Russian IT Quarterly

April, 2006

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Where Does Russia Fit Into The Global Software Industry?

25.11.2005
By Michael A. Cusumano
Communications of the ACM

I've written my last two columns on the Japanese software industry (July 2005) and the Irish software industry (October 2005). This time, it's Russia's turn.

In October 2005, I gave a talk on the state of software engineering and the software business as well as a workshop on software entrepreneurship at the first annual Software Engineering Conference-Russia (www.secr.ru).

This conference was held in Moscow, and had more than 500 attendees. Intel, Borland, Microsoft, Telelogic, IBM, and Siemens were conference sponsors. The organizers were RUSSOFT (www.russoft.org), the Russian National Association of Software Development Companies, and RUSSEE (www.russee.com), a 20-person venture based in Moscow that is actively engaged in education and consulting on best practices in software development.

Artem Ikoev of RUSSEE was the conference executive director and worked tirelessly to make this event a success. RUSSEE's two founders, Ilya Antipov and Dmitry Dakhnovsky, both studied computer science at Carnegie Mellon University, worked in U.S. industry, and have retained close ties to the university and the Software Engineering Institute (SEI). I used this opportunity to learn something about Russia and its software industry, though I want to frame my comments within a broader context.

In The Business of Software,1 I offered some generalizations on how I thought the software business differed in different parts of the world. With regard to Europe, I suggested that too many companies I had worked with tended to treat software as a science. My experience has been with various software groups and telecommunications producers, ranging from startups like Business Objects to Siemens, Alcatel, and Nokia. I also have studied the history of the computer industry, where many inventions (not the least of which is the Web) have come out of excellent European and British universities and research labs. True, there are a few successful global product companies, led by SAP in Germany, and global IT services companies, led by CapGemini in Paris, and several Irish companies that have made a good business of software outsourcing and local customization. But most of the European programmers I worked with seemed mainly concerned with excellence and elegance in program architecture, design, and construction, incorporating the latest technologies, or building custom systems for the various European markets. Often I found myself frustrated at how long they took to ship products and how little money they made from their considerable software skills.

In Japan, where I lived for seven years, it seemed to me that programmers and managers largely treated software as a problem in production. It is not surprising that Hitachi, Fujitsu, NEC, and Toshiba tried to institutionalize the best IBM engineering practices by establishing "software factories" during the 1970s and 1980s.

They successfully built large-scale systems and customized industrial applications relying heavily on standardized development processes, rigorous quality-assurance techniques, extensive tool support, reuse libraries, and low-cost labor, especially at networks of coding subsidiaries and subcontractors. We continue to see programs with remarkably few defects coming from Japan. The great weakness of the Japanese factories, however, was their focus on mainframes and staff largely consisting of employees with little or no background in computer science.

The factories had trouble migrating to the world of client-server, Windows, and the Internet, and became highly priced as Japan became one of the most expensive places in the world. The Japanese are slowly training a new generation of programmers and learning to build more up-to-date computer systems. But they still focus on derivative customized applications for the local market (except for the video-game business and some consumer electronics and embedded software). Overall, Japanese computer science departments remain far behind the West, and Japanese software development remains high cost.

I also observed that the Japanese factory-like approach to software process management and quality control migrated to India in the 1980s and 1990s.

Infosys, Tata, Wipro, Satyam, Patni, and several other Indian software companies have made their mark on the outsourcing industry by treating software as a service and service as the business. (Full disclosure: I speak from experience here as well. I have been a member of the board of directors of Patni Computer Systems, Ltd., for the past two years.)

Most of these firms have achieved CMM Level 5 status and exploit it as a marketing tool. In comparison to the Japanese, the Indian companies have benefited from ubiquitous English language skills, much lower wage levels, a strong process focus, and excellent university training in computer science, mathematics, and other engineering and science subjects.

A central argument in my book was that there is something unique about the U.S.-based software business. To be sure, the U.S. has great university departments and programmers who are second to none in their knowledge of the science.

It also has many firms, beginning with companies such as the old System Development Corporation (once part of the RAND Corp. and now part of Unisys) as well as IBM, who pioneered factory-like approaches to large-scale software development as far back as the 1970s.

It has the world s largest IT services companies, with IBM and Accenture at the top of the list. But the U.S. industry is known worldwide for several generations of software startups including Microsoft, Computer Associates, Oracle, Lotus, People-Soft, Intuit, and Netscape - that focused on building "good enough" products for enterprise and consumer mass markets.

