



OUT AND IN CONTROL

Against all odds, Ukraine has become one of Europe's fastest-growing IT outsourcing hubs. **Justin Keay** reports

■ SEA CHANGE
 (Above) The Ukrainian port of Odessa at night. Buoyed by outsourcing, the country is experiencing new growth

For those familiar with its dysfunctional politics and its bureaucratic and opaque business environment, it seems a wonder that anything works at all in Ukraine. Yet despite the lack of progress in these key spheres since the 2004 Orange Revolution, green shoots have become evident: the IMF was obliged to raise its forecast for 2006 GDP growth from 2.5% to 6%, and foreign investment has been picking up.

Outsourcing has been one of the big beneficiaries; according to a survey published in June by IT outsourcing consultancy Global Offshore Associates Limited (Goal), Ukraine is becoming one of Europe's most attractive outsourcing destinations, fuelled by low labour costs, an increasingly Western outlook and a population of some 48 million. Goal found that the value of Ukraine's IT outsourcing sector alone rose 47% last year, to reach €179m. Given the large size of Ukraine's grey market and the high level of undeclared earnings in the country, this is almost certainly an understatement: Ukrainian Hi-Tech Initiative, an alliance of outsourcing providers, puts the real figure at around €436m. This may seem like small potatoes compared to India – the world's largest IT outsourcing market, valued at around €9.5bn and able to provide a complete range of high-tech and other services, including client-facing – and it pales alongside Russia's IT outsourcing market, which Goal estimates at around €708m; however, those close to the sector say Ukraine has built itself a comfortable, low-cost niche, with young, IT-savvy Ukrainians keen to obtain the stability, prestige and higher-than-local salary – around €130–€145 a month – that comes with working for a foreign-owned company. Furthermore, unlike in, say, Poland or Slovakia – which are now in the EU – employment restrictions mean local employees cannot up sticks and move to western Europe for the much higher salaries on offer there.

"The primary focus of the industry has been to provide dedicated software development teams to customers in the technology sector; web development is also strong," says **■**



■ **STRAIGHT TO THE SOURCE** Ukraine's rapidly improving IT skills base has been a key factor in attracting foreign companies

Banking on offshore

Despite wage rises in IT, business processes and call centres, the cost advantages of offshore locations for office services will last for another 20 years, according to a report by consulting firm AT Kearney on behalf of the Global Business Policy Council.

The most striking thing about the results of the Global Services Location Index, based on data for 2006, is how the relative cost advantage of the leading offshore destinations has declined almost universally, while their scores for people skills and business environment have risen significantly.

Reflecting the number of countries competing, the Index includes 10 new countries, including the three Baltic states and Ukraine. Newer contenders in central and eastern Europe are increasingly outshining more established players. Telecoms costs in many emerging markets dropped by 25% or more, as competition and volumes in the telecoms market continued to increase.

The highest-placed European location in the list – which ranks the top 50 services locations worldwide in terms of cost, people skills and availability, and business environment – is Bulgaria, followed by Slovakia, Estonia, the Czech Republic, Latvia, Poland, Hungary, Lithuania, Romania, Germany, the UK, Spain, Portugal, Ukraine, France, Turkey and Ireland. Meanwhile, a report from TPI notes that the total value of new European outsourcing contracts in the €40m-plus range rose 78% in the first half of 2007 compared to the same period last year. This represents €12.3bn in new business, or 54% of new outsourcing contracts signed globally. Just five years ago Europe accounted for only 12% of the global outsourcing market. Most of the growth reflects a small number of mega-deals worth in excess of €800,000, where telecommunications giants provide large networking solutions to corporate clients.

Goal CEO Natasha Starkell. Indeed, with more than 7,500 software developers across Ukraine (although Kyiv remains the heart of Ukrainian IT outsourcing, Lviv, Donetsk, Dnipropetrovsk and Odessa are all growing fast, with lower salaries), overseas customers have a large and growing supply base. German IT providers in particular have been attracted by Ukraine's proximity, with ease of access into and from the country, low wage costs and an eager, well-trained workforce all positives. Russia remains the largest client, however: along with geographic proximity, cultural and linguistic factors are a primary reason for this and have proven especially important in enabling management to work effectively with outsourced IT teams.

Aleksander Farstad, CEO of eZ Systems, an open source content management company that has had an IT outsourcing operation in Odessa since 2003, admits people were the main magnet. "Ukrainians are highly educated with a European cultural background, and this is very attractive for companies outsourcing there," he says.

Dmitry Loschinin, CEO of Luxoft, one of Russia's largest software companies with clients including Dell, T-Mobile, Deutsche Bank, IMB and Harman/Becker, echoes this. He adds that the soft skills of Ukrainian workers – such as the ability to speak English, understand commands and work well with management – have been a big positive. For these reasons Luxoft's Ukrainian outsourced personnel have increased from 45 to around 150 in Odessa, and from 280 in Kyiv to an expected 600 by the end of 2007.

Loschinin is optimistic about Ukraine's IT future, and states that as skills evolve and become more sophisticated the country will attract the likes of Microsoft and other Western IT companies; the fact that IT salaries in central and eastern Europe are rising fast will accelerate this process. "In terms of delivery footprint, this is one of the fastest-growing markets I know," he says.

Allan Martinson is head of Martinson Trigon Venture Partners, which has invested heavily in Baltic IT. He argues that Ukraine needs to focus on broadening its IT skills and thinking internationally rather than in local terms. Others argue that for the industry to continue to develop Ukraine needs to improve its image, something that can really only happen at the macro level as issues of business corruption and political paralysis start to improve. Costs must stay stable – although right now this does not seem a problem, with wage costs in Kyiv at least 20% below Russia, while those in Dnipropetrovsk are 35% lower – and infrastructure needs to improve at almost every level. "Cons here include technical infrastructure – electricity and telephone lines are expensive and unstable – and legal infrastructure," says Farstad.

Most agree that the industry can look forward with confidence to continued growth. A report released in July by outsourcing agency TPI says that over 2007 so far, demand for outsourcing in Europe has powered ahead; the continent now accounts for 54% of new global outsourcing contracts against just 32% a year ago.

Assuming the government allows entrepreneurship to flourish – and doesn't drown it in taxes and petty bureaucracy – observers say that with a little luck, Ukraine's growing IT talent could yet deliver a surprise, in the form of a major new IT product company.

"The DNA of outsourcing companies is and will always be different from the DNA of technology/product companies," argues Martinson. "An offshorer will not develop the next Skype, but it can develop the person who will." ● **EB**