

# Maturity finally beckons for booming Russian IT services

The impressive achievement of 15pc year-on-year growth for five consecutive years could easily obscure the huge difficulties and drawbacks surrounding the Russian IT services community. That growth has largely been confined to the very top accounts in sectors such as oil and gas, banking and the public sector. What's more, the pervasive 'personal contact' culture meant large accounts often picked friends rather than the most proficient supplier of IT for large-scale projects. But as we head into the middle of the decade, Russian corporate culture is improving, competition is now welcomed, and a gaggle of other verticals are now beginning to join the Russian IT services spending revolution. *IT Europa* surveys the trends and players battling it out in Europe's largest country...

by Douglas Woodburn and Andrew Seymour

**D**espite boasting consecutive annual growth rates of over 15pc since the infamous financial meltdown of 1998, the Russian IT services market is light years from fulfilling its massive potential. 144m inhabitants, 34 companies making over \$1bn (€825m) in annual revenues, and a further 400 achieving sales of over \$150m (€124m) make Russia one of the richest end-user landscapes in Europe. But the market is still embryonic, and with fairly standard services such as ERP implementation and outsourcing still a relative stranger to all but the top Russian accounts, the explosion in Russian IT services has only just begun.

This immaturity is reflected in the stats: IT services and software licenses accounted for just 35pc of a total IT market worth \$4bn (€3.3bn) in 2003 - meaning the Russian services arena is dwarfed even by modest western European counterparts such as Norway, Belgium and Switzerland.

'20pc to 30pc growth in IT services is realistic for the next year or so, but this is coming from a very low base, with big projects driven mainly by the oil and gas industry,' illustrates Thomas Stuemer, managing director at US-based SI and consultancy BearingPoint's 64-strong Russian subsidiary. 'There is still a big need for the basics. ERP penetration is low. The biggest SAP implementation is the Russian railways - which has 10,000 users - and in total SAP has just 30,000 users in Russia.'

BearingPoint plans to dramatically expand 2004 sales of \$12m (€9.9m) by adding expertise in Oracle to its existing focus on SAP. International service providers playing further up the ladder in business and strategic consulting - including PwC, IBM and Accenture - are also set to finally be rewarded for their market presence as a raft of accounts move to higher value services. 'The market was

at first very chaotic after we entered in 1992 but is now maturing,' explains Alexander Landia, managing director at 150-strong Accenture Russia. 'A large part of our revenues are now from strategic IT projects as top management become interested in IT.'

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*'Russia is becoming a consumer society. To manage this growth the retailers need contemporary systems.'*

**Boris Volpe, SAP**

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This boom in IT is set against a backdrop of economic growth and political stability. Oil prices stand at a 20 year high, the country now has a trade surplus and economic growth is ticking along nicely at around 7pc. Vladimir Putin, elected for a second term earlier this year, has been hailed as the catalyst, with onlookers crediting a change in political leadership - rather than a potential collapse in oil prices - as the main threat to IT services growth.

Onlookers argue the emergence of a whole tapestry of other vertical markets should safeguard against any future oil catastrophe: 'Oil prices help but we're also seeing healthy growth in other sectors including construction and retail,' opines Eugene Peskin, executive VP marketing at 3,000-strong Russian IT group IBS. 'I believe the market will continue to grow at 15pc if there is no political crisis.'

