

*A Reflection on the Business Climate
in the Ukraine*

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WHERE SOFTWARE CONCEPTS COME ALIVE

Outsourcing operations during political instability

Current business climate in Ukraine and beyond
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- Geopolitical concerns: What's at stake?
- Geopolitical risk management
 - Lessons from history
- Ukraine business climate
 - Ukraine IT
 - Crisis impact: fears, opportunities, future
- Closing thoughts

- Established in **1995**
- Over **450 full time employees**
- About **130 “crowd” contractors**
- Customers in **30+ countries**
- **200+ successful projects**
- 2006-2014 **Top Outsourcing 100**
- 2007-2014 **Global Services 100**
- 2009-2014 **Software 500**
- 2008-2014 **Inc 500/5000**
- 2010 **European IT Excellence Award**
- 2014 **EOA Best Project Award**

- Head Office: **Chicago, IL**
- Global Locations:
 - **Düsseldorf, Germany**
 - **Tokyo, Japan**
- Delivery Centers:
 - **Minsk, Belarus**
 - **Kyiv, Ukraine**
 - **Kharkiv, Ukraine**



› **2013 Philippine typhoon: *Power outages & delays***

- › “IT-BP operations in the cities of Cebu, Iloilo, and Dumaguete [were] suspended in preparation for the typhoon. Temporary power outages and disruption in telecommunications infrastructure led to higher absenteeism in these cities. Flight connectivity was hampered with the cancellation of a number of domestic and international flights.”

– Everest Group

› **2008 Mumbai terrorist attacks: *Need for contingency plans***

- › Attacks “will not affect outsourcing, but it is a concern that points to the prevailing bad condition of Indo-Pak relations; companies need to asses the risks and make sure they are outlined in their contracts”

– Alsbridge

› **2014 Ukraine crisis: *Falling sales***

- › “It definitely affected the industry. Even though the clients are sympathetic of what’s going on, and they kind of trust what we say to them, we did notice that there is a fall in pre-sales.”

- Ciklum, Ukraine

› Egypt's Uprisings: *Internet shut-off*

- › “When the first response of the government, in times of political crisis, is to shut down the Web, this has a massive impact on the nation's global sourcing infrastructure to support global businesses.”

– Phil Fresht, HfS Research

› Argentina debt restructuring: *Default?*

- › “If Argentina defaults, the country would be completely excluded from the financial markets. There would be devaluation, inflation, unemployment, and economic activity would go down,”

– Marcos Leonetti, economist, La Economia Online

› Japan-China island dispute: *Limited trade*

- › “As many as 60% of China's corporate leaders [are] unwilling to do business with Japanese firms, according to a new poll. Only 13% of Chinese businessmen said that they were able to separate their work from the current political tensions.”

– Telegraph.co.uk

› USA-Mexico travel restrictions: *Dangerous travel*

- › “U.S. citizens have been the target of violent crimes, such as kidnapping, carjacking, and robbery by TCOs in various Mexican states.”

–US Department of State

➤ How do geopolitical risks affect offshore investors?

➤➤ Project management:

- Project deliverables & workforce productivity
- Talent shortage & brain drain
- Data loss & security
- Communication & connectivity problems

➤➤ Strategic planning:

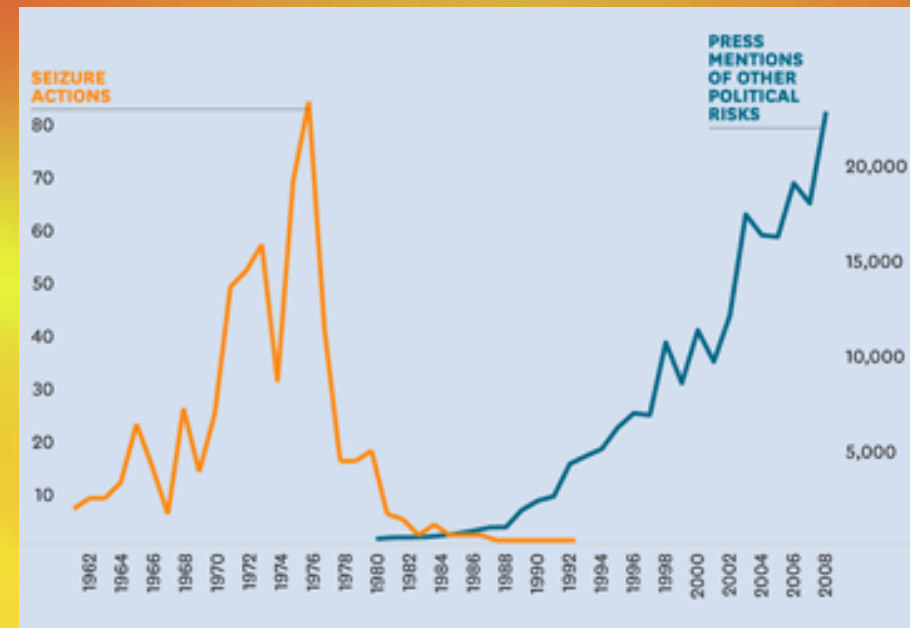
- Necessary awareness of political risks
- Creation of contingency plans
- Preventative contract clauses

