Rocky road ahead for the CIS' rough diamonds

By Alex Brownsell and John Garratt

Much has been made of the rise and rise of Russia's IT industry, with local players and international titans boasting mighty annual growth rates. But what of the oft-forgotten former Soviet republics and their fledgling economies? We asked local experts to give us an insight into the developing IT industries of Ukraine, Belarus, Kazakhstan and the remainder of the CIS...

What is the Commonwealth of Independent States? The CIS group comprises eleven former Soviet republics: Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Ukraine, and Uzbekistan. Turkmenistan discontinued permanent membership as of 26 August 2005, though it is now an associate member.

In reality, though, the only parts of real economic and IT interest are Ukraine, Belarus, and Kazakstan. Although S&T CEO Christian Rosner reveals his company is a leading services provider in Moldova, and Georgia has a very west-facing government in search of investment, the chances are limited in these countries. Only Ukraine has anything resembling a western city, in Kiev, and is undoubtedly the most business-friendly environment in CIS. Therefore, Ukraine is probably the most interesting place to start.

The interest is not just European: last week, Ukraine was approved as a new member of the World Trade Organisation, the reward both for reforming its economy and for tilting towards the West rather than Russia. The agreement to make it the WTO's 152nd member will not be signed until summer, but even so, it looks as though Ukraine has beaten Russia to the prize.

The Ukrainians have been working hard on their credentials: two weeks ago, during a working visit to Brussels, Ukrainian Prime Minister Yulia Tymoshenko presented key provisions of her cabinet's programme to EU officials. Critically, these included the Tymoshenko Transparency Initiative (TTI), a new comprehensive initiative to improve Ukraine's investment climate by introducing European standards of business and government transparency.

Tymoshenko has, however, initiated a number of controversial policies which have instigated a spell of inflation and created in Kiev one of the more expensive cities in the world (it leaped 33 places over 12 months to become the twenty-first most expensive world city, according to a report by Mercer Consulting). Among the economic measures are overnight changes in the exchange rates in Ukraine that raised the value of the local currency, the Hyrvna, against all foreign currencies by 15%. Tymoshenko has also agreed to pay out $26bn (€17.8bn) to the population as 'compensation' for some of the losses incurred when the Soviet systems collapsed.

Such is the nature of a former Soviet state - investors must take the rough (political instability, highly localised business environments) with the smooth (mouth-watering growth rates). But GDP growth across the major CIS countries hints at a promising future. Despite its fluctuating economic policy, the Ukrainian GDP grew by 7.3% in 2007, while Kazakhstan and Belarus achieved growth in the region of 8.5%.

Business writer Marat Terterov, editor of the *Doing Business In...* series of books looking at the economic picture in emerging European markets, says economies in the region are doing "relatively well". From the Russian financial crisis in August 1998, most republics have registered consistent year-on-year GDP growth. Terterov singles out Ukraine and Kazakhstan for special praise.

"With exports getting cheaper, domestic raw material production and coupled with the high world prices for global commodities (such as oil and gas), Kazakhstan has done really well. There has also been prudent fiscal management of the economy in the country," says Terterov. He does admit, however, that the strong performance of states like Kazakhstan and Azerbaijan in the energy market is not always reflected when one drills down into other business sectors.

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Alan Hambrook, co-founder of R&D consultancy group Zoral, has come into regular contact with the Ukrainian IT world and enthuses as to its potential. "From our point of view, we see it booming, especially in the major sectors. IT is growing rapidly. And it's becoming simpler to do business, with regards to movement visas, infrastructure etc. The outlook is very positive," he says.

So what prospects are there for IT services and software players? The enterprise space remains hit and miss. Each of Ukraine, Belarus and Kazakhstan has burgeoning financial sectors, while telcos and government are also good sources for IT spending.

Valentin Kazan, VP at Belarus-based software developer IBA Group, identifies several vertical sectors with growing IT needs in his country: banking, railway, manufacturing, extractive industry, the chemical and petrochemical industries, and power engineering. He says: "Security systems differ in vertical industries. But all clients want the same: a quality product at a minimum price."


Valentin Kazan, VP IBA Group

"Banks are more exposed to international innovations. They are forced to do that to get international rankings," adds Kazan. For example, he claims, Belarussian banks will not implement popular local or Russian ERP solutions (such as 1C), and instead look to larger international vendors like SAP.