IDC data reveals IT spend in Russia's booming retail sector jived up 43pc in 2003, topped only by wholesale and telco. Five or six of the 20 Russian accounts that command an IT budget exceeding \$50m (€43m) may well be oil and gas companies, but Russian IT

## Leading Russian IT Services Companies

by 2003 Russian sales (\$m)

company	2002	2003	total staff	Website
IBS	320	470	3,000	<a href="http://www.ibs-company.com">www.ibs-company.com</a>
Lanit	200	270	1,200	<a href="http://www.lanit.ru">www.lanit.ru</a>
R-Style	150	158	1,200	<a href="http://www.r-style.ru">www.r-style.ru</a>
Aquarius	85	109	330	<a href="http://www.asi.ru">www.asi.ru</a>
TechnoServ	45	85	440	<a href="http://www.technoserv.ru">www.technoserv.ru</a>
I-Teco	60	85	350	<a href="http://www.i-teco.ru">www.i-teco.ru</a>
Croc	55	81	370	<a href="http://www.croc.ru">www.croc.ru</a>
USP Compulink	66	76	160	<a href="http://www.microtest.ru">www.microtest.ru</a>
Microtest	52	75	350	<a href="http://www.microtest.ru">www.microtest.ru</a>
BDO Unicon Consulting	60	75	300	<a href="http://www.bd.ru/en">www.bd.ru/en</a>
Sibintek	40	57	2,100	<a href="http://www.sibintek.ru">www.sibintek.ru</a>
I.T.Co	49	56	850	<a href="http://www.it.ru">www.it.ru</a>
Open Technologies	-	55	100	<a href="http://www.ot.ru">www.ot.ru</a>
Optima	36	48	300	<a href="http://www.optima.ru">www.optima.ru</a>

All figures are estimates based on market sources and Cnews figures ([www.cnews.ru](http://www.cnews.ru)). Figures include revenues from assembly, distribution and resell activities. For instance, IBS, R-Style and Lanit all have big distribution wings and the majority of their sales does not come from services. Internationals including Accenture, IBM GS and Sterling Group would be in the top 10 on IT services revenues alone.

service providers are rapidly shifting their antennae towards higher growth verticals. Listen to Peskin at IBS - which has just unveiled a new business unit for retail: 'Oil and gas used to be over 50pc of our consulting revenues, but we believed that was a risk. Now we're moving into new market segments and mid-sized ERP systems for retail are going to be huge.'

Boris Volpe, marketing director Russia/CIS at ERP goliath SAP - which was one of the first internationals to break into the market in Russia in 1992 and now boasts annual sales of \$80m (€66m) - agrees the retail boom will bring a big windfall for business application players: 'Russia is becoming a consumer society. Retail is booming because of this, with the largest chains in Moscow all growing 40pc to 60pc year-on-year. To manage this growth the retailers need contemporary systems.'

The biggest Russian verticals - oil, telco and banking - have emerged as the mightiest spenders after a period of privatisation, fragmentation and then consolidation within these sectors spawned the emergence of some very streamlined and cost-conscious organisations. Onlookers argue other verticals will soon follow: 'Privatisation will have a positive effect. After privatisation, that industry will consolidate and the companies will start to think about business process

improvement and optimisation,' argues Stuemmer. IT players are currently salivating over the prospect of large-scale privatisation of the energy and defence sectors during the coming two years.

The government too is slowly changing its backward attitude to IT services. After waxing lyrical about e-government for several years, Landia argues the government's talk has been well-matched with action in the last 12 months: 'There was a reluctance to let western consultants into internal governmental affairs but it's now actively inviting advisors to talk about its core processes.' Accenture and SAP will be among the bidders for a recently

announced multi-million dollar World Bank-funded treasury contract, that will be one of the biggest deals on the market this year when it is released in September. 'This tender represents a very important step,' adds Landia.

This ground-swell of juicy projects is being accompanied by increasing openness and competitiveness. 'This is the biggest change,' proclaims Peskin at IBS. 'Private companies don't have to perform tenders but increasingly they are - and this means we gain access to deals that were previously off-limits and done under the table. They're looking into cost reduction, and because Russia has a history of unsuccessful IT projects, end-users want to make sure



Alexander Landia, managing director at 150-strong Accenture Russia (left) and Thomas Stuemmer, managing director at BearingPoint's 64-strong Russian outpost. Accenture boasts a stern reputation in consulting, while BearingPoint is keen to diversify from its core SAP consulting focus this year: 'We will still keep our focus on IT but want to be recognised as one of the top Russian systems integrators,' says Stuemmer. 'We'll do this by approaching new clients in telco, oil and gas and secondly by increasing our solutions portfolio, for instance developing our Oracle applications business.'



