

CIS: one for the brave?



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Geographically vast and economically poor, the CIS, excluding Russia, offers an opportunity for some of the gamblers among the IT industry to find a place where returns good be good, or disastrous if the results fall away only slightly. With more countries than the Baltics and the Balkans put together it, yet with each having a different language and currency, is certainly a region that merits a closer study.

The irony of the former umbrella states of the Soviet Union having their economies blasted apart by the problems of the financial institutions in the west is not lost on their populations. But the IMF has just warned that the emerging market banks, "especially in Europe and the Commonwealth of Independent States", may need to be recapitalised, because of the estimated €250 billion capital shortfall. Commonwealth of Independent States (CIS) members will need to spend 1-3% of their GDP to support the banking system of each country during the financial crisis, the Russian finance minister said just this week. And with declining economic fortunes, the countries are in no position to help themselves. What will the effect on the emerging IT businesses be in 2009?

To start with, we are removing Russia from our considerations; while it is being badly hit by the global situation, it has its own issues and we are holding off on its analysis until much later in the year. Some of the remaining CIS countries such as Ukraine and Belarus also have their own issues, some of them political. But given that most major IT vendors and support organisations group

What is the CIS?

*Azerbaijan
Armenia
Belarus
Georgia
Kazakhstan
Kyrgyzstan
Moldova
Russia
Tajikistan
Turkmenistan
Uzbekistan
Ukraine*

The Commonwealth of Independent States (CIS) is the group of countries previously under the control of the Soviet Union, which banded together in 1991.

Rumors that the Executive Committee of the Commonwealth of Independent States (CIS) will soon disband are "grossly exaggerated," a top official of the CIS Executive Committee said last month. "Rumours that the CIS will soon come to an end have proved grossly exaggerated," the Itar-Tass news agency quoted Sergei Lebedev, chairman of the CIS Executive Committee, as saying.

But the CIS has become a political cockpit. Anatoly Serdyukov, the Defence Minister, told the same meeting that the US was attempting to gain gain control of oil and gas resources in Russia's former Soviet neighbours in the Commonwealth of Independent States (CIS).



these states together, not least because individually, they are so small, but many of the problem they face are the same. That being said, the ten countries have ten different currencies, and have their own inflation rates, and tendency to devalue.

The IMF meeting on regional issues

concluded these problems: the difficulty of obtaining foreign capital, with the largest impact observed in Kazakhstan because of the large share of private external financing in the banking sector;

- Lower oil and commodity prices, the impact of which is most pronounced in the four energy exporting countries—Azerbaijan, Kazakhstan, Turkmenistan, and Uzbekistan—which have seen a sharp turnaround in both their external and fiscal balances;
- Lower remittances primarily from Russia, which will impact the smaller countries in the region, where remittances account for at least 20 percent of GDP. With less work available for migrant workers in host countries, some of them will return to their home countries, contributing to a worsening in social indicators and putting additional pressures on social spending; and
- Lower trade flows in view of the slowing growth in trading partners.

One of these countries under the inescapable shadow of its heavyweight neighbour is Belarus. The Coface Group notes in its latest quarterly country experience study the financial influence Russia has had on the Belarusian inhabitants. Subsidised imports of gas from Russia have greatly helped Belarus' economic performance. The gradual alignment of the imports with world gas prices by 2011 tends to weaken local industry and spur surges of inflation. The slowdown in Russia also affects Belarus, as does a lack of market share over there.

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Kirill Degtiarenko, IBA Group

Kirill Degtiarenko (*right*), director of the IBA Group's Business Development Centre: Belarus has an open economy and most of its enterprises produce goods for foreign consumers. The same can be said about the IT industry. Major Belarus-based software development centers are involved in offshore software development. Therefore, the recent developments in the world economy have dramatic impact on the Belarussian IT industry.

