



Industry Insights

Russia & Ukraine as Financial Technology Outsourcing Destinations

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Despite a series of high-profile and well-publicized success stories, Eastern Europe remains a relatively unknown field on the outsourcing landscape, at least compared with India, China and the Philippines.

The biggest outsourcing news makers in Eastern Europe have been high-tech firms that have set up R&D operations, such as Intel, Sun, IBM and, most recently, Google. What works for these high-tech leaders makes Eastern Europe attractive to the financial services industry as well.

The basic data points that both high-tech and financial firms look at when evaluating an outsourcing destination are the same: labor market, infrastructure, legal/IP protection, local risks and cultural/work ethics flavor. One important but often overlooked detail that makes financial firms, selection job more difficult is industry-specific knowledge – in today's fast-paced world, basic technology skills are often not enough. In this article we will analyze these factors for the two largest countries in Eastern Europe – Russia and Ukraine, focusing primarily on IT and technology R&D work, which is the vast majority of outsourcing in the region. The same arguments mostly hold true for the second, and fast-growing, area of interest – quantitative analytics/KPO. Traditional BPO work is virtually not represented in the region.

Industry-specific Knowledge

Industry-specific knowledge is critical for financial firms and Eastern Europe had neither the tradition nor the internal market compatible with Western financial systems to provide a stable pool of trained resources. That is changing fast. Russian banks, money managers and insurance firms are now among the most active buyers of Western financial technology, most notably in electronic trading, derivatives, portfolio analytics and risk management. Many top technology executives are "returnees" – Russian or Ukrainian nationals who emigrated to the U.S. or the U.K. in the 1990s, made a career in investment banking technology and moved back home to oversee massive technology upgrades. This will produce large pools of qualified technical staff. However, the trend remains highly localized as the vast majority of the Russian financial sector remains in Moscow.

Outside of Moscow, individual firms train their own staff. Some firms take training very seriously and establish sophisticated training facilities, hire expats to train and mentor their staff and carefully preserve the knowledge within the firm. Others take an easier path, declaring industry knowledge and hoping that fast-learning Russians will "figure it out quickly." A client's ability to tell the difference is key. When vendors claim that their staff knows C# or Java or Tibco, it can be taken for granted most of the time. However, if they claim expertise in reference data management or fixed-income trade execution, it should be verified very carefully. Those who do have the knowledge they claim will often produce results far beyond expectations; those who do not may drag the client through a painful knowledge transfer process.

While Russia does not yet have big-hit stories like i-flex, there is a surprising number of leading financial technology firms who do development in Russia. Many popular products, including portfolio systems, FIX engines, and analytical and risk management packages have been and continue to be developed in the region. Such stories rarely make it to the press because product vendors are still wary of telling their clients

that they used engineers in Russia. This might very well change as Russia's profile as a financial center rises.

Labor Pool and Costs in Russia & Ukraine

The cost of IT labor in Russia is determined by the competition among local IT companies, off-shore service vendors and R&D centers of large western firms. As a result, IT salaries are higher in cities with a large concentration of IT firms. Historically, the salary benchmarks are determined by local companies in Moscow, R&D centers in St. Petersburg and off-shore companies in the regions.

The main source for qualified IT labor is universities with 50-70% of the labor pool composed of computer science and math graduates. However, the quality of education varies, from extremely low to outstanding. The best technical universities are based in cities that participated in the state-sponsored Soviet programs of cybernetics studies. In Russia such key centers are Moscow, St. Petersburg, Novosibirsk, Nizhny Novgorod, Yekaterinburg, and Tomsk. In the Ukraine the key centers are Kiev, Kharkov, and Lvov.

Moscow tops the chart for labor costs, St. Petersburg follows closely with 10-20% lower rates. In more rural areas, average engineer salaries may drop as much as 50%. Interestingly, however, salary levels of mid to top management are roughly the same regardless of region because there is a much smaller pool of experienced management staff further away from the largest cities.

In contrast with Russia, there are no large Western R&D centers in the Ukraine and IT salaries in the entire region are determined by the off-shore industry. In the Ukraine, the population is much less segmented than in Russia, and practically every regional center has a decent university. Ukrainian IT salaries are slightly lower than in Russia but vary by region. For instance, salaries in Kharkov (Ukraine) are slightly higher than in Voronezh (Russia) due to higher competition for the labor pool in Kharkov. [DataArt has R&D centers in both cities.]

The ongoing economic crisis has affected salaries, but not as dramatically as some clients had hoped. Salary freezes are evident throughout all regions. However, in the Ukraine, 90% of IT salaries are paid in dollar equivalents. In Russia the situation is mixed – many salaries are paid in rubles (which has lost more than 20% of its value to a dollar) or in units whose denomination is not always clear. So far, only a few IT outsourcing firms have used the crisis to lower salaries and beef up their margins. Long-term labor loyalty remains a top consideration so many firms cannot yet lower their billing rates. Most IT companies had layoffs of 10-20% of poor-performing personnel. Considering the rapid expansion of recent years, this is likely to positively impact overall quality of service.

Security and Intellectual Property Risks

Contrary to popular belief, Intellectual Property is highly respected among IT providers both in Russia and the Ukraine. Both countries have recently upgraded their IP laws making them compatible with the Western tradition. While the risk of intentional IP rights infringement is arguably not higher than in developed countries, the potential for breach due to negligence is elevated. The situation is less problematic with companies where the focus is not on the paperwork and technicalities but on comprehensive personnel training and management programs. It's important to provide specific instructions on IP risks and potential issues to the outsourced IT team.