## Pack of locals at liberty to stay independent

Consolidation and M&A are words not yet in common usage among Russia's brigade of local services players. Besides IT group Lanit snapping up Apple distributor DPI in Spring 2003, the landscape has remained largely unchanged for the last five years. Eugene Peskin, executive VP marketing at 3,000-strong IT group IBS offers an explanation: 'Consolidation is not going to happen this year. It never does as the owners are also the managers and they are not ready to give up their empires.' Ambitious locals have had to rely on organic expansion. 'We have been looking to buy niche players offering vertical solutions for the last five years, but have not been able to,' testifies Peskin. 'If you pay a premium, everyone has a price but we're not ready to pay that kind of money.' With a prolonged purple patch of market growth yielding just one high profile bankruptcy - Ankey - in the last five years, it is easy to see why local Russian companies believe they can survive as independent.

M&A may be non-existent, but local IT services players are beginning to form ad hoc and even regimented unions to provide total solutions in an increasingly complex market. 'Now competition is much higher, our strategic direction is to form alliances,' says Alexey Golosov at FORS. 'We have formed temporary teams with competitors to promote our products such as Government Resource Planning Systems (GPRS)' FORS's regular allies include IBS, i-Teco and Compulink.

Consequently there's still a gaggle of around 20 to 30 local SIs that can be considered as serious players in the Russian market. With 2004 sales expected to nudge towards the \$500m (€412m) mark, and 1,000 staff added since last year, 3,000-strong local monster IBS is the undisputed king of IT services. Internationals including IBM, Accenture, BearingPoint and HP Services may have good claims for a spot in the top 10 from a pure IT services perspective but are out-numbered in sheer volume by the locals. 1,500-strong Lanit has earned a reputation in low-end consulting, and has recently been signed as middleware vendor BEA's Russian partner of choice; Tecnoserv is a strong niche player in the railway industry, 300-strong Cisco partner Croc has a fierce notoriety in networking; and BDO Unicon is an established player in consulting and audit. A catalogue of other names, including Dell partner Optima, 350-strong HP ally i-Teco, government specialist Microtest and corporate reseller R-Style, litter the upper echelons of Russian IT services.

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**Eugene Peskin, IBS**

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This group of players can be characterised by their efforts to move away from hardware - assembly, distribution and resell activities generally still account for over 50pc of their sales - towards higher-margin services. 'Like any other big Russian services provider, most of our revenues are still from hardware integration, admits IT. Co marketing director, Dmitriy Vedev. 'But we plan to become a real IT services company.'



Alexey Golosov, FORS (left) and Dmitry Vedev, IT. Co. Consolidation of the local landscape has not yet occurred. As a result, each Russian systems integrator retains a niche focus, meaning partnering with competitors is the only way to contest large bids: 'It is now normal to form joint proposals with some of our rivals for big tenders,' comments Vedev.

they don't make the same mistakes again.' End-users are now learning that competition between their suppliers is the only way to avoid costly cock-ups: 'We're currently doing an SAP installation for the oil and gas company BTW after its three previous attempts failed,' adds Peskin.

Although progress in corporate standards is undoubtedly helping to thump the notorious Russian personal contact culture, stern doubts remain. 'Corruption is still a massive problem,' judges Landia at Accenture. 'Last year we made little progress, as the government was less able to crack down on corruption than it was on the oligarchs.' Another international source is even more scathing: 'At the end of last year, we were forced to turn down a tender we

had already secured. When we won, the company said "you know the drill, where's the kickback?" - so we had to walk away. This was a very large corporation. Last year the local Russian SIs raised their fees despite the fact the quality of their services is not comparable with the internationals. I'm afraid part of that money is going into kickbacks - particularly in the regions.'