➤➤ Financial concerns:

- Increased costs
- Unexpected transition costs
- Canceled projects
- Loss of investment

➤➤ Presence in unstable markets:

- Foreign seizure & policy risk (graph)
- Opaque policy-making equivalent to 33% increase in taxation
- Loss of communications (like Internet)



Emerging markets: Since 1980, foreign companies experience less seizures, but more political risks like regulatory action



First Internet infrastructure was laid in mid-19th century

- Countries with capability of shutting down national internet:
 - Russia, China, Syria, Egypt, Iran, Libya, Maldives, Nepal, Burma, North Korea, Turkey

Internet communication:

- Technological base for outsourcing and globalization
- Internet cables have become as important as oil pipelines
 - ... raising similar geopolitical concerns
- Location and access to cables depends on diplomatic relations with other countries
- Implications for big cloud data centers?
 - (Google just finished building a huge one in Finland)

“To remain a global player today, a firm must be able to survive **not only economic downturns, but also *geopolitical shocks*.**”

– *Sven Behrendt & Parag Khanna*

World Economic Forum advisors

“With the political situation between _____ tense, analysts [are] warning clients that have outsourced operations to _____ companies to ensure they not only have thorough contingency plans in place, but that they are in "constant communication with their vendors" to make sure that those plans are "viable and can be executed immediately".

– *Information Age, 20__*

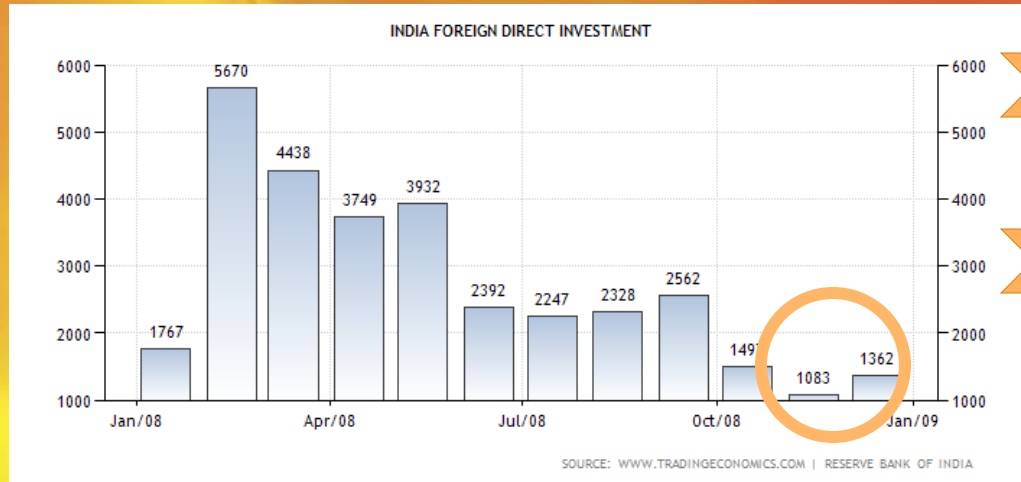
➤ What can we learn from history?

➤➤ How have companies dealt with this before?

“With the political situation between Pakistan and India tense, analysts [are] warning clients that have outsourced operations to Indian companies to ensure they not only have thorough contingency plans in place, but that they are in "constant communication with their vendors" to make sure that those plans are "viable and can be executed immediately".

