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Guest CEO Editorial

**THOLONS**

Advisory • Investments • Research



Mr. Dmitry Ponomarev

President and Chairman
MERA Networks

Dmitry Ponomarev has served as President and Chairman of the Board of Directors of MERA Networks since the day of its inception in 1989. Dmitry has built MERA Networks from a small software development company with a handful of employees to a global software development leader providing full cycle software development services in the cutting-edge technology areas. His entrepreneurial spirit is the driving force behind the creation, growth and ongoing success of MERA Networks. The company owes much of its leadership in the Russian software development outsourcing market to Dmitry's personal commitment and contribution.

Prior to starting his entrepreneurial career in 1989, Dmitry was Professor at the Nizhny Novgorod State Technical University. He earned his Master's degree in Telecom Engineering in 1974 and PhD in 1979 from the Nizhny Novgorod State Technical University. He is an author of 70+ publications in scientific and technical journals and a holder of 12 patents.

Dmitry Ponomarev is also a co-founder of other several successful Russian and international telecom companies.

Tholons:
As the leading software development service provider from Russia to the world's leading telecom firms/ equipment vendors, what do you see / look forward to as an innovation / future trend that can revolutionize this space?

Dmitry Ponomarev:

Let me point out that MERA Networks specializes in high-value added software R&D

Services. This type of services stands out significantly of mere ITO (IT Outsourcing) and BPO (Business Process Outsourcing) because both ITO and BPO clearly fall into category of non-core activities for most of organizations while in contrast to ITO and BPO, R&D is as core as it gets.

For instance, MERA provides software R&D services for customers' core products/solutions which are already on the market and even for some which are not on the market yet. Moreover, in addition to R&D MERA provides Professional Services. Hence, enhancing customers' market offering and facilitating sales. To top it all off, MERA files a few patents a year on behalf of its customers! Hence, as one clearly see MERA brings value to its customers through innovation by contributing to their core products/solutions and market offering rather than acting as a mere means for cost saving.

I believe that the software R&D services industry is undergoing the next step of evolution rather than revolution. All leading world telecom equipment/solutions vendors are consolidating their suppliers' portfolios as we speak. This will inevitably result in further separation of best-of-breed suppliers from runner-ups - the best suppliers will reinforce their positions even further. So the future trend is being innovative, creative and proactive and in some respect better than your customer's R&D resources or die!

Tholons: What are some of the critical factors that make Russia an attractive location for offshoring in the R&D space? What are the unique challenges you face?

Dmitry Ponomarev: No doubt that the most critical factors that make Russia an extremely attractive location for offshoring in R&D space are quality and availability of R&D resources. The Russian educational system proved throughout the decades to be very effective in fostering well educated, highly skilled and motivated staff in exact sciences (e.g. math, physics, computer science, etc). Besides Russia features long history of scientific research and innovation achievements (first satellite in space, first human being in space, first manned orbital station, etc) combined with accomplishments in R&D intensive industries (e.g. space, nuclear, defense, aircraft industries, etc). So both these factors such as proper education and intrinsic almost genetic hunger for R&D intensive work have earned Russian engineers a reputation of ultimate "ice breakers". They are by far the best in the world when it comes to quickly adopting, rapidly learning and most importantly delivering in the fast paced and rapidly evolving technological world.

Keep in mind that many western high tech companies like Alcatel-Lucent, EMC, Intel, Motorola, Sun Microsystems, to name just a few established their captive software and engineering R&D centers in Russia long time ago. And many more chose a vendor business model and successfully collaborate with Russian and Eastern Europe's vendors like MERA Networks.

Truly by far the most unique yet manageable challenge we face at MERA is keeping people motivated when it comes to software R&D for products/solution based on old outdated platform/technologies. Our employees are keen about contributing to innovative and advanced products/solutions!

Tholons: Apart from St. Petersburg, Moscow and Nizhny Novgorod in Russia, are there any other locations (in Russia or globally) that seem attractive to you and if so why?

Dmitry Ponomarev: Let me disagree with your statement about attractiveness of Moscow and St. Petersburg as destinations of choice for offshoring software R&D to Russia. The capitals – Moscow and St. Petersburg – are no longer viable choices if you are looking for effective offshoring of software R&D with best value. If you consider outsourcing your software R&D you need to be looking at Russian Tier-2 cities and Nizhny Novgorod is probably the best example of such a city. It lacks all the issues you would face at the capitals while offers all benefits one expects from a destination of choice for software R&D services: quality, performance and commitment.

Let me explain why. Historically the Russian capitals - Moscow and Saint Petersburg had a head start over the rest of the Russian IT export industry. In early 90s the two cities evolved as the Russian destinations for software R&D outsourcing due to a number of objective factors such as availability of talent as well as better telecommunication and transport infrastructure. However what originally appeared as a blessing for IT export industry located at the capitals turned out to be its curse.

