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Outsourcing Business Faces Bumpy Road

By Rachel Nielsen

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HP is one of a handful of Western and domestic firms looking to boost revenue by selling IT outsourcing services.

When consumer electronics company M.Video was transforming itself into a nationwide chain, it had to make a choice: set up the information-technology systems for far-flung stores on its own or hire external specialists to do the job.

The chain, whose expansion took it from a Moscow retailer with two stores in 2001 to a national empire with almost 300 stores in more than 100 cities today, went with the second option. In doing so, it became an early customer of what is still a tough sell for information-technology companies in Russia: IT outsourcing.

The business of managing a customer's databases, digital applications or computer networks is in its infancy here, even though it has long been a significant revenue stream for IT companies in Europe and the United States.

The obstacles to the growth of this specialized segment include customer fears over leaks of sensitive information, complacency with in-house IT teams and other factors particular to Russia's business culture.

Vladimir Zaitsev, director of Hewlett-Packard's corporate services department in Russia, said companies hesitate to use outside IT services because of both "undoubtedly weighty reasons" and "typical cop-outs."

Moreover, potential clients are often unaware of potential benefits, including financial ones. Typically, they will save money by paying outside experts to handle IT tasks because of the economies of scale, expertise and local relationships that those external companies can offer. The upshot is that any expansion of the IT outsourcing market will involve both patient salesmanship and a change in prevalent attitudes among top executives.

Since IT outsourcing is a foreign practice introduced with the arrival of multinational companies, simply making customers comfortable with it can be a challenge.

For M.Video, one of the biggest sticking points during its consideration of IT outsourcing in 2004 was the newness of the concept.

Though it now has five external IT suppliers, including Russian heavyweights IBS Group and Croc, the main issue then "was that the idea of outsourcing in Russia was still not well-developed," said Igor Veselov, IT operations director for M.Video. "In fact, even now Russia still lags behind Europe in this area," he added.

Alexander Prokhorov, a research manager for IDC in Russia, says the spending on IT outsourcing is about 13 percent of the nearly $6 billion in revenue that IT service companies here earned last year, or about $780 million. J'son & Partners Consulting calculates a similar figure.

Security First

Fears of undermining the security of a company's information is "one of the typical reasons why companies don't consider outsourcing," Zaitsev said, adding that it is also "one of the biggest myths."

Dina Nurkayeva, who has worked for technology conglomerate IBS Group and the in-house IT company at defunct oil holding Yukos, said that for some corporate managers, when data "is not under [their] desk, there is a concern it will leak."

But that is misguided, said Nurkayeva, who now is business development director at Siemens Enterprise Communications. The high-security practices of a professional outsourcer can in fact make data more secure, she said.

Nurkayeva also said distrust is an issue in selling IT services.

"There are some paranoid people who will never, ever trust you," she said. For customers who are interested but hesitant, the salesperson should offer outsourcing for noncore business functions — those that won't shut down the company if they misfire — and prove to the customer that the data can be handled competently.

“Then, when the trust comes, when the service is confirmed ... you can enrich your contract” with the customer and add more outsourcing, she said.

Robert Farish, regional director for IDC in Russia and the CIS, pointed to what he views as deep-seated hesitations.

There is “a very long-term cultural suspicion of dealing with third-party suppliers in this country,” he said, and the distrust is “deeply embedded in” the corporate culture here. When they have in-house IT services, executives can control the employees directly, he noted.

Imported Culture

Another cultural factor at play is that third-party technology support is a relatively young concept here, one that came with the onslaught of multinational companies after the fall of the Soviet Union 20 years ago.

In major state offices and research centers in the Soviet Union, internal IT operations were the norm, Nurkayeva said. Except for some number-crunching computers that research institutes sometimes rented out, IT operations “were always in-house,” she said.

Though local companies have been progressing in their use of information technology over the past 15 years, outsourcing hasn’t come as far.

“The emphasis on Russian investment has been on infrastructure within companies,” Farish said.

“It hasn’t helped [firms supplying IT services such as] HP and IBM, which maybe would’ve made a lot more money if things had been different here” in terms of outsourcing practices, he added.

Yet, foreign firms actually drive the outsourcing demand. “They’re typically leading the way in this market,” he said.

Large foreign companies setting up operations in Russia tend to seek second-party IT services once they land here, as “outsourcing is very much part of the culture of international companies,” Farish said.

Long-running, cross-border businesses have an advantage when it comes to outsourcing: They generally maintain detailed information about what their information technology requirements are and how much they cost. That allows them to easily transfer those tasks to another company, Farish said.

If a company says it isn’t ready for second-party IT support and services, that might actually be the case, said HP’s Zaitsev. That could be an honest realization of what it needs to accomplish before it can transfer its own internal processes.

Ruslan Zayedinov, deputy general director and data processing division head for Russian systems integrator Croc, also said senior management may believe that shifting to outsourced services might require more self-assessment than the company is prepared to undertake.

Yet, the benefits can make the transparency pay — in a literal sense.

The Payoffs

Veselov said M.Video will shave at least 20 percent from IT support costs for its stores by using outsourced services. M.Video also relies on outside services for applications, and though it probably doesn't save money on that aspect, it does minimize dangers to critical systems, he said.

Also, Zayedinov said a company risks far less money by outsourcing a brand-new project than by handling it in-house.

It can test out new computer applications or projects on an outsourcer's [servers] without making long-term commitments to hiring, equipment and office space, he said.

Long term, the potential for the IT outsourcing market is positive, but the growth picture is still hazy, executives and experts said.

The market is growing continuously, Zaitsev said, adding, "I think it's on the verge of explosive transformation."

Anatoly Karachinsky, founder and president of IBS Group, said the cost benefits eventually will force even the biggest Russian companies to turn to outsourcing.

Currently, behemoths such as state-owned Sberbank, gas monopoly Gazprom and privately held oil firm LUKoil maintain sprawling IT divisions that essentially are companies in their own right. Such companies rarely use outsourcing, Karachinsky said.

That will change in the next decade: Management teams at big domestic companies won't commit to IT outsourcing for another "several years," but they are being driven in that direction, he said.

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