– *Information Age, 2006*

- Some economic impact is to be expected, but it can be managed
- **Example:** Historically, the India and Pakistan conflict has often affected the levels of FDI flowing into the country

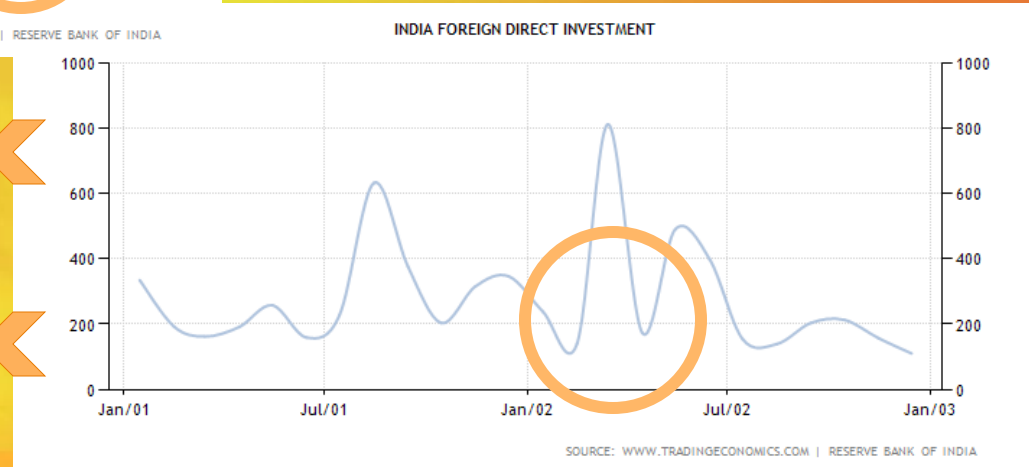


➤ 26-29 Nov 2008 Mumbai terrorist attacks

➤ 26-30 Dec 2008 conflict escalation

2001-02 India-Pakistan standoff

Dec 2001 – June 2002, escalation May 2002



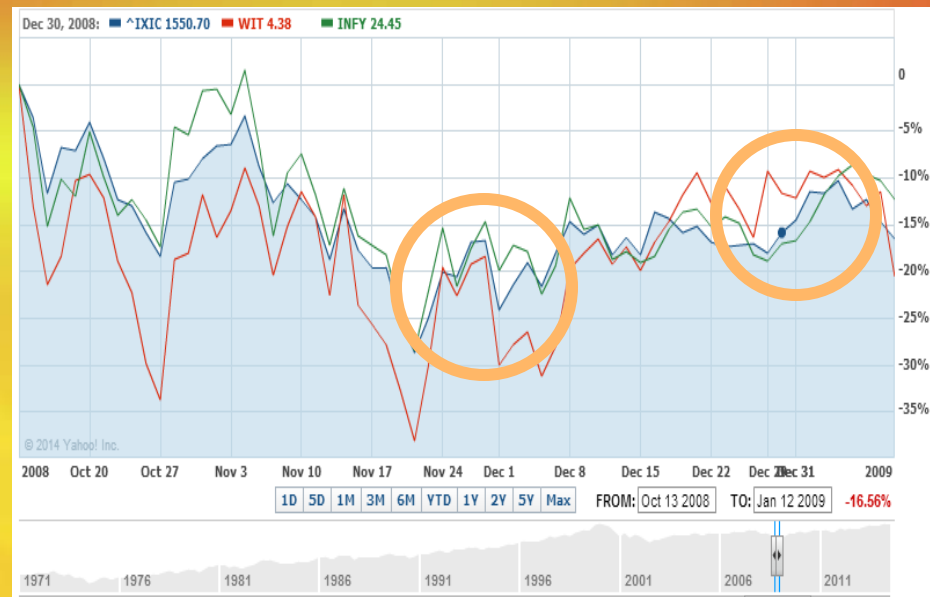
➤ But it seems that what matters most is the commercial partner, not the geopolitical climate itself

➤ Example:

➤➤ Stock prices of **Infosys** and **Wipro** show no major divergences when compared to NASDAQ during conflict escalation



➤ 2001-2002 India-Pakistan stand-off



➤ 2008 Mumbai terrorist attacks

- Biggest risk is for companies that are unprepared (typically small companies)
 - **Globalization requires companies to:**
 - Define governance
 - Be aware of regional vulnerabilities
 - Protect information and technology
 - **Preparation throughout outsourcing lifecycle:**
 - Define strategy & operating model
 - **Develop solutions & proposals**
 - *translate goals into solution scenarios; consider risks including geopolitical risks*
 - Evaluate deal & transactions
 - Manage transition
 - Manage relationship
 - Actions within client's control:
 - Strong project management
 - Process orientation
 - Onsite knowledge retention
 - Good system documentation
 - Open communication with vendor
- All these things make it easier to transfer work when absolutely necessary**

➤ Dec 2013-Feb 2014: Mass protests & ousting of president

➤ March: Annexation of Crimea by Russia

➤ May 25th: Ukraine presidential elections

➤ July: Fighting in Eastern Ukraine continues (map)