Back in 90s offshore outsourcing companies were to compete for talent with each other only due to lack of demand for IT talent both from international corporations and other Russian domestic IT players. Currently the competition pattern has changed tremendously – capitals experience considerable pressure for human resources from other emerged IT industry players. In Moscow offshore software outsourcing businesses face tough competition from the domestic IT companies and various non-IT businesses including government agencies that also lure IT talent to support their IT-enabled operations. Saint Petersburg has become an R&D hub for global IT giants – Alcatel-Lucent, Borland, Intel, Motorola, EMC, Siemens, Sun Microsystems, etc – that have established their R&D operations there, which further aggravated the local IT labor market situation. While the competition patterns in capitals differ in terms of competing players the effect is fairly the same - shortage of IT labor force resulting in ever increasing wages and high attrition rates. Importantly, job hopping and the resulting high attrition rates in the capitals impede effective accumulation of the most vital asset for the IT business - technological expertise and process maturity. Moreover, the infrastructure costs (office space, utilities, etc) are also higher in the capitals than in the regions. Hence, the overall costs of software R&D services in the capitals are considerably higher than those in the regions thus lowering the capitals' competitiveness against the regions considerably.

Hence the regions are playing and will play a major role in further development of the Russian IT export industry. They have roughly 5-6 times more R&D resources to offer than capitals. The competition for the talent is significantly lower than in the capitals.

There are a number of Tier-2 cities in the European part of Russia, Siberia and Far East with population of over a million people. The European part stands out because it offers an additional competitive advantage over other regions as being nearshore to Western Europe. Nizhny Novgorod is an obvious leader in this region. It features Russia's and Eastern Europe's top telecom software R&D Services Company – MERA Networks and a couple of captive centers for western companies - Intel and Teleca.

Tholons: How easy is it to scale up operations in Russia? How would you rate the quality and quantity of the talent pool in Russia against other offshore nations like China and India?

Dmitry Ponomarev: Frankly we at MERA never faced a situation when we could not scale up our software R&D operations as fast as our customers wanted. Fortunately in contrast to ITO and BPO software R&D area is fairly complex and the scale up rate is limited by the rate of technology uptake rather than availability of resources. So we always managed, manage and will manage to satisfy appetites of MERA's even most demanding customers. As far as numbers go, MERA usually grows at the rate of 25-30% a year so given our current size of over 1,000 engineers we are looking at the annual ramp-up rate of 250-300 engineers.

We talked about the quality of Russian software R&D resources above and briefly touched upon the underlying reasons for it. I would definitely rank Russia, India and China as top players when it comes to Software R&D services however I would be reluctant to assign certain places. Admittedly all competition we experience currently at MERA as a company comes from large Tier-1 Indian companies. However, in the long run I'm honestly more afraid of China as a competitor for R&D than India. The Chinese government pays a lot of attention to building and nurturing their country's R&D ecosystem by actively stimulating international companies to open captive Software R&D centers. On the other hand India's success in services resulted in serious overheating of the entire services industry. India's attrition rates are surging and reach tens of percents. And for Software R&D area low attrition rate is highly crucial for building-up and retaining technological and process expertise and thus is a key for successful delivery.

So the current global landscape for Software R&D services looks fairly simple: China is catching up quickly but I think is not quite yet there with regard to maturity of its R&D culture, India is struggling with some issues which in reality are byproducts of the industry's early maturation, Russia is falling in between – a niche player with a clear cut focus on Software R&D services featuring unique unquestionable R&D skills and yet enjoying up-hill evolutionary development stage of the outsourcing industry without notoriously high attrition rates and scalability issues. But at the end of the day success is measured against revenues. The stage is set so let's see what is going to happen!

When it comes to quantity, well over 1 million students graduate each year from Russian universities. Out of those at least one tenth – roughly 100,000 students - could join the software R&D industry. So given the projected total of Russia's software export revenue for 2008 of US\$3.35 billion, Russia has every ability to more than double its revenues each year.

Tholons: What initiatives has the Russian Government taken to promote offshore outsourcing in the country?

Dmitry Ponomarev: There have been a few Government initiatives with regard to taxes, special customs and visas regimes, educational and infrastructure development. We as a company benefited significantly from a new visa regime with EU which started in the beginning of 2008 – right now MERA can issue company's invitational letters for EU's citizens directly instead of going through a bureaucratic and long procedure of getting an authorization. Besides we enjoy an open and fruitful dialogue with customs authorities who realize the importance of supporting export-oriented businesses and show a lot of goodwill in facilitating MERA's activities with regard to exporting/importing equipment.

Moreover MERA contributes actively to fostering local educational and industrial ecosystem through active collaboration with universities and IT community. With great satisfaction we acknowledge that the Russian Government finally started increasing the budget quotes for students in exact sciences. This will ensure the future growth of Russian Software R&D industry.

Tholons: Do you plan to service the local opportunities in Russia/Eastern Europe in addition to international clients?

Dmitry Ponomarev: Historically MERA Networks has been oriented at providing Software R&D services for the international markets. Nonetheless we always kept an eye on Russia's/Eastern Europe's markets and were obviously keen to explore any viable opportunities in value-added Software R&D originating in these markets. The demand side of Russia's and Eastern Europe's markets has matured tremendously over the last 3-5 years and finally to our satisfaction we experience a demand for high-quality value-added Software R&D services. So we plan to service local opportunities and as a matter of fact we started providing Software R&D services to local large players already this year.