

returned to Russia to fill top positions in finance IT and management consulting companies, obviously enriched with wealth of Wall Street related knowledge.

According to a Forrester Research, many Russian companies understand the importance of system project management and have taken steps to acquire necessary knowledge, adopting standardized quality practices. Many have developed sophisticated and transparent project management systems, streamlining communication and allowing clients to track projects in real time. They are confident and believe that they would be able to replicate their success in hi-tech and R&D in this sector too.

Russia's New IT Labor			
Company Name	Profile	Expertise	Major Clients
LUXOFT	Leading software developer and IT services exporter	IT, Manufacturing, Energy, Aviation, Finance, Govt sector Bank	Boeing, Dell, IBM, Deutsche Bank, Citi Bank, Google
Reksoft	Leading ISO-9001 certified company	Outsourcing & technology consulting, application development, maintenance, deployment of dedicated development centers	Ascom, Alcatel, Avaya, Benefon, Philip, Morris Swisscom Mobile AG
Auriga	World's leading software services firm with engineering centers in Russia	Develop, test and maintain the most competitive software products and solutions	BroadVision, Ecora Software, LynuxWorks, NMS Communications,, Pigeon Point Systems (PPS), Pilot Software
DataArt	Premier offshore software outsourcing company serving the needs of SMBs in the U.S. and Europe, with headquarters in New York and an R&D center in St. Petersburg, Russia	Develops mission-critical, custom-tailored solutions for most demanding areas of investment process	AC Nielsen, Samsung Electronics, Inglet, the British Council
VDI	Experienced global software outsourcing provider	IT, Telecommunications, Healthcare, Financial Industries	Mobile TeleSystems, Sonet, VimpelCom, Sberbank ICOSR, International Bank of Moscow
Aplana	Member of leading Russian technology group I.T.Co & testing	Custom software development, maintenance & testing	GE, Tetrapak, P&G, Wrigley
Mirantis	Mirantis is a premier provider of managed offshore development center for major software, hardware, biotech, and other sophisticated	Leading provider of BOT model ensuring a system process that guarantees a smooth transition from the managed technology development centers to a wholly owned company	LondonBridge Software ware, MIPS Technoloies United Health Group, Veritas
EPAM	Provider of IT	Provides software	Reuters, London

	outsourcing and software services and solutions in Central and Eastern Europe	development, e-commerce and content management services to forward-thinking companies and government organizations in over 30 countries worldwide	Stock Exchange, NumeriX, World Bank Group, SAP, Microsoft, BEA Systems, Hyperion
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And Why Not?

Well, may be the Russians have a valid reason to feel upbeat. According to DataArt Executive Vice-President, Alexei Miller, "Today's Russia has the right combination of talent, expertise, and cost to be the location of choice for developing financial technology." DataArt is a leading provider of high-end software outsourcing services for SMBs, specializing in enterprise application development, system integration, and business automation tools, with industry-specific software expertise in financial, telecom, and media sectors.

The strong background of Russian developers in mission critical real-time systems, math modeling, and scientific, and military application is well recognized. However, there is a much less known fact that from the days of the former Soviet Union in the 1980s, hordes of Russian immigrants in the US have established themselves in the US financial services industry. Visit an IT department of any major New York financial services company – and there is every possibility that you will find a significant number of Russian speaking staff doing either quantitative analysis, complex algorithm modeling, or source code development.

Now, with the fall of the Soviet Union and the establishment of a free market economy over the last 15 years, there's been some flow of expatriate professionals from the US and Europe who successfully transferred back to Russia a great amount of financial sector expertise. Some expatriates with critical domain knowledge and experience took leading position in IT outsourcing firms providing services for the US and European clients. In addition, the recent economic boom in Russia has attracted major financial institutions around the globe like Citigroup to establish local Russian presence.

Just a few years back, it would have been quiet impossible to find a software engineer with sound knowledge of Wall Street in Russia. Today, even though there is a considerable difference in the Russian and Western financial markets, many Russian developers have become experts in the financial technologies, as a number of leading US and UK software providers contracted and trained them, or launched dedicated R&D centers in Russia. There are groups with substantial experience in risk management, trade order management, electronic trading, pricing, swift, and other aspects of financial technology.

Russian Vendors Gear Up

Not wanting to lag behind, many Russian vendors are investing heavily into knowledge transfer and business domain skills across the organization, to capture the business pie. A good number of Russian vendors such as Luxoft, EPAM Systems, IT Consulting International, Rekssoft, DataArt, eStyle Software, InfoPulse, Leaves, FORS are notable examples of businesses with niche specialization in the financial industry. They provide services to leading Russian banks (such as Sberbank, or Petrovsky Narodny Bank) and to Fortune 100 financial clients including global investment banks such as Deutsche Bank USA, Commerzbank, and ABN AMRO.

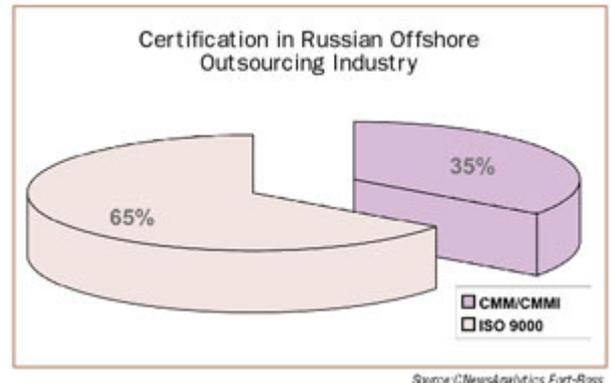
Luxoft has Deutsche Bank among its clients. Others like EPAM Systems, the largest outsourcing provider in Eastern Europe has clients which include financial heavyweights like the London Stock Exchange and Reuters, and Rekssoft, manages an offshore center for developing mission-critical trading systems for a leading European banking institutions. So, may be they have every right to feel upbeat.

Luxoft Vice-President, Lilia Tsalalikhin aptly summed up the Russian determination when she observed, "Driving this is an obsession with quality, conformance to global standards, and an end-to-end approach to service." Luxoft is Russia's largest software development outsourcing company, providing its clients with a full spectrum of software development services performed in dedicated offshore centers or on customer sites.

Versus India

Svetlana Vronskaya, Director, Corporate Communications, Reksoft is of the view that Russia and India need not compete. "There are different types of projects that go to these countries." Lilia Tsalalikhin goes a step further. She observes, "Looking into the future, Russia is predisposed to taking a leadership position in emerging high-end knowledge-based outsourcing, as global corporations start moving processes like data and intellectual property researches to offshore locations."

Steve Chase, the head of Intel's branch in Russia sums it up when he says, "We at Intel have a saying: Give the urgent projects to the Americans, big project projects to the Indians, and the impossible ones to the Russians."



That was the positioning in high tech. If Russia wants to keep that positioning in financial services, it is going to be pretty challenging. -

The West still does not see them that way. In India's case, coming of Amex and GE helped. They acted as anchor investors in offshoring. What catalyzed the process is the relentless campaign by NASSCOM, with a little help from Indian government. What NASSCOM did-and many associations in the emerging countries fail to do-is NASSCOM never allowed itself to be the platform for Indian vendors. Rather, it has become a neutral "India" champion, with active members including not just captive subsidiaries but companies like IBM, EDS, and CSC etc.

For Russia to be successful in financial services, it has to sell its capability, get in at least one anchor investor, ensure that there is no discrimination between the Russian companies and outside companies, and finally incentivize companies to come to Russia.