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IT outsourcing in Central and Eastern Europe

Source: IT outsourcing in Central and Eastern Europe 2009
Countries' attractiveness and development forecasts

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Central and Eastern European (CEE) region is emerging as one of the world's leading IT outsourcing locations. Although labour costs are higher in the CEE than, for example, Asia, the region has managed to turn both its geographical and cultural proximity with Western Europe and its multi-lingual labour force to its advantage.

CEE region becomes more competitive

Defined as mid- to long-term supply for a specific service, outsourcing in the IT industry has today replaced offshore outsourcing. A growing trend among IT companies worldwide is to relocate various parts of their business, chiefly IT and human resources, to countries with lower labour and production costs and better growth prospects. At least 70% of major Western European companies recently surveyed by Ernst & Young (over 600 decision-makers were canvassed) outsource at least one arm of their operations, and 20% of them are set to increase their outsourcing volume over the next two years. The same survey, which covered companies with a turnover of at least €100m in France, the UK, Germany, Italy, Spain and Belgium, shows that in their drive to gain a competitive edge businesses are turning to outsourcing primarily as a means of trimming costs (49%) and improving quality by hiring specialists (33%). The functions most commonly outsourced are maintenance (76%), logistics (73%) and computing/telecommunications (68%).

According to the main indicators of growth for the IT outsourcing industry, i.e. chiefly market volume, the number of IT professionals and IT companies providing outsourcing services, and the cost of one professional for the end customer, CEE is now on a par with established global outsourcing centres such as India and China. Imports of IT-based services from the CEE countries into the EU-15 rose by an average of 13% a year between 1992 and 2007. By way of comparison imported services from India increased at only slightly faster (14%) during the same period.

Nevertheless, IT outsourcing overheads in CEE countries remain steep, and the availability of human resources in the region is still low compared to Asia, especially India and China. However, what makes the CEE region so attractive for IT outsourcing orders is easier and better project management due to cultural and geographical proximity and a frequently common language (especially in the case of near-shoring locations). Another key factor working against Asian locations such as India or the Philippines (where English is the sole operating language) is that staff in the CEE region speak a variety of languages.

Russia: IT outsourcing leader

The IT outsourcing market in the CEE region was worth €2.3bn in 2007, with Russia strongly leading the way followed by Ukraine, Poland and the Czech Republic.

The total number of professionals in IT outsourcing companies in the region hovers around 110,000. Besides Russia, which is an unquestionable leader, Ukraine, Romania and Poland continue to boast the largest pool of IT professionals in the region, accounting for a third of the region's entire IT outsourcing human resource potential. In addition, a number of multinational IT outsourcing players have managed to gain a foothold or expand their presence in CEE countries, the largest of which are Accenture, Logica CMG, EDB, Siemens and Nokia.

Value of the IT outsourcing market (€ m), number of IT outsourcing companies and the number of IT outsourcing employees in selected CEE countries, 2007

Country	Value of the market (€m)	Number of IT outsourcing companies	Number of IT outsourcing employees
Ukraine	320	800	16,000
Poland	270	400	9,000
Czech Republic	211	300	8,000
Hungary	188	360	7,500
Romania	164	600	10,500
Bulgaria	75	400	5,000
Slovakia	62	170	3,000
Total CEE	1,290	3,030	59,000
Russia	1,040	1,000	52,000

Source: Source: Report "IT outsourcing in Central and Eastern Europe 2009 – Countries attractiveness and development forecasts", PMR Publications, 2009

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Outsourcing costs vary across the region

One of the region's clearly unbeatable advantages is that it offers a highly educated, multilingual pool of talent, which is both reasonably close at hand in geographical terms, and can be tapped at relatively low cost. The success of both outsourcing in general and IT outsourcing in particular in the region has also been helped by improved economic conditions and the entry of some CEE countries into the EU.