➤ July 10th map of rebels and gov't forces:

➤ Situation now better:
• rebels fleeing from gov't offensive

➤ Economic cost: Ukraine has borrowed more money in 2014 than during the 2008 recession



➤ Talent

- 30,000 ICT graduates every year; 861 universities
- 47,000 professionals
- 4th country with most certified IT professionals

➤ Industry growth

- 20-25% annual market growth (2013)
- \$1.3 US\$ billion industry

➤ Cost efficiency

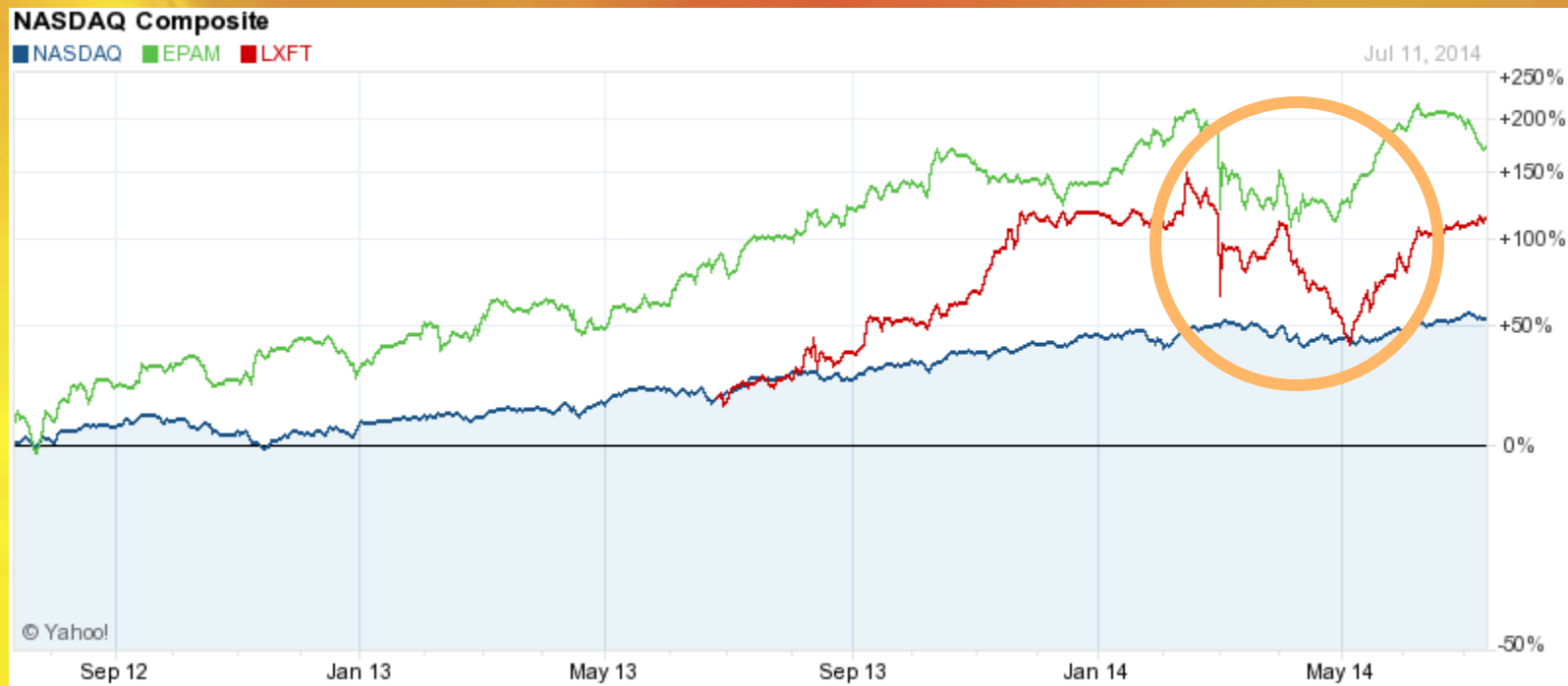
- Rates in IT are 42% of those in USA
- Lower wages than EU members
- Developer salaries range \$18,000-\$48,000 (after tax)

➤ Government support

- Intention to become “Silicon Valley of Europe”
- Efforts to prevent brain drain; create 100,000 jobs by 2020
- Expansion of tax benefits (currently: 5% tax rate for IT companies)
- “Innovative Ukraine” initiative to improve IT education & industry



- Customers are more cautious
 - Asking about contingency plans & formulating transition strategy
 - Some are transitioning out of Ukraine and considering new locations
- Observed drop in pre-sales and new contracts
- Observed drop in stock prices for **EPAM** and **Luxoft**; with signs of recovery



"Some clients have voiced concerns over the situation in Ukraine, but queries from customers tended to seek information on regional plans, rather than worries about the feasibility of continuing to do business there."