Russia has been a highly bureaucratic society, leading many technical professionals to habitually find shortcuts, working efficiently within the spirit of the law but not always to the letter of each detailed regulation. Such "out of the box" thinking often produces amazing technical results but must be managed very closely since shortcuts may compromise data or IP security.

Cultural Considerations

One of the more popular clichés is that Russians will present their objections and discuss problems right away, while Indians will hold back until problems cannot be hidden any further. Reality is far more complicated. Russians do tend to discuss problems upfront but may resist a solution they believe is less than

perfect technically, even though it may be the only option given business requirements or time constraints. In this sense, our experience shows that Ukrainians are on average more positive and more open to communicate in the traditional Western style. In both countries, individualism in decision making is extremely strong, so project management is essential.

There is a popular quote by an Intel executive: "Intel does urgent projects in the U.S., large ones in India and impossible ones in Russia." This sounds like a compliment (and is much used by Russian outsourcers) but has a flip side. Russian engineers want their projects to be interesting in the "challenging" sense. Sometimes this means that system design uses unproven technology or is more complicated than necessary. Engineers are almost always focused predominantly on technology and often overlook process or political issues. It is not surprising, therefore, that most technology-focused clients give raving reviews, while business-focused ones are often less happy.

Culturally, engineers in post-Soviet regions have a very high sensitivity to grading and positive and negative reinforcement. They appear indifferent but watch their marks very closely. In practice, this means that it is almost always pointless to try to get Russians to admit to and apologize for their mistakes; it is far more effective to quietly hint at what needs to be done. Often, such indirect motivation will drive dramatic efforts.

In Russia, like in many Eastern cultures, people typically don't ask questions unless necessary and are very wary of situations where questions are looked at as a sign of poor understanding. This means that outside of technical areas, clients and project managers must take special steps to stimulate proactive discussion of business, process and regulatory issues and priorities.

One issue that is often overlooked by even the most experienced outsourcing managers is holiday scheduling. Russians and Ukrainians celebrate many local holidays and almost none of the traditional Western ones. For example, there is no Christmas break but often a large New Year holiday in the first two weeks of January that can shave weeks off of project time. Most engineers will readily change their holiday schedule or skip them for other perks, but this needs to be managed in advance and taken into consideration during planning sessions.

Infrastructure Challenges

Key infrastructure factors for the outsourcing industry in any region are electrical, communications/Internet and transportation. Throughout most of the region, Internet and phone connectivity is readily available and of top quality. However, connectivity gets pricier further away from large cities. As a result, some of the regional companies choose to save on telecommunications, leading to poor voice or data quality. Clients should remember that this is not because better quality is not available, but almost always because it costs a little extra.

Unlike Internet and phone networks, electrical grids are very old. Failures are very rare but even small ones may lead to hours of downtime. This section of the vendor's disaster recovery plan often deserves special attention.

Importantly, many of the areas active in outsourcing do not have good transport links with the rest of the world. Major airlines fly to several large cities in Russia and the Ukraine, providing excellent links but most others are served by either very old (and often uncomfortable) aircrafts or slow rail links. It is very important for clients who require frequent communication to choose their location carefully. Both Russian and Ukrainian nationals need visas to travel to most client sites. The U.S. and U.K. visas are issued relatively easily and quickly in the Ukraine; Russians get scrutinized more. One of the client's due diligence steps should be to check if their Russian vendor is a member of the U.S. or U.K. trade council organizations which ensure a reliable and transparent visa process.

Other Countries in the Region

Belorussia provides excellent conditions for larger firms who are not afraid of political risks. There is a unique system of assigning university graduates to future jobs, somewhat similar to what existed in the Soviet Union. Few students refuse their assignments. As a result, the salaries for entry-level developers are half of what

they are in St. Petersburg yet skills are just as strong since local universities provide excellent education. Senior developer salaries are about 20-30% lower than in Russia,s R&D centers. The country,s relative isolation from the rest of the world stimulates student interest in precise sciences (as opposed to humanities). However, political risks are a reality. If you appoint a local to a top managerial job, make sure that he,s not a dissident or his problems with the government will become your own. Try to demonstrate absolute neutrality towards governing political powers. Don,t be surprised if your employees will be required to do community work (street cleaning, etc.). Quality office space is rather scarce and even most basic telecom service, although readily available, may be slow to setup in the highly bureaucratic system.

On the other side of the spectrum is Estonia, a small country in the European Union very representative of the Baltic region. IT salaries are on the level of St. Petersburg, but the labor pool is much smaller than in Russia. Among Estonia,s advantages is a more transparent legal system, more Western mentality and better English language skills. Overall, Estonia is best positioned for product development companies (and was made famous by hosting the key development center for Skype), but it doesn,t provide enough labor pool scale for IT services companies.

Conclusion

Russia and the Ukraine are known as excellent R&D destinations for a good reason – superior technical talent and a can-do attitude for the most complicated tasks. Basic operational commodities, such as reasonable costs, reliable infrastructure, telecommunications and a legal system are now widely available throughout the region. However, individual vendor firms have a lot of freedom and may take shortcuts. Prospective clients are best advised to look beyond vendor marketing and invest in due diligence.

Our on-the-ground experience shows that while most high-tech firms have publicized their efforts in the region, many financial firms that have been doing no less impressive work have largely kept quiet. Will it change soon? Will financial firms recognize that affiliation with Eastern European engineers will support their technology prowess? We believe the road will be long but the tide is turning.

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