Arkadiy Dobkin, CEO at rival developer EPAM (which has offices in Belarus, Ukraine and Armenia), also highlights IT investment from insurance and retail businesses. "Although our target markets are still the US and western Europe, recently we started paying more attention to eastern Europe, and first of all to the Russian, Kazakhstan, Ukrainian domestic markets which are developing most dynamically," he says.

Over in Kazakhstan, Maxim Kazak - the head of Russian news and research organisation CNews Analytics - says that the national telco provider, Kazahtelecom, has been the busiest when it came to IT spending in 2007. Including the investment by Kazakh mobile providers, products from HP, Microsoft, Oracle and SAP have all been implemented.

"The financial and public sectors are also investing a lot into the development and modernisation of IT infrastructure. The primary and manufacturing sectors are only in the process of introducing IT, so peak expenses on IT can to be spared in the future," says Kazak.

2007 was a pretty good year for the Kazakh IT market, and it managed year-on-year growth of over 25%. A particular fillip came in the form of a $137.2m (€94.1m) e-government project set to run till 2010. But one ought to bear in mind, despite talk of all these projects, that the market for IT services in Kazakhstan is still very small by European standards.

Going on CNews figures, the total market was only worth about $150m (€102.9m) in 2007, though this is set to increase to $190m (€130.3m) this year. Most of this investment going on implementation (50%), while IT consulting is down at 10% of total spend.

Charles Arizmendi, SMS&P lead for CIS Microsoft, agrees that the financial services space along with the public sector is driving IT spend, but he suggests

that upper-middle enterprises are growing quickest of all. “The upper midmarket is growing twice as fast as enterprise. A lot of this is legalisation of software. They and the SMEs have been the least legal.”

Victor Tatarnikov at US business intelligence (BI) vendor Information Builders sums up his perspective: “As Ukraine is the most western orientated state in CIS, IT there is flourishing. Large IT budgets, a high variety of local IT companies and skillful human resources have lead to a large variety of different scale projects.”

“However, many states require excellent communications beforehand and rigorous documentation before anything can be facilitated, which is why these states are still in development. In Belarus the state is extremely centralised in the sense that all decisions regarding IT projects are made by government bodies, making it hard to create business.”

“Armenia has even less of an IT budget, work in this area in almost solely offshore programming. In a similar vein, Azerbaijan has not developed a full IT strategy, and is not a current target for us.”

Anyone with their eyes on the CIS markets should be prepared to come across some tough business terrain. Some of these issues come down to poltical instability, others simply due to the geographical nature of the countries. For instance, Kazakhstan is a vast country - the ninth largest in the world - and the population density little more than five people per square metre.

As such, says CNews’ Maxim Kazak, “The provision of IT services in Kazakhstan has always been related to significant financial expenses. Expenses per capita for construction and exploitation of any information landlines and corresponding infrastructure are significantly higher than in Europe. So, the fees for information services are higher, including internet access.”

Inevitably there are also political challenges. Since gaining independence from the Soviet Union in 1991 many of the republics have slipped into a form of authoritarian presidential rule, hence hindering international investment and stunting the growth of IT.

A classic example is Uzbekistan. Despite its landlocked position, Uzbekistan is fairly resource rich. It currently stands as the second-largest cotton exporter in the world, and also earns from gold, natural gas and oil exports. With such economic potential, you would expect IT firms to be queuing up to gain a foothold. But unfortunately the country’s president, Islom Karimov, who is now entering his eighteenth year of power, is keeping international business at arm’s length.

A CIA report on Uzbekistan states: “While aware of the need to improve the investment climate, the government still sponsors measures that often increase, not decrease, its control over business decisions. Strict currency controls and tightening of borders have lessened the effects of convertibility and have led to some shortages that have further stifled economic activity.”

Belarus has enjoyed a more vibrant IT sector, and with the rise of software developers such as IBA Group and EPAM is transforming itself as a centre for IT outsourcing.

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Although Russian systems integrator IBS is keen to grow its position in the Belarusian market, general director Sergey Matsotsky admits that the process of transferring revenue from Belarus to Russia incurs double value-added tax (VAT) payments.