Speaking about the degree of such impact, he believes that it depends on a variety of factors:

1. The ability of an IT company to adapt to the changing environment, diversify its portfolio, and apply new technologies
2. The ratio between products and services and the possibility to switch from one business line to another
3. Target industries. The companies that render services in the financial sector are more vulnerable to the recession
4. Customers. The clients that have a “margin of safety” are better positioned to use the opportunities offered by the crisis.

According to local media, major IT players in Belarus face a sharp fall in the number and value of contracts. As a result, they are forced to cut costs and lay off personnel.

In December 2008, a number of Belarussian IT companies released all interns and refused to hire university graduates. The steps were followed by more radical measures. Some companies cut up to 20% of their jobs, shut down a number of field offices, canceled bonuses or revised their employee support programs. Others preserved nominal salaries without adjusting those to a new

Belarussian ruble exchange rate, which resulted in 20-30-percent lower real earnings.

These developments are not surprising because the IT industry is highly responsive to global changes. IT budgets are among the first to undergo reduction at organizations in crisis situations. Moreover, right before the downturn many IT companies were aggressively recruiting



IT specialists, which led to a sharp deficit of programmer resources on the labor market and unjustified growth of salaries. In many cases, people were employed while the projects were not available.

“As for IBA Group, I would like to say that we feel the changes but fortunately, they had no significant influence on our business. The reasons are the possibility and the ability to diversify our portfolio, the wide geography of our services, our rich client base, and a careful approach to staff augmentation.”

The economic crisis has transformed the Ukrainian IT industry, says Pavel Olszynka (*right*), Head IT & Telecoms Analyst at local experts PMR. During the last two months of 2008 sales in key market segments dropped by 20-50%, he says.

“The declining purchasing power does not represent the only challenge for IT companies in Ukraine. Changes in buyers’ needs have made many established IT products and services needless. In 2009 almost all vendors will have to re-think their business models, search for new products and optimise performance. Those who manage to pass this exercise successfully will stay in the business and even gain better market positions.”

Leading distributors and system integrators in Ukraine do not expect the Ukrainian IT market to recover quickly. In 2009 market volume will be about 30% smaller than in the previous year. Sales could begin to climb again only in 2010, and only if the overall economy improves in Ukraine. Future growth rates will also not be as high as they had been in the past.

But despite the economic crisis, in the country with 46 million citizens, developed industry, banking sector and infrastructure, there is still significant potential for IT business. Ukraine had heavily under-invested in IT in the past and still falls behind other Central and Eastern European countries in PC penetration level, IT spending per capita and usage of management information systems in traditional business, he says.

Suppliers of IT products and services to Ukraine mention that even in industries very much affected by the crisis, such as banking and metallurgy, there are strong players who have been able to stabilise their operations and have implemented anti-crisis measures. These companies already use advanced IT systems and will need further IT investments for efficiency improvement. However, their IT needs and the projects they are looking for are different from the mainstream IT needs and projects executed before the crisis.



In 2009 the role of the Ukrainian IT market engine will pass from retail hardware sales to corporate IT system optimisation and upgrade projects. The market will not ask for design and engineering of new data centres and network infrastructure, supply of high-end servers and lots of performing workstations as it had in 2007 and 2008. These segments will shrink significantly. The future also looks bleak for multi-month implementations of new full-scale ERP, CRM or BI systems.

What Ukrainian IT buyers will be looking for is improvement and better performance of existing IT systems.

Solutions like server and data storage virtualisation, cost control or modifications of corporate information systems due to business restructuring have high chances of market success in 2009.

“IT projects should now meet at least the following three basic criteria to be in demand during an economic crisis:

- Should be fully operational within three months and start generating or saving money immediately after implementation.
- Should be focused on resolving specific business problems, be simple and clear. Chances to implement sophisticated complex solutions are low.
- Should have high and transparent return on investments (ROI) and entail low risk.