I think the premier European and Japanese firms would never have shipped pioneering versions of products such as MS-DOS, Quicken, Windows, and Navigator or other early applications due to inelegant architectures, clumsy features, or large numbers of defects. But these are precisely the kinds of products, running on hardware like the IBM PC and compatibles, that brought cheap and powerful computing to the masses, and generated billions of dollars in revenues and profits. One could argue that Russia will have great difficulty escaping the paradigm of treating software primarily as a science. So I found myself asking the question serving as the title of this column: Where does Russia fit into the global software business? Will companies there go the way of many other European firms and emphasize the science more than the business, and on expertly meeting the needs of local industry, but encounter limited success in global product markets? Will Russia go the way of India and emphasize service companies that will do anything the client wants at highly competitive prices but fail to build a products-based business? Will Russia become a lower cost Ireland, with many small companies and lots of technical expertise, but too much emphasis on leisurely lifestyles and independence from venture capital and the stock markets? Or will Russia become something different?

One could argue that Russia will have great difficulty escaping the paradigm of treating software primarily as a science. The Russian software industry is characterized by thousands of Ph.D.s or other highly trained researchers with extensive backgrounds in mathematics and physics.

The defunct government of the Soviet Union put them to work building defense-related military and communications systems. But what remains is a remarkably talented pool of people who understand how to solve complex "system" problems. They can clearly help foreign technology companies build new wireless communications systems or other types of software with sophisticated algorithmic underpinnings. But can they build "good-enough" products or invent technologies that come to market quickly and capture the imaginations of mass market enterprise or individual users?

One could also argue that the Russians will have great difficulty escaping the paradigm of treating software primarily as a service. RUSSOFT claims that programmer wage levels in 2004 were similar to India and the Philippines, with annual salaries topping out at about $9,000, compared to top levels of $36,000 in Ireland and $20,000 in Singapore. These numbers seem to include a myriad of small, local Russian companies.

More established Russian firms with international offices and clients pay average programmer salaries more in the range of $14,000, with managers or senior architects receiving considerably higher compensation, which is also true in India. Nonetheless, many U.S. and European companies, including Intel, Microsoft, Motorola, Sun Microsystems, Alcatel, Siemens, and Borland, already have set up facilities in Russia to take advantage of relatively inexpensive, highly trained people.

And here, most likely, is where Russia's competitive advantage lies: the ability to perform highly sophisticated technical work at relatively low cost. Even as wage levels rise, the technical skills of the Russians should continue to guarantee a vibrant software business for years to come.

The infrastructure (transportation, roads, office space, electrical supply, Internet access, sewer and water systems) seems better than in India. Both Moscow and St. Petersburg have excellent universities and are far more accessible from Europe and the U.S. than India. A number of Russian companies already boast overseas clients and offices, and hundreds of employees. For example, Luxoft, Russia's largest custom software firm and a CMM Level 5 shop, was founded in 2000, grew to $24 million in revenue in 2004, and in 2005 had 1,400 employees.

Other companies I learned about include Mirantis, which uses its headquarters in California to provide access to Russian software developers; Reksoft, which is based in St. Petersburg but has strong ties to the Swedish market; and StarSoft Development Labs, which has offices in St. Petersburg and the Ukraine as well as a headquarters in Cambridge, Mass.

StarSoft, which has CMM Level 3 certification and employs some 400 people, has tripled revenue since 2003 and expects sales to exceed $11 million in 2005.

Another notable firm, Telma, is located in the science city of Nizhny Novgorod and specializes in telecommunications and embedded software. It received CMM Level 5 status in 2003 and had 700 employees in 2005. A larger global outsourcing firm, EPAM, a CMM Level 4 shop based in Budapest, Hungary and Princeton, NJ, has some 1,200 employees and is noted for large development facilities in several Russian locations as well as Belarus.

My initial impressions are that the Russians still need to work on several things to make their companies stronger outsourcing partners and sources of technology - English language skills and software engineering processes, which companies can control, and confusing tax laws as well as weak anti-piracy laws, which will require government action.

In addition, most local companies are small (under 20 people) while export-oriented firms with more than 100 people are rare. So scaling up or consolidating to handle large outsourcing projects is a challenge. But it is only a matter of time before Russia gives India and Ireland a run for their software money.

China, which seems more product-oriented and contains an enormous domestic market - more than 1.1 billion people, compared to less than 150 million in Russia - is perhaps the most interesting software market in the making, but I leave that country to a future column.

Software Developers Making Global Impact

By Yekaterina Dranitsyna
14.02.2006
The St.Petersburg Times

Last year a number of leading analytical agencies, Gartner Group and Forrester Research among them, included Russia in their lists of the world's leading markets for IT outsourcing - only a few years ago it was hard to foresee the country receiving such recognition.

