

Guest CEO Editorial



Dr. Alexis Sukharev
President, Auriga Inc.

Dr. Alexis Sukharev is President and founder of Auriga, Inc., a U.S.-based IT software Development Company with five locations in Russia.

Dr. Sukharev was one of the first to explore the benefits of IT outsourcing to Russia. A consistent champion of promoting Russia as a reliable strategic partner in offshore IT outsourcing, Alexis Sukharev uses all his experience and energy to contribute to industry-important events aimed at increasing the Russian IT visibility and recognition. Under his leadership Auriga is now recognized for many years as one of the top Central & Eastern European service providers. This year, Auriga has been named to the 2008 Global Outsourcing 100 and the Global Services 100 – two of the world's most respected ratings of the top global providers of business and technology services. Being an industry visionary and practitioner, he has been quoted in numerous publications like The New York Times, BusinessWeek, eWeek, Computerworld, etc. Moreover, Dr. Sukharev was named a "Godfather of Russian outsourcing" by the renowned New York Times. In 2001, Alexis Sukharev's book "India: Targeting for the Status of a Global IT Superpower" was published by Moscow State University Press. The book highlights lessons learned from India's experience and articulates trends and perspectives of Russia's software development market.

Prior to founding Auriga, Alexis Sukharev was Professor of Operations Research and Numerical Analysis at Moscow State University. Dr. Sukharev has published ten books and numerous articles that have been translated and published internationally.

Tholons:

There seems to be a growing interest for R&D and product development services to be offshored. What levers have driven such growth? Do we see Russia developing to be an R&D "Center of Excellence"?

Dr. Alexis Sukharev:

There is an undeniable trend of growing R&D and product engineering outsourcing among both emerging and established technology companies. The driving factors behind such

growth are increasing competitive pressure and consumer demands. As a result, high-tech companies are forced to increase the quality of their software products, simultaneously dramatically cutting time to market and operating costs. Equally important for them is creating a greater bandwidth of skills and expertise by going global and gathering ideas and concepts all over the world. In my opinion, Russia has excellent chances to become the world R&D "Hub of Excellence".

In fact, product development became the Russian IT outsourcing industry specialization a long time ago. Back in 2003, Aberdeen Group research found that 67% of Russian companies' customers are companies in the IT industry sectors including 41% ISVs while Russian "engineers and software developers are most often involved in core application development projects, project planning, requirements gathering & analysis and specification design activities, which is particularly noteworthy given that these life cycle activities are not typically associated with software offshore outsourcing".

The key requirements to a product engineering vendor are innovation capabilities, top engineering skills, and a wide technological expertise range. Last November General Manager of Intel Digital Enterprise Group Tom Kilroy, speaking in Hyderabad at a TCS sponsored conference on "Intel Innovation: China, Russia, & India", stressed Russian "software development innovation" vs. Chinese "marketing innovation" and Indian "silicon design excellence". He said that the Russian engineers are "exceptional problem solvers and software developers, extremely strong on the fundamentals (mathematics & sciences), want a problem to solve not a spec" and even "unmatched in the industry".

Aside from research and customers' voices, there is compelling data evidencing top skills of Russian programmers. This and last year 5 out of 12 medalists at highly prestigious ACM International Collegiate Programming Contest were teams from Russia including #1 and #3 in the world this year. To understand the scope of the latest Contest note that 100 teams to participate in Alberta, Canada in April 2008 finals were selected from 6,700 teams at 1,821 universities in 83 countries competing at 213 sites from September to December 2007. In 2000-2006 a Russian team 4 times became the world champion, and out of the remaining 3 years - 2 times #2 and #3 in the world. At Google's latest Global Code Jam Contest #1 and #3 top world coders were from Russia, as well as 32 out of 100 finalists selected out of more than 21,000 registered competitors from more than 100 countries.

Tholons: What are the typical HR challenges (talent acquisition, development and retention) you face and what strategies do you use to counter them?