- Luxoft, Ukraine



- ***Propaganda and “hybrid wars”***
 - Continued instability perpetuated by war propaganda
 - “Infused” instability
- ***Recession***
 - Economic downturn after conflict
 - Political instability
- ***IT market fragmentation***
 - Population movement causing permanent fragmentation; small companies increasingly unable to compete
- ***Personnel shortage & brain drain***
 - Fear of talent shortage caused by military draft
 - Immigration
- ***Delivery interruption***
 - Infrastructure damages
 - Developers fleeing troubled regions affect workflow
 - Monetary loss





- › **Information and data loss**
 - ›› Need for backup and recovery schemes
 - ›› Availability of local hardware, connection and project management tools
 - ›› Loss of bookkeeping, finance, legal support
- › **Network & infrastructure security**
 - ›› Continued support and connection for production and delivery
 - ›› Retain access to all parts of the system
- › **Employee safety**
 - ›› Employees getting to work on time and unharmed
 - ›› Communication plans in case of danger
 - ›› Ability to work from home
- › **Contingency plans**
 - ›› Is there a plan of action in case of imminent danger
 - ›› What is the worst-case-scenario (at which point does production stop?)
- › **Need to transition project**
 - ›› What are plans to transition work to other locations and assure delivery continuation
 - ›› Status of team and employees in case transition becomes necessary (relocation vs. new team)
 - ›› Time needed for relocation & restoration of production

› **Fall of Hryvna**

- ›› Dropping currency can become an extra advantage (helped in India)



› **Best offshoring destination**

- ›› Ukraine remains an attractive IT regions in CEE (provided the conflict is resolved)

› **Increased government support**

- ›› To avoid recession, new government is actively trying to support IT market

› **Low attrition:**

- ›› Developers might be more likely to stick with their jobs to avoid insecurity

› **Moving West-ward**

- ›› Ukraine has been traditionally split between Russia and the West; Russia over-stepping its boundaries might propel Ukraine to join the EU and look to the West
- ›› “Traditional” EU acceptance transformation period with high volume of FDI

› **Concentration on High-tech**

- ›› Industry is likely to move further into high-tech development with new funds from EU

➤ ***Rapidly rising outsourcing location***

- Became prominent outsourcing location in last 5 years
- Became “equal” to other locations like India, Latin America, China, SEA, Africa

➤ ***Developing trust...that's now lost***

- Clients perceived adequate business conditions
 - After 25 years free of Soviet rule
- Big business finally began to explore the region
 - First mega deal (EPAM & Barclays ODC for 700 people)

➤ ***Long-term regional damage***

- Slower CAGR: mega deals will go elsewhere
- Eastern Europe market share: still short/mid-term R&D projects
- Puts the region back 10-20 years
 - Negative perception of Russia rose from 42% in 2013 to 72% in 2014 in US, from 54% to 74% in Europe

➤ Situation improving

- Last week S&P changed Ukrainian rating from 'CCC negative' to 'stable'
- Rebels flee under Ukrainian government offensive



➤ Rebel forces on May 20th 2014



➤ Rebel forces on July 10th 2014

› **Service delivery will continue**

- ›› “Over the longer term -- the next three or more years -- the issues with Russia are unlikely to have a significant impact on service delivery in Ukraine. Ukraine's proposition as a technology service location is well-established, particularly for domain-intensive skills.”

— Salil Dani (Everest Group)

- ›› “Workers actually stepped up productivity this year, despite distractions. (Or maybe because of those distractions.)”

—Anthony Conte, EPAM Ukraine

› **Demand on the rise**

- ›› The demand for talented software engineers is increasing
- ›› Very bright future for Ukraine, if situation de-escalates
- ›› People will realize it's not Russia

› **IT organizations contract with companies, not countries**

- ›› “IT organizations and CIOs don't contract and outsource to countries, they contract and outsource to companies. Given that, it's time to stop assessing location-based risk in a vacuum because sometimes the 'riskiest' suppliers may have the most innovative solutions.”

– Charles Green, Forrester Research

› **Businesses are politically agnostic**

- ›› Locations & partners selected based on ROI
- ›› Ukraine will be able to provide attractive ROI for many companies even after conflict

Thank you!

Q & A

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