Some players allege that even the largest deals still fall prey to private interests. While some market sources say the appointment of Oracle in the Svyaz invest deal was 'unfair', and subject to 'insiders' influence', others complain at the recent appointment of Otkrytye Tekhnologii (Open Technologies) as prime contractor for implementation of this deal: 'In my opinion this was a bit strange,

as this is a huge deal and Otkrytye Technologii has no real experience,' snipes one onlooker.

Gauging whether these outbursts reflect the truth or are just sour grapes from disgruntled rivals is a hard task, and for every detractor there is another company eager to dispel any suggestion of corruption. Onlookers point out that a subsequently appointed commission which looked into how the Svyaz invest contract was awarded was fully satisfied that there was no foul play.

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#### Russian source

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Accenture is one of several companies reporting a slow turnaround in end-users' attitudes to outsourcing. But although some reports suggest outsourcing could already be worth 5pc of the total IT market (around €164m annually), these figures are probably overblown. 'Currently it's just the international companies outsourcing certain processes like payroll and infrastructure,' cautions Landia. 'Most of the outsourcing deals out there have no contractual basis or clearly defined service level agreements (SLAs) - and should not be considered as outsourcing.'

Accenture is currently taking an educational approach, advising large corporates and government accounts on designing proper

outsourcing SLAs. Peskin at IBS also paints a picture of an outsourcing market in the throes of immaturity: 'Outsourcing is still in its first steps but we are starting to see some demand. Last month we signed a deal with one of the biggest Russian insurance companies to take over 50 of their employees.' Yukos's failed attempts to crack the IT outsourcing market through spun-off IT arm Sibintec exposes the limitations of this embryonic sector: 'Sibintec tried to compete in other accounts but still gets 95pc of its revenues from Yukos,' asserts one critic.

But if its painfully slow progress means outsourcing is the dim child of Russian IT, the country's increasingly vibrant software development scene is certainly the precocious blue-eyed boy. Offshore programming outfit EPAM recently opened a location in St. Petersburg to add to several bases across CIS after acquiring Hungary-based Fathom in March. IBS - whose 500-strong subsidiary Luxoft provides programming for big western clients such as Boeing, Dell and IBM - is the region's second big powerhouse.

But does Russia have what it takes to challenge the Indian offshore kings? 'Russia is gaining respect as an offshore software development site, and once you've had a few success stories, customers continue to come in,' argues Peskin. Secondly, we have a high technical ability of staff. Last year we were certified at CMM level 5 and only a few companies in Europe have this. We do more sophisticated work than the Indians, solving problems rather than just simple coding.'

Peskin says there are several Russian IT groups poised to emerge as big threats: 'Eventually we will see some big offshorers emerging from the CIS. IBS will be one of them and Luxoft will have 5,000 employees in three to five years.' VDI and RekSoft are among five or ten names to watch out for.

## \$153m telco project exposes ERP under-capacity

DC reckons the Russian ERP market trebled in size in 2003, but most of this growth came courtesy of Oracle's \$153m (€126m) victory to supply software licenses to state-owned fixed line telco, Svyaz invest. But in a twist that will turn trampled western European ERP integrators green-eyed with jealousy, some players speculate the Russian services channel actually lacks the capacity to implement on this massive deal. 'We see a big problem as not one Russian company is ready to implement these licenses,' explains Stuemmer at BearingPoint, which is currently 'in negotiations' to fulfil a part of the roll-out.