Over the last two years the average growth rate among Russian offshore software developers has been 30 percent to 50 percent. Some companies have performed even better - Reksoft turnover, for example, grew by 87 percent in 2005.

Recognition by international analysts "is a major step forward in the marketing of services provided by Russia-based export-oriented software development companies," said Svetlana Vronskaya, director for corporate communications at Reksoft.

"2005 was marked by $1 billion of market volume and we expect the 30 percent growth trend to continue into this year," she said.

According to the association of Russian software developers RUSSOFT, in 2005 the country's software export companies have been establishing representative offices in key regions.

Every third Russian company has a sales & representative office in the U.S. or Canada. Over one third of software developers have got sales offices in different parts of Western Europe: 12 percent in Germany, Austria and Switzerland, 12 percent in Scandinavian countries. These figures will most likely rise in 2006, according to RUSSOFT's annual survey.

By improving foreign perceptions of Russia the credibility of Russian IT firms on the global market is increased and allows them to participate in tender lists, Vronskaya said. At the moment about 20 percent of Reksoft turnover comes from Germany, but it took the company around four years to establish its presence in that country, she added. Another sign of international recognition is that from the autumn of 2005 until the beginning of 2006 a number of Russian software service providers have either been acquired by another larger company or invested in by a third party, Vronskaya said.

Choosing the way

Mikhail Zavileisky, COO of DataArt's St. Petersburg office, divided Russian outsourcers into three groups. "The first group has chosen the "Indian way" - make a stake on large size, low prices and adequate quality. This way was tried out and is understandable to foreigners. The main problem is that the labor force in Russia is significantly smaller than that of India or China," Zavileisky said. Companies belonging to this group are a mixed bunch, occupying various niches on the global market, and are likely to open offices in the CIS, Eastern Europe and Asia to overcome the limits of the national labor market, Zavileisky said. Companies of the second group follow the "Irish way" - integrating into the world system through outsourcing and the realization of complicated, science-intensive, informal and "impossible" projects.

"Specialization in applied fields and close, focused ties with a limited number of clients is typical of such companies," Zavileisky said. Despite the attractive correlation between risks and returns, this approach often results in the company being acquired by a strategic client. The third group of companies follows the "Russian way" of trying to increase sales in the Russian market. However, low prices and under-developed IT infrastructure leads to smaller return on investment than in other approaches, Zavileisky said.

Unique offer

One could forgive Russian outsourcers for repeating a joke told by the head of Intel in Russia, Steve Chase - "large projects we make in India, urgent - in America and impossible - in Russia."

The large number of science students in Russia (up to 50 percent of all university students, according to UNESCO) results in highly-qualified IT personnel. Most Russian IT employees hold IT Masters (seven years of higher education) or IT Specialist (five years) degrees.

Russia possesses a unique intellectual capital and is known for its pool of well-educated talent that is constantly increasing in terms of quantity and quality.

According to RUSSOFT's report, although the availability of Russia's IT personnel and skills rose in 2005, in terms of the effectiveness of these skills Russia is still behind its competitors. The Gartner report suggests that the effectiveness of programming and project management skills belonging to US external service providers (ESP) is 100 percent. In Ireland ESP has 90 percent effectiveness, in India - 76 percent, in Russia - 74 percent, in China - 31 percent. According to DataArt's Zavileisky, between 10 and 20 Russian outsourcers are known abroad, increasing turnover by 20 percent to 100 percent in a year, though it is still debatable whether this growth results from the quality of services or the small size of the companies.

Russia's presence in high-end offshore outsourcing is still rather insignificant, Vronskaya said. Russian software developers are mostly known in niche markets like anti-virus software or among companies specifically interested in the outsourcing topic.

However Russian developers are "noted for their ability to solve complex software engineering tasks," Vronskaya said. "We will be seeing more and more software development tasks with a stress on R&D, entrusted to Russian companies," she predicted.

Reksoft Earnings

03.03.2006
The St.Petersburg Times

Reksoft, a local software outsourcing firm, increased its earnings by 87 percent in 2005, with turnover reaching $8.9 million, the company said in a statement Wednesday.

Last year the company expanded its customer base, attracting Germany's most popular TV channel ProSieben, postal service company Francotyp-Postalia, and two of Europe's largest systems integrators. Reksoft also secured an equity investment from MartinsonTrigon, a Nordic venture capitalist fund.

Firms and Universities Join Forces to Satisfy IT Boom

14.03.2006
By Yekaterina Dranitsyna
The St.Petersburg Times

With demand for IT specialists growing at 25 percent to 30 percent a year, software companies and universities are joining forces to offset a state system of education that is failing to keep pace with the booming industry.

