

Analytical Review

IT Outsourcing in Ukraine

**Strong trend despite political and
economical challenges**

The aim of this paper is to analyze political, economical and social changes that occurred in Ukraine since "Orange Revolution", discuss dynamic of Ukrainian IT sector and point to effects of the Global Financial and domestic political crises on the Ukrainian economy in general and IT industry in particular.

Economic Growth

In 2005, many believed that Ukraine experienced a key change in its move to democratic and economical prosperity. The electoral triumph of opposition leader Victor Yushchenko and the victory of Ukrainian people over their country's corrupt leadership represented a new landmark in the country's history. The Orange Revolution seemed to brought positive changes to the conscience of Ukrainian society in general and shape of Ukrainian geopolitical orientation in particular for years to come. The Heroes of Orange Revolution, popularly elected President Victor Yushchenko and his revolutionary comrade Yuliya Tymoshenko, who subsequently was appointed as Prime Minister, have been seen as people of high personal integrity capable to fight with corruption, reform the economy and establish better relations with West.

According to many experts the Orange Revolution has brought many new opportunities to Ukraine for the European and Global integration as well as brilliant perspectives to improve its socio-economic and legal spheres. Many projects have been kicked off to push Ukrainian integration into Europe, in particular Ukraine's accession to the World Trade Organization, regulatory policy and private sector development, as well as monetary and fiscal policy and agricultural policies.

Newly formed pro-western government pushed to adoption of legislation necessary to WTO accession (it's worth to mention that Ukraine joined World Trade Organization in 2008), including improved intellectual property, better regulation for banking and insurance sectors as well as liberalized trade import policies. As a result of western-oriented policies and improved investment climate the country saw a warming in relationships with West and increased inflow of economic help and investment from European Union and United States.

In 2006-2007 Ukraine experienced the fastest economic growth in the region supported by incredible investment increase (23%) and foreign capital inflows, while domestic consumption grew by 18%, becoming one of the main sources of GDP growth, stimulated by major increases in real wages (17%), bank credit (70%) and pensions. The production, service and export spheres showed a rapid growth with machinery expanded by (29%), metallurgy (8%), construction (13%) and trade (21%).

Rise of Information Technology Sector

In the same period, Ukraine's export of goods and services in dollar equivalent grew strongly by 20%. While mostly this figure reflected the export made by heavy and agricultural sectors for goods, the services dynamic was due to rise of emerging Information Technology sector.

Since Ukraine was a major hub of scientific research and space industry for Soviet Union it has inherited a nice majority of space, racket and scientific industries. After the collapse of USSR many of its rocket building facilities and scientific bases were re-qualified for providing hi-tech services and products. Since early 1990s Ukrainian hi-tech organizations have been providing software development services to foreign companies. But real growth Ukrainian IT Outsourcing industry has seen during 2006-2007 when it became one of the most dynamic sectors in the country, with ICT increase in volume revenues by 23% in 2007 compared to 2006.

The growth of IT Outsourcing market was conditioned by the improved regulation, introduction of intellectual property and favorable investment climate. The government created a State Agency for Investment and Innovations (SAII) with two more additional bodies such as the Ukrainian Center for Investment and the State Company for Innovations, where brought into existence a year later. Being the closest to Europe out of those which have not yet joined the EU, Ukraine brought very attractive opportunities to the Western European countries to invest in IT sector with its legacy of Soviet Science, strong educational system with a huge pool of highly-skilled resources and visa-free regime.

IT outsourcing quickly became one of the most popular trend in Ukraine, supported by the fact that Ukraine was included in the five most attractive outsourcing directions in some Eastern

European countries in 2006. The next year's report made by Central & Eastern European Outsourcing Association ranked Ukraine as leading country in the CEE region with the biggest market volume (\$544 Mln) and most employees involved in the industry (14000).

Collapse of the Revolution Ideals

Curiously enough, but behind the economic growth and integration reforms there was completely different situation at the politics arena. In spite of heightened public consciousness and politicized Ukrainian society Ukraine's politics has gone through many ups and downs since the Orange Revolution. During the Orange Revolution country was divided into two distinct camps, the "Orange" and the "Blue". Shortly after however, the leaders of orange camp split and changed the political formation to triangle. The new configuration of political forces in Ukraine appeared with each party tried to divide state power.

The problem with unity between Orange Revolution protagonists started just six month after. In September 2006 the President sacked his revolution comrade Yuliya Timoshenko and her government. However, next year's parliamentary elections helped already disunited orange leaders to outnumber by combined 243 seats their opponents Party of Regions with 186 of 450 seats. But this time the Timoshenko bloc has the best score of "orange" groups that ensured an advantageous position in talks with Yushchenko backed "Our Ukraine". As a result Yushchenko allies begun seeking chances to forming a coalition with opposition after 80 days of talks fail to produce a government.

Meantime, Yushchenko enemies passed the law to reduce his control over government, a heavy blow to Youshchenko's authority. Yushchenko vetoes the law twice, but it later comes into effect.

Yushchenko signed a decree dissolving the chamber and ordering a new election. After that step many Ukrainians doubted Yushchenko's ability to rule the country anymore and hold him responsible for the chaos.