IBA Group’s Valentin Kazan agrees the company has trouble with “unreformed economies and state regulations” in the CIS, one reason behind IBA’s decision to relocate its corporate HQ to the Czech Republic. And Kazan says that international expansion in the CIS is even difficult for a company based in one of the member states.

He says that IBA has hundreds of enterprise clients across the region, from railway providers in Turkmenistan and Uzbekistan, to central banks in Belarus and Kazakhstan. But conditions are rarely the same in each country. “Though it is easy in Russia and Ukraine as they have similar languages as Belarus, with Kazakhstan the things are different. We need to translate documentation jointly with a client," he says.

"A complicated legislation base that differs from international norms and from country to country poses a problem, too," says Kazan, adding that IBA has had to develop an expertise in legislative procedures across CIS borders - something it uses to assist clients when they venture into the region in search of business.

IT skills seem less of a concern that in western Europe, but could emerge as a growing problem. IBA VP Kazan comments that the "skills situation differs from country to country" in the CIS, depending on what the area was used for during the Soviet era. He says: "Belarus has an excess of IT skills. But the domestic market has limited demand for IT. According to our estimates, more than 50% of Belarusian IT specialists are working for foreign clients."

"In the Ukraine the excess is not that big. Their domestic market is larger than in Belarus. In Kazakhstan, the IT shortage is perceptible. The problem originates in the situation that was created in the USSR. Belarus was an IT centre, while Kazakhstan had a different specialisation."

Sergey Matsotsky, general director at Russia-based systems integrator IBS, say, "Staff recruitment, especially managerial staff recruitment, is one of the most pressing issues in those regions. There is a severe lack of experienced managers having appropriate competencies as business cultures in those countries are just taking shape."

"Staffing challenges are one of the most acute in the Kazakhstan IT sector," says CNews' Maxim Kazak. "The shortage of personnel and high salary expectations are negatively affecting the charges for IT services. The educational system has trained too many specialists of popular professions such as lawyers and economists, while the number of IT specialists is significantly lower. Years are needed to improve the situation."


Sergey Matsotsky, general director IBS

But despite these problems, western investors are still arriving. "The investment climate is certainly quite challenging. The governments can alter legislation, and investors should expect the unexpected! But from what the US Chamber of Commerce reports, most business is doing well," says author Marat Terterov.

Although, as we have heard, various western enterprise software vendors (SAP, Oracle, Microsoft) are dipping their toes in the CIS markets, the IT services landscape is dominated by local companies. "Most of the biggest players in the enterprise IT market are local companies. The rule is that local companies do not work for foreign clients," says IBA's Valentin Kazan.

Rather than seeing your HPs, IBMs and EDSs heading into the CIS markets, you are more likely to encounter big Russian SIs like IBS.

Matsotsky tells *IT Europa* that the IT services provider has stretched over the borders into Ukraine and Kazakhstan, and is now eyeing the Belarusian enterprise space. As well as having a keen understanding of local business practises, Russian players like IBS can offer end-users in the CIS the same international-class software used by the West.

"So far those countries fall behind the Western standards [for IT], which they are so attracted to, including automation," says Matsotsky, whose firm is now partnered with both Oracle and SAP in the wake of the acquisition of rival Borlas.

And the IBS boss is confident that CIS countries will continue to mature over the next few years. "In the next five years there will be continued vibrant growth in the market. Business consolidation processes will start in a few years time, first in Ukraine and Kazakhstan and then in Belarus. And concurrently the business environment will undergo a 'clean-up' to improve its investment appeal," he says.

IBA's Kazan expects "more and more rapid growth", and a move towards advanced IT services such as outsourcing. He adds: "The economies will be more open and CIS countries will join different international organisations. Consequently, the most demanded IT services will be those that foster integration in the world economy."

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At the moment these countries hover on the periphery of our vision of Europe, but they will inevitably become more significant as IT companies look further afield for margin. Big software vendors will increase their footing as piracy is clamped down on, but it will still be hard for western IT services players to gain market share. The big competition will come from Russian companies, who will be strong in cultures similar to their own. As one interviewee suggested of the CIS republics, "All roads lead to Moscow," and it will be tough to break this bond.