Dr. Alexis Sukharev: The key challenge is growing competition for IT talent. The Russian economy as a whole had nine straight years of growth, averaging 7% annually, with a 7.7% GDP growth in 2007. The IT sector in the same period was growing at a much higher rate of over 20% achieving 27% last year, while the software segment grew 63% in 2007. I think that the IT labor market situation in Moscow is worse than that in Silicon Valley in 1999 – early 2000. In 2007 the IT labor pool in Russia was about 1 million vs. 1.5 million needed. According to a trustworthy source, in 2012 the demand will be met only by 36%. This situation causes accelerating salary growth and staff turnover.

The 2007 IDC White Paper on “Russia as Offshore Software Development Location” states that “a quarter of the companies interviewed for this study mentioned a lower turnover of staff to be one of the reasons why they had chosen to go with a Russian software development firm rather than an Indian firm”. Better retention is still a strong positive factor but the situation is deteriorating, especially in Moscow and St. Petersburg.

The leading IT companies are taking drastic steps like opening new Master's programs in Moscow Institute of Physics and Technology, the “Russian MIT”, expecting to get 95% of the graduates. Smaller companies can counter the challenge only in their strictly defined competence niches by becoming training "Centers of Excellence". For example, my company Auriga opened a training center in cooperation with Moscow State University with course offerings such as POSIX and Linux kernel. Our advance kernel courses were offered even at International Institute of Information Technology in Pune and received the highest grades from engineers of the leading Indian companies. By offering courses of this level, we are able to attract the best students subsequently employing them at Auriga.

Tholons: Is there a potential for Business Process or Knowledge Process Outsourcing to Russia?

Dr. Alexis Sukharev: Even though BPO in the Russian domestic market is growing, I do not see either a necessity or a real chance for Russia to compete in the world markets in the key BPO segments like data entry or voice-based services. Both younger demographic profiles and much larger pools of English speaking talent give countries like India and the Philippines a considerable edge over Russia. Higher end KPO services such as market research, data mining & analysis, technology research, management & financial services, life sciences research, legal & insurance claim analysis and IP research have better prospects. But few companies in Russia are exploring this new sector. However, success stories of Engineering Services Outsourcing like that of Boeing show Russia's large potential on that front.

Tholons: What has the government and trade bodies such as RUSSOFT undertaken to promote Russia as a key offshore destination? Do you see any challenges that are roadblocks to Russia becoming a leader in offshoring?

Dr. Alexis Sukharev: Let me answer in a broader context. Building a new knowledge economy was declared #1 priority by both former President Putin and new President Medvedev. Supported by huge state financial resources of over \$600 billion, a number of programs have been initiated in recent years. A good example is a hi-tech parks initiative launched by President Putin in 2005. Federal Task Force was established in 2006; construction began in 2007 and is to be completed in 2010. The initiative involves \$1.1 billion of public and estimated \$7 billion of private funding. Each of hi-tech parks is 40 to 100 hectares of land, 100,000 to 200,000 square meters of office space and 250,000 to 350,000 square meters of residential space, production facilities, social infrastructure, and a major education or R&D center.

Success of such programs will be the best way to promote Russia as an outsourcing destination for knowledge based high-end tasks.

The major roadblock is a wrong perception of Russia abroad. The Russian economic success story of the last 9 years is mostly overlooked by the Western public. Just look at this: 14% of 830 directors of large American, British, French and German corporations, respondents of the 2007 Datamonitor study on BRICS countries (where “S” stands for South Africa), believe that vodka is the main product of Russia. As a result, Russia is viewed as by far the least favored location for doing business among the five BRICS emerging economies. This is the issue that needs to be addressed in earnest by the Russian government.

I think that RUSSOFT is more successful in delivering on its part of the task. Say, on April 17 this year The Mass Technology Leadership Council spring conference in Boston “China, India, Russia - Our Partners in the New Global Economy” attracted 300 people with such keynote speakers from Russia as Vice-Chairman of the ICT Committee in the Russian State Duma and IBM VP of Operations Systems & Technology Group. The Russian track of the conference was organized by RUSSOFT and the US-Russia Chamber of Commerce of New England. A similar event three years ago with the same organizers and Mikhail Gorbachev’s keynote presentation on the “Role of IT in the Global Economy” attracted about 800 attendees, had an extensive press coverage, and brought about the following comment by a Gartner VP and Research Director: “The Boston event might become a turning point in the way the Russian industry markets itself”.