Party of Regions won the majority of the seats in the off-year parliamentary elections, while the Bloc Yuliya Timoshenko was in second place with 7.16 million votes or 30.71%, and the

Our Ukraine-People's Self-Defense (NUNS) alliance, backed by President placed third with 3.3 million votes, or 14.15%.

The shaky YTB-NUNS coalition had a majority of just two seats in the new Parliament and Timoshenko was reappointed as Prime Minister.

As a result Ukrainians have seen two parliamentary elections and five cabinets in less than five years.

Economic Decline and Financial Crisis

The political crisis in Ukraine has eventually reflected on its economic situation. The country has suffered because of resultant governmental and parliamentary crises and rampant corruption. Being busy in dividing state power among the president, parliament and administration Ukrainian politics failed to take in hand soaring inflation and rising trade deficit and a negative hard-currency-payments balance. In addition, prevalent focus of government on Western integration resulted in deterioration of Ukraine's relations with Russia. Occurred energy dispute between two countries resulted in sharply rising cost of imports, which already have been raised by global inflation of energy resources.

To make matters worse the global financial crisis dealt one of the heaviest blows to the country's economy, forcing it to shrink by a staggering 14 percent per year. After a robust expansion Ukraine's economy experienced a sharp slowdown in 2008 continuing into 2009. Real GDP growth dropped from record 7.7% in 2007 to 2.1% in 2008. Even accession to World Trade Organization in 2008 after 14 years of negotiation hasn't prevented collapse of Ukrainian economy, destabilization of Ukrainian currency and drop in stock value.

Many experts observed Ukraine's economy was relatively weak even before the crisis hit. The country experienced two years of rapidly rising trade-deficit and a negative hard-currency payment balance. This situation meant that the halt of foreign-capital inflows brought on by the crisis has struck the national economy hard, producing a sharp decline in production and consumption.

While inflated global prices for oil and gas supplemented by worsen relationships with Russia resulted in additionally increased prices for gas have further weakened Ukrainian economy. Ukraine was de facto a major contributor to the Stabilization Fund in Russia and had no opportunity to build up its own reserves.

The slowdown of commodities and industrial markets abroad reduced export of Ukrainian industrial and agricultural products, decreases in the prices for key exports, and sharp losses for major enterprises.

IT Outsourcing in Ukraine – remained stable amid the crises

The Global Financial Crisis coupled with invalidity of Ukrainian politics resulted in economic tsunami that has swept over Ukrainian economy with major enterprises halt production; banks closed their branches and massive lay-offs. Investments in most industries dried up, and major sectors slowed down. The effects of Financial Crisis were hard felt in Ukraine.

However, amid this catastrophe there was one industry that despite all economic, politic and other problems performed quite well. It is exactly an IT Outsourcing industry in Ukraine that showed stable growth during economic expansion in 2004-2007 and sustained its business activity during the Global Financial Crisis with comparatively slight decrease in its second part.

In 2007-2008 Ukraine had the highest IT industry growth rate among Central and Eastern Europe countries. Ukrainian IT market ranked fourth after Russia, Poland and the Czech Republic, with almost 40 percent growth and over \$3.4 billion in volume.

Apart from internal factors such a dynamic growth was possible due to several macroeconomic factors as well. Among them:

- Intensive growth of IT outsourcing market in region (Europe signed a record number of outsourcing deals in 2008)
- Rise in demand for Nearshore outsourcing services by Western European companies

- Strengthening positions of Central & Eastern Europe cluster as a major player in global outsourcing market

Escalating uncertainties of regional threats in offshore locations combined with increased focus on vulnerability management and demand to keep data, process resources and account executives closer to where clients actually based have contributed to the shift in delivery preferences.

Industry surveys and reports indicated growing popularity of CEE region for provision of Nearshore IT outsourcing for the Western European countries and offshore IT outsourcing for the US market.

Meantime, Ukraine has been included in Gartner's Top 30 countries for offshore services for two consecutive years. The country was scored well on cost grounds, close geographical and cultural links and solid pool of skilled and motivated IT talent. Combined with significantly lower-wages, visa-free regime and strong educational system those factors presented Ukraine as a very attractive Nearshore outsourcing destination for Western European countries. While such differentiators as solid legacy in the fundamental sciences and established engineering base played a significant role in further development of the industry and strengthened competitiveness during the recession, when quality aspect gain particular importance.

Even though, at the outset of 2009, the IT outsourcing industry in Ukraine by following a global trend experienced a reduction of 10-15% on contact levels compared with the same time the year before it has sustained positive dynamic and has been seen much more stable than any other business sector in Ukraine.

Hope for the future

With rich farmlands, a well-developed industrial and science base, highly trained labor, and a good education system, Ukraine has the potential to become a major European economy that closely integrated with its neighbors on both sides. The country already showed a substantial progress in formation of its democracy and implementing western-oriented policies, while

the “Orange Revolution” has had a profound impact on the civil, political and governmental structures of Ukraine. It transformed the country politically and socially, with more competition among political parties, more transparency, a more open dialogue about political disagreements, more checks-and-balances and more accountability than ever before in the country. Ukrainian society expressed its desire for European integration and democratization becoming a guarantor of democratic continuity. And this year's Presidential Elections that met the very high standards of democracy, legality and fairness just proved a democratic achievement that Ukraine made during past years. This accord would be a much more realistic and positive step forward for Ukraine that speeds up integration and propagation of Ukrainian economy.