“These changes represent big challenges and opportunities for vendors active on the Ukrainian IT market. In addition to the current problems of liquidity, lower revenues, high costs and unsold inventories, IT companies will need to resolve more fundamental issues of careful selection of market segments and of building up attractive solutions and developing the right internal competencies,” says Pavel Olszynka. Companies with a portfolio of established clients have better chances of survival, he thinks. The most optimistic forecasts for market performance are formulated by suppliers of solutions for corporate information systems and IT consultants, while retailers of box software and PCs do not expect their market segments to behave well. Some PC retailers have started to develop additional services, like “computer first aid” and support services, to balance sales.

PMR interviews with leading market players showed significant variance and sometimes even contradiction in the respondents’ vision of interesting market segments and sellable solutions. For example, some managers believe IT outsourcing has good chances while others think that lower wages and surplus

Top national IT services companies in CIS (excluding Russia) By sales Euros (m) based on IDC and IT Europa estimates				
Company	Country	Headcount	2007	2008
BelHard JSCV	Belarus	1100	9.1	15.16
S&T Mold SRL	Moldava	22	4.5	n/a
S&T Soft-Tronik Ltd	Ukraine	189	43.6	n/a
IBM Global Services	Ukraine	75	9.0	n/a
LLC ComArch	Ukraine	23	4.4	n/a

skills will make outsourcing needless during the crisis.

Almost all Ukrainian IT vendors developed anti-crisis packages for their clients at the end of 2008. Also, they started to offer new distribution models, like SaaS (software as a service), leasing and even trial piloting. It is difficult to forecast which model will become successful as today the Ukrainian IT market is dependent on a number of highly unpredictable factors, including performance on export markets and internal political development in the year of president elections of 2009. One issue is certain: changes will happen fast and results will be visible closer to autumn 2009.

Alexander Egorov, General Director at outsourcing specialists Reksoft, admits that the recent financial uncertainty has made everyone more careful with spending, but that outsourcing is in a beneficial position. "It certainly strengthened companies' interest to outsourcing as a tool helping to reduce expenses and focus on their core business. At the present moment the number of RFI from overseas companies has increased and we even receive inquiries from such unusual for Russian providers delivery destinations as Middle East and Australia."

The CIS region is vulnerable at the moment, with the finance sector in particular problems. Egorov agrees that the region's financial structure is in trouble, and says there has been a drop in financial, mining and the manufacturing sector. Though considering industries such as telecommunications and energy generation will remain stable, Egorov also highlights the Ukraine as being particularly vulnerable. "Fortunately, we don't have any clients or branches in Ukraine. However we are being informed by our partners that the economic situation there is rather a hard one. Ukraine has been affected severely by the global economy crisis due to the absence of its own stable economy, constant political shakes and uneven industry portfolio."

Pressure on the survival of companies in eastern Europe, particularly in Russia and the CIS states is making many turn back to piracy says Symantec's local distribution manager, Oleg Nikitsky.

"It's tough for everyone now," he tells IT Europa. In the last three years, the SME sector had started to turn legal, but now this is not so important to small companies fighting to survive." Even mid-markets are feeling the pressure: "Where previously they would have bought all the options for backing up three SQL servers, they now only want the more important to be protected."

Telecoms is still spending on IT as users have not stopped using their phones, but the retail sector has seen a significant decline, he says. And companies are buying security software, but trying not to take maintenance, relying on existing coverage of anti-virus and anti-spam. With Symantec's core business in security and storage, he expects to be less badly hit than suppliers of ERP systems, but the next year will be very difficult to predict.

And the government and public sector is still buying strongly, though devaluation of currencies especially in Ukraine has made buying very hard for dollar-priced goods such as software.

Egorov at Reksoft is extremely positive regarding piracy. Though the region has long had a reputation for being amongst the worst in Europe, Egorov believes there have been strong improvements. "Due to energetic government measures taken during the last year, the level of piracy is declining. Thus, in 2008 Russia has signed the agreement of World Intellectual Property Organization. A number of renowned cases against non-legal usage of global vendors' products were brought to the court."

► OUR ANALYSIS

Whether this anti-piracy momentum can be sustained is going to be up to the giants like Microsoft and Symantec, who we reported last year were having some success. Otherwise even the main IT market may suffer.