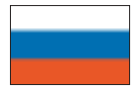


# Global Outsourcing Report 2005

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# Russia



## RISK DIMENSIONS

**POLITICAL RISK:** Highly censored and controlled; stable and “strong” government of President Vladimir Putin; corruption is an issue, mafia is still all-around but less of an issue in IT/software outsourcing. While some progress has been made on the economic front, recent years have seen a recentralization of power by President Putin and an erosion in nascent democratic institutions.

**LEGAL RISK:** Old-fashioned tax/legal system, law not fully enforced and IPR not really respected. Weak protection of intellectual property rights; considerable progress in revising several of its intellectual property recently; progress toward alleviating red tape and bureaucracy; strict labor laws; government only recently supporting IT growth; piracy of works on optical media is a significant and growing problem.

**CULTURAL RISK:** European culture, but still early stage of capitalism; close to Nordics; cities like St. Petersburg are full of European culture; creative and innovative people; affinity toward Europe; limited understanding of foreign markets, customer service and culture; ability to work in undefined environment and succeed. English is being practiced at top levels and people are gaining proficiency, but most programmers still have difficulty with the English language. Russia is proving a convenient location for Nordic companies looking for inexpensive, highly skilled labor.

### ECONOMIC RISK:

GDP—purchasing power parity: \$1.282 trillion

GDP growth: 7.3%

Constant growth, averaging 6.5% annually; high oil prices and a relatively cheap ruble are important drivers of this economic rebound; high-growth perspectives, but high volatility as well, firm economic policy; high inflationary trends; tight currency controls.

Real fixed capital investments have averaged gains greater than 10% over the past four years and real personal incomes have averaged increases of more than 12%.

Russia has also improved its international financial position since the 1998 financial crisis, with its foreign debt declining from 90% of GDP to around 28%. Strong oil export earnings have allowed Russia to increase its foreign reserves to some \$80 billion. These achievements, along with a renewed government effort to advance structural reforms, have raised business and investor confidence in Russia's economic prospects.

Problems include a weak banking system, a poor business climate that discourages both domestic and foreign investors, corruption, local and regional government intervention in the courts, and widespread lack of trust in institutions.

President Putin is granting more influence to forces within

his government that desire to reassert state control over the economy.

### IT INFRASTRUCTURE RISK:

Telephones: 35.5 million

Internet users: 6 million

Improving infrastructure, but still inexperienced in managing large scale offshore development centers; communication costs are getting higher in St. Petersburg and Moscow. Communication costs are even higher outside large cities. many R&D labs and institutes; government is only starting to spend capital on improving connectivity and infrastructure; growth of specialized software companies; government is fostering programs such as Electronic Russia and others. Cost of bandwidth is expensive and infrastructure is poor in cities other than Moscow and St. Petersburg.

Telephone system underwent significant changes in the 1990s; there are more than 1,000 companies licensed to offer communication services; access to digital lines has improved, particularly in urban centers; Internet and e-mail services are getting better; Russia has made progress toward building the telecommunications infrastructure necessary for a market economy; a large demand for main line service, however, remains unsatisfied.

In the beginning of 2005, President Putin, announced the beginning a special program to set up, develop and support IT technoparks in four regions of Russia. This could signal the beginning of a shift from state support to the industry of the raw materials to the free development of high technologies and (ICT) information communication in the first place.

Putin noted that technoparks, with new zones with special economic conditions will be created to benefit information technologies companies. The benefits will include:

- Significantly reduced corporate and income taxes (up to 75%);
- No more than one tax audit in three-year period;
- Simplified custom conditions for the import of equipment and export of software products; no custom duties;
- Construction of affordable housing for young programmers, kindergartens, etc.

### IT COMPETENCY RISK:

Quality project management; excellent technical and management experience lacking, but growing; highly skilled IT workers

Custom Code Writing (body shopping): Average

BPO: Average, but growing

System Writing Project R&D: Excellent

Preferred country for R&D and innovation expansion. R&D creative experience; growth of specialized software companies;

# Russia *continued*



excellent research; extremely skilled programming workforce; expertise in large complex engineering and algorithms; project managing is lacking, but developing.

Programming, software/hardware reengineering, telephony-based solutions, wireless, radio technology, security, hardware technologies such as laser, substrate growing, molecular chemistry.

**HUMAN CAPITAL RISK:** Large pool of engineers, scientists, lot of young talent; stable workforce; small group of MBAs and managers; Russia has more than 20,000 professional IT Personnel and growing in IT field; Most Russian programmers have a formal science degree and have worked in complex defense programs. Programming is a secondary skill; major expansion in deep Russia/Siberia; leading universities focus on technology, engineering and IT.

With a significant R&D heritage, it is one of the world's best educational systems and the largest pool of highly qualified software engineers and researchers.

Labor force: 71.68 million

The World Bank estimates that Russia has the third-highest number of scientists and engineers per capita in the world

## COSTS

Labor costs are moderate but starting to grow in major cities; Moderate costs; cost advantage in remote areas of Russia.

## MARKET OPPORTUNITY

### **OUTSOURCING MARKET:**

2005: 20%

2006: 24%

2007: 23%

Compounded growth 2005–2009: 21%

(source: Forrester Research)

—Population growth: 0.45%

—Market Size: Region could exceed \$1 billion USD in outsourcing revenue by 2005. In 2003 exported IT services totalled \$475 million.

According to Ernst & Young, the Russian IT and telecommunications sectors are experiencing an average growth of 45% and are expected to reach \$20 billion in 2005.

Russia is planning to increase the current (U.S.) \$500 million software exports market to (U.S.) \$1.3 billion by 2008.

**GLOBAL COMPETITIVENESS:** Average to poor

**OVERALL ASSESSMENT:** Focusing on niche software companies; Russian companies tend to focus on building personal relationships; pay close attention to small projects; flat organizations; highly skilled, creative talent; Russian IT offshoring is expanding; economy has been growing to assist IT offshoring, government has to be more committed for IT outsourcing and lessen bureaucracy and restrictions; poor enforcement of IP; needs to bolster management.

**INDEPENDENT RATING:** Recently achieved investment grade status by independent Moody's Investment Services. Made the list of the world's ten most attractive countries for direct foreign investments.

**MAJOR PLAYERS:** Auriga, DataArt, Diasoft, EPAM, Estyle, Exigen and IBS/Luxoft

## FUTURE

Russia will become a major outsourcing center and the focus will be on creative solutions and R&D services; Russia has a large technical labor pool, but declining population growth; may become a center of intellectual growth and innovation.