With an iron grip on the telco and oil and gas sectors respectively, Oracle and SAP are well placed to continue surfing the tide of demand in the ERP arena. Note the two have contrasting strategies, with SAP boasting 150 of its own consultants

in Moscow alone, and Oracle relying solely on strong partner links with international partners and locals including BDO Unicon

*Eugene Peskin at IBS. 3,000-strong IBS is the top Russian company in both IT consulting and software programming. Mirroring most of its competitors, IBS also boasts resell, distribution and PC assembly activities.*



## **national survey**

Consulting, Tops BI and Borlas. SAP itself works with international partners such as Accenture, BearingPoint and IDS Scheer, as well as a smattering of locals such as oil and gas specialist IKT, Technoserv and IBS.

But rival PeopleSoft – fresh from the launch of a Russian office earlier in June – reckons there is still plenty of room in the midmarket. ‘The timing is right’, proclaims Jeff Read, VP PeopleSoft distribution group EMEA. ‘The high-end of the market is saturated but we see the dynamic emergence of mid-to-large accounts. They need flexible systems and we’re going after this.’ The business applications giant is in talks with a number of ‘both international and local’ partners to attack the key verticals of mining, manufacturing, construction and real-estate with its EnterpriseOne product.

Volpe is less convinced, and asserts SAP will pile on more pressure in the SMB market later this year: ‘We’ve begun building a specialised partner channel around Business One, which is set for an Autumn launch. Midmarket and SMBs will account for 10 to 15pc of our business by 2007.’ Alexey Golosov, CEO at 300-strong software developer and Oracle distributor FORS, warns: ‘It’s not a question of the quality of product. We’ve seen companies that are not well-known failing in Russia and any newcomer must invest a lot to win the market.’

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PeopleSoft isn’t the only international software outfit moving in. Supply chain management vendor i2 and middleware goliath BEA both entered Russia earlier this year, while a host of niche vendors including Australia-based Mincom, have recently begun attacking opportunities in verticals such as mining and metallurgy. ‘Supply chain management will soon be a big market, not just from a systems point of view but also from a business process perspective,’ adds Stuemmer at BearingPoint. ‘Now the oil companies have a big potential to optimise their whole business processes from extraction to export.’

While international service providers continue to pour more resources into this market – Austria-based systems integrator S&T just opened up a second Russian office in St. Petersburg and IBM is said to have just completed a hefty recruitment drive – established locals are also setting their sites on geographic expansion. ‘We were the first company to expand and obtain national coverage, but in the last year or two other SIs have started to open offices in the regions,’ says Dmitriy Vedev, marketing director at 600-strong



*Alexey Saraev, country manager PeopleSoft Russia/CIS, is looking for 10 Russian partners following PeopleSoft’s launch in Moscow earlier this month: ‘Companies operating in several verticals are now coming under one holding and it’s important for them to manage their data flow and cash flow centrally through one ERP system,’ says Saraev.*

IT. Co, which became the first Oracle partner to offer software support services outside Moscow and St. Petersburg last year and is poised to add to its 20-strong network of Russian/CIS offices. ‘Croc recently opened an office in the Urals and IBS in Nizhny Novgorod,’ says Vedev. ‘If you want to be a supplier of the major customers, you have to open offices.’

### **our analysis**

**1) Although the Russian IT services market has been booming for over five years, only now is it becoming a truly attractive market to operate in. Two years ago a select few governmental, banking and oil and gas accounts were alone in their progressive attitude. With oil prices soaring and economic stability finally arriving, this spending culture has spread to other verticals such as retail, construction and energy. Expect 30pc plus growth in these verticals for the next three years as end-users rapidly move to install systems to handle their expansion. International consulting companies are set for a huge influx of public sector contracts as the government finally opens its processes to international service providers.**

**2) S&T’s recent Russian expansion highlights the allure of this high-growth market for internationals. But pulling off an acquisition of a Russian niche player is comparable to prising a stubborn old limpit from a rock. Potential targets remain ferociously independent and organic growth is the only option open to hungry western service providers.**

**3) Corruption remains a large-scale problem. Stories of even the largest accounts engaging in kickbacks endure. But the increasing volume of public tenders and improving corporate climate will help.**

**Any feedback? Please contact:  
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