

## The Outsourcing Study

Central and Eastern Europe IT Outsourcing Review - Nearshoring gains momentum

*The research "Central and Eastern Europe IT Outsourcing review 2008" has been conducted by Central and Eastern European Outsourcing Association (CEEEOA) with the support of the Council of European Professional Informatics Societies (CEPIS) with the aim to examine key development indicators of IT Outsourcing industry in Central and Eastern Europe and perspectives of the potential of the CEE region for provision of nearshore IT services to Western Europe and offshore IT outsourcing to the North American market.*

During last few years there is observed an increased interest to the CEE region as an IT Outsourcing services and Business Process Outsourcing (BPO) destination. The 2007 research report "Central and Eastern Europe IT Outsourcing review 2007" indicated a high potential of the CEE region for IT outsourcing services facilitated by the growing near shoring trend. The report was accessed by more than 10000 professionals and used by many research agencies.

Political, economical and social events during last year have a substantial impact on global IT outsourcing industry. Although, BRIC (Brazil, Russia, India and China) countries, with India in the lead have been traditionally rated by research bodies as offshore leaders there were other 120 active offshore locations offering IT outsourcing and business process services or captive locations for these. Gartner, in turn scored particularly well CEE region for close geographical and cultural links with the Western Europe. Moreover, the BRIC countries are not without their problems, with the leader India has been hit hard by 2008 terrorist attacks, accounting scandals that rocked an Indian outsourcing industry and increased attrition and labor cost levels.

The market for IT outsourcing service providers in CEE region is growing at a fast rates, one that is ahead of average rates worldwide. The main factor of such grow is that the Eastern European outsourcing providers offer the valuable model of outsourcing services "nearshoring". Cultural and geographical proximity, time-zone and visa advantages along with strong technology-oriented educational system make the CEE region a very attractive place for foreign companies to set up Research and Development centers and being favorable for development of independent IT outsourcing vendors. According to the Deutsche Bank Research the import of IT services from the Central and Eastern Europe to Western Europe increased an average of 13 percent per year between 1992 and 2004. This growth nearly comparable to the import of IT services from India, which averaged 14 percent per year over the same time period. Clients from Western Europe are attracted by Central and Eastern European suppliers for many of the same reasons that US customers attracted to Canadian suppliers: common language, cultural understanding, minimal time zone differences, geographical proximity and low labour costs.

There also some other factors contributed to development of CEE cluster in 2008:

- Europe beat US in the number of outsourcing deals in 2008. There were a record number of outsourcing contracts signed by European companies during last year
- Shift in outsourcing delivery preference to Nearshore and Sameshore. The realities of politically, economically and socially unsafe world have had a direct influence on outsourcing decision process. Clients demand their data, process resources and account executives be as close as possible
- Increased focus on security and vulnerability measurement. Central and Eastern Europe viewed as a top location for operating with lowest downstream risks.

### **Expert View**

To enhance further perspectives of the IT outsourcing market in Central and Eastern European countries, an independent experts survey has been conducted for the report, in which independent IT experts with a deep domain expertise provided their views on the trends for IT outsourcing in the CEE region and the influence of the global crisis in the region and worldwide.

The experts agreed in terms of significant affect of the Financial Crisis on the Global IT outsourcing market. However, some of them consent with analysts's forecasts claiming that there is likely increase in IT outsourcing spending influenced by the crisis, while others still cautious about market perspectives. However, all the questioned experts are close to prediction that prices for outsourcing services will fall between 5 to 20 percent due to economic environment and constrained IT budgets.

Providing their views about the position of CEE region in comparison with other global offshore markets and how it changed in 2008 experts have stressed a significant shift in outsourcing decision making process, where investors and customers interest are no longer motivated by saving costs and labor availability. The realities of unsafe world have fully overrun into outsourcing decisions. As a companies perceive a significantly higher downstream risks in working with offshore providers over those onsite due to the lack of legal and regulatory environments in offshore countries there are new outsourcing security trends have emerged.

The ability of supplier to ensure customer's sensitive data and business processes remain safe has been included in offshore strategic planning. As the savings gap between India and other outsourcing locations widens to less than 10 percent, the value proposition is tempered by potential treats. The main component of outsourcing management has shifted to mitigating security risks by determining best location choice for company's organizational processes.

Providing their opinion on how economic recession influenced clients' plans to use the offshore outsourcing services experts emphasized an increased interest to nearshore services. However, this is mitigated by the pressure on clients to balance local workforces and comply with domestic needs. We already can see that escalating US unemployment brings workforce back home. Growing US unemployment has already driven domestic wages much below where they previously were. Moreover, the U.S. Immigration Service slowed the process of obtaining H1B visas discouraging foreign workers to apply for local jobs.

### **Tendencies in 2009**

Among the main factors that might influence the industry in the nearest future the experts emphasized the following:

an increased demand on IT outsourcing services in Western Europe, as it was indicated above European companies have signed a record number of outsourcing contracts in 2008. With increase in outsourcing from Western Europe, the CEE region is well-placed for winning nearshore IT services work.

While traditional outsourcing innovation will go at a slower pace the greening of IT outsourcing will be prospering in CEE region as much as anywhere. American and European vendors have lead the discovery and innovation of green initiatives. Awareness of changing environmental market needs and readiness to make provision increases attractiveness of offshore supplier.

With the growing popularity of web-based business applications and Software as a Service (SaaS) business models and spreading success of Salesforce.com the SaaS delivery model is more often considered as an alternative to outsourcing. At present it isn't clear how SaaS will impact IT industry, but it's definitely clear that SaaS will act as a catalyst for streamlining business operations, getting to market faster, and increasing flexibility.

### **Summary**

The global Financial Crisis combined with political, economical and social events in 2008 had a deep impact on IT outsourcing industry. During the first half of 2008 the CEE region sustained positive business activity due to positive market inertia from 2007. However, in the second part there was a decrease by 2-3 percent, in comparison with 2007 figures.

At the beginning of 2009 an IT outsourcing industry underwent a 15-20 percent decrease in terms of contract levels, comparing to the same period year before. Despite the economic crisis the cost of services didn't drop significantly as suppliers had a mid and long-term contracts with clients. However, as recession deepens more are pressured to short-term cost-cutting behaviors, including outsourcing contracts and supplier relationships.

Most analysts predict there is expected a significant drop in prices for IT Outsourcing services between 8 to 25 percent in next two years stimulated by to economic recession, increased competition on the market between traditional and emerging players and customers' focus to extract more value from the outsourcing contracts.

With the economic recession the behavior of IT outsourcing service consumers might change as well. Focusing only on deriving the value and cost-cutting we could see buyers rushing into renegotiation without taking a time to consider what the opportunity might be and how more value can be derived therefore making pressure on suppliers with an attempt to reduce cost of service delivery.

However, most analysts predicts a fast recovery in the volume of IT outsourcing services after global economic stabilization. With recovering economy companies will have new projects and initiatives to be executed, but will have lack of local resources to increase production level quickly enough. As a result they will be attracted to use outsourcing partners, so it will be business critical for CEE outsourcers to position themselves with a clear business model to profit from recovery.

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