These strengths have come to the fore as Western European companies, faced with increasing labour shortages in various professions, have turned their eyes Eastward. In 2007 Hungarians and Czechs earned on average a quarter and Slovaks only a fifth of what their peers made in Western Europe (compared to the average salary published by Eurostat). However, according to recent calculations made by www.outsourcing-asia.com in recent years costs have risen sharply in CEE countries, especially in the new EU members, and they now top those in Asia. An IT engineer in the Czech Republic is paid about €5.03 an hour, compared with a corresponding salary of €2.38 an hour in China and €1.63 an hour in India. In Romania and Bulgaria, the same specialist can expect to earn €3.13 and €2.99 an hour, respectively.

On the other hand, the added value that CEE professionals offer, in terms of a better education and multilingual skills, still pays dividends for many Western companies. In general, average labour costs for non-public services in the new EU member states are around one-fifth of those in Germany. In Romania and Bulgaria labour costs are less than 10% of those in Germany. The most expensive wage bills in the IT outsourcing industry are in Poland, Hungary, Romania, Czech Republic and Slovakia.

Ranking of the costliest IT outsourcing locations in CEE*, 2007

Country	Minimum cost (€)	Maximum cost (€)
Poland	22,323	44,918
Hungary	22,030	44,591
Romania	20,439	42,430
Czech Republic	20,405	41,315
Slovakia	17,871	35,525
Ukraine	17,661	33,797
Bulgaria	18,529	33,353
Russia	15,122	30,655

* Countries were ranked by maximum annual cost (as measured in €) of one IT specialist, performing services for final customer, includes salary, taxes, office, etc.
Source: Report "IT outsourcing in Central and Eastern Europe 2009 – Countries attractiveness and development forecasts", PMR Publications, 2009

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Future of IT outsourcing in CEE

Russia

According to PMR forecasts in 2009 and 2010 the Russian IT market is expected to grow by 15% annually to reach a total of \$25bn. Russia is in a good position to attract IT outsourcing contracts in the coming years due to its cost efficiency and abundant human resources. Russian software exports are set to soar by nearly 80% between 2007 and 2010, according to the domestic IT and Communications Ministry estimates. Most outsourcing projects will come from consultancy firms, ICT industry and research and development companies. All in all, Russia's IT outsourcing industry will grow by approx. 25-30% by 2010.

Russia is today the third leading global destination for IT outsourcing, albeit well behind India and China in this respect. India's popularity as an outsourcing destination for IT services has driven up its labour costs, which in turn has offered Russia space to compete. According to various estimates from the International Association for Outsourcing Professionals (IAOP), employee turnover in Luxoft, the largest provider of IT outsourcing services in Russia, is five times lower than in India and four times lower than in China.

Russian IT service providers will continue to eat from the global IT pie. U.S. and European firms are expected to continue working with Russian companies rather than their Indian counterparts, mostly because Russian companies are known for being able to implement more complex projects. Analysts from major market research firms agree that Russia's IT outsourcing industry is not necessarily about to overtake India globally in terms of market volume. Rather, it hopes to specialise in and draw revenues from more complex and innovative projects, e.g. those connected with IT security or dedicated software development.

The other CEE countries

The CEE's IT outsourcing services market, except for Russia, is forecast to expand by 18% by 2010. Global giants have already started to move parts of their operations to the region. They include US companies such as IBM, Dell, Capgemini and Morgan Stanley. IBM, for example, has a combined staff of 5,500 employees in two offices in Brno (the Czech Republic) and Budapest (Hungary), which support 500 global clients. Also, some of the €27.8bn that the company spends globally on supply chain procurement is sourced in Budapest and Sofia.

By 2012, off-shoring start-ups in the region are expected to make a considerable dent in India's dominance on the IT outsourcing market. By then, according to a poll carried out by Gartner, about 30% of Fortune 500 enterprises will outsource to three or more countries in the CEE region compared to 10% of those companies in 2007.

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