Another roadblock to Russia becoming a leader in IT offshoring is the lack of tax and customs incentives for the IT industry. Even though there were many attempts to introduce new laws, most of them proved to be insufficient, flawed, or simply failed. The major problem is the so called Unified Social Tax, which imposes equally high salary taxes on the employers in the oil industry, where salaries are a fraction of the production costs, and IT, where salaries account for more than 50% of the costs. We expect the situation to improve in 2009 due to a law that recently passed the first reading in the State Duma, even though such hopes proved fruitless in the past.

Tholons: Do you see keen interest from the investor community for strategic investments in offshore service providers (as currently seen in India/Philippines) in Russia?

Dr. Alexis Sukharev: Again, I’d answer it in a broader context of the emerging innovation economy. The government is actively involved in creating new investment bodies such as Rosnanotech with \$10 billion for nanotechnology development, Rosinfocominvest with \$100 million for ICT, \$1 billion Russian Venture Corp., and others. There are some positive signs from the investment community like a recently announced \$50 million investment into EPAM Systems but international investors still strongly favor the old natural resources economy.

Tholons: What is your view on the growth and evolution of the offshoring industry in Russia in the next 3 - 5 years?

Dr. Alexis Sukharev: It decisively depends on the World and Russian economies and finances. A weak dollar and high inflation in Russia hurt the Russian offshoring industry much more than it's seen from abroad. A recent report by Bloomberg says that analysts from Merrill Lynch, Goldman Sachs, and Deutsche Bank believe the Ruble is seriously undervalued and predict its further strengthening by 4% in the next 6 months. Merrill Lynch says that the real value of the Ruble should be 17.92 to the USD (it is 23.55 today). The Russian government forecast published at the same time says that the dollar will gradually rise to over 28 Rubles in 3 years. You need to be an astrologist rather than IT expert to predict the IT offshoring future.

Tholons: How do you compare the skills availability and cost of outsourcing in Russia vs. India and cost savings vs. US and Europe?

Dr. Alexis Sukharev: The situation in India and Russia is changing rapidly and it's difficult to make accurate estimates. I believe that salaries in both countries are growing at about a 20% rate. Cost of outsourcing is of course of primary importance for the client. However, for the first time in the 2006 study by Booz Allen Hamilton and Duke University almost 70% of the 537 respondents across Europe and the US stated that offshoring is driven by the need to tap the global talent pool, as opposed to the previous years' surveys where respondents stated lower costs as the highest incentive to offshore. I agree with Daniel Marovitz, COO for Technology, Deutsche Bank's Global Banking Unit, who says that in 12 or 15 years costs in India, for example, may be on par with London or New York. The labor arbitrage story is temporary; the real story is about recruiting talent.

As for the skills availability in Russia vs. India, I think that the best measure is the number of IT-capable graduates. The Russian official statistics do not provide the data, just some raw material, but since this is, in my opinion, of paramount importance for comparison of IT industries in Russia and India, we at Auriga, conducted and published our own research based on the official statistics. The problem is that in Russia the majority of graduates get 5-year degrees equivalent to Master's while in India the majority graduate with 3 or 4 years' degrees. So, the difficulty was to count Russian non-IT and even non-engineering graduates who get IT-training equivalent to a 3-year IT college. Here are the results:

Fresh IT Labor Supply in Russia and India

RUSSIA		
Russia's New IT Labor	2003 - 2004	2005 - 2006
IT engineering (Com Sc, Electronics, Telecom) graduates	45,994	61,869
Math and physics graduates	22,132	12,279
Non-IT engineering graduates capable of entering IT workforce	76,435	61,060
Non-engineering graduates capable of entering IT workforce	81,270	109,260
Total IT-Capable Labor Supply	22,831	24,4468

AURIGA

INDIA		
India's New IT Labor	2003 - 2004	2005 - 2006
IT Professionals from degree (4 years) colleges	84,000	133,000
IT Professionals From diploma (3 years) colleges	95,000	113,000
Total IT Professionals	179,000	246,000
Total Engineering Professionals from degree and diploma Colleges	316,000	441,000

NASSCOM

It's easy to see that even though the Indian numbers exceed those in Russia the gap is much narrower than it's thought to be.