Valentin Makarov, president of the association of software developers RUSSOFT, said that there are two types of worthwhile education - programs held at university departments in close cooperation with software developers, and courses organized in further education and retraining centers.

"In both cases qualified programmers are trained by teachers who have experience in commercial programming and scientific research," Makarov said.

Andrei Terekhov, head of system programming in the department of mathematics and mechanics at St. Petersburg State University, indicated that the absence of unified educational standards for program engineering was the main problem.

"Education programs even in specialized institutions are too academic. Students are not taught to plan, assess risks, manage projects and tackle other practical issues," Terekhov said.

Companies have to spend about six months training the young specialists they hire, he said.

Only 10 percent of IT specialists become high-level programmers just after graduating. About 40 percent of graduates attend additional training courses. Half the students find jobs in other areas.

To tackle these problems the city s leading universities have started experimental programs in cooperation with private companies. As CEO of Lanit-Tercom, Terekhov organized additional education for his students. About four years ago company specialists started running courses on new technologies and management. Students also run experimental projects.

"Nobody expects a commercially profitable product. The goal is the study of new technologies and science," Terekhov said. The projects get more complicated as studies advance. Students are also taught to plan budgets and present projects. The most talented ones are already employed by Lanit-Tercom and other companies by the time they graduate.

"At the moment we are trying to create a techno-park near the faculty in Petergof to house 2,500 people from between 30 and 40 companies. We expect them to participate in educating students," Terekhov said.

SoftJoys Computer Academy has a program of further education, which comprises over 500 hours of lectures divided into six terms.

The program aims to compensate for the State University's focus on physics and mathematics at the expense of computer science. Professors combine teaching experience with software development, and the program is based on the suggestions of IT companies.

At the end of the program students undergo practical work in leading IT companies and complete diploma projects. Network equipment producer D-Link holds lectures in the Polytechnic Institute to prepare specialists in network technologies. While D-Link tries to make those courses available to a mass audience, the Polytechnic Institute promotes the introduction of such courses in school and university programs.

Reksoft launched a center in 2001 to train students in programming, testing and project management, the best students being offered positions with Reksoft at graduation.

"Russian companies choose various ways to overcome the deficit in personnel. We not only monitor wages and adjust them to market conditions, but also try to create a comfortable social and cultural environment in the company," said Nikolai Puntikov, director of StarSoft Labs. StarSoft Labs also hires people from other countries in the former Soviet Union and educates students from local universities, which allows them to hire 10 to 30 people per month. Puntikov agreed that traditional courses should include the preparation of software engineers. However, he said that fundamental education should not change dramatically, since Russian specialists are sold om the global market as "people able to solve problems" as opposed to routine programmers within a limited field.

"Programmers who understand quantum mechanics could easily solve a client's problem," he said.

Unlike their Indian equivalents, most Russian programmers hold degrees in higher education. However most programmers should be supplied by a system of vocational colleges, and this "does not function at all," said Valery Andreyev, general director of SoftJoys Computer Academy.

"We have more and more projects that while far from 'rocket science,' still demand important professional skills. People with higher education are often bored with such work. It is time to educate specialists in narrow fields within the framework of secondary specialized education. I have no doubt they will be in demand," Puntikov said.

IT professionals see a solution to the problem by combining the advantages of the classic education system with working specialists, in constant supervision of programs from professional associations.

RUSSOFT promotes amendments to university education program in the ministry for informational technologies. At the city level the association promotes development of technical schools.

"IT science has a constant part like theory of algorithms and permanently changing part like programming technologies. To keep an eye on it within the framework of standard education is impossible," Andreyev said.

Reksoft clinches Russian .Net deal

21.03.2006
By Joe Warner
IT Europa

Offshore development ace Reksoft has been selected to provide Fujitsu Siemens Computers in Russia with web application development, maintenance and support services for both internal and external software applications. The 260-strong, St Petersburg-based outfit has iced the cake with an 87pc rise in turnover to push sales to nearly $9m (€7.5m).

Reksoft was awarded the partnership after a ‘close fit’ with FSC’s criteria which centred on factors such as profitability, technological capabilities and cultural fit. CEO, Alexander Egorov, tells IT Europa he is delighted with Reksoft’s selection, especially as a shortlist was generated internally by FSC without any external influences. ‘This was a clean win for us,’ he says. ‘We are very pleased and exited that FSC came to us with this co-operation and we look forward to working together.’ Reksoft will now begin projects based on Microsoft .Net technologies.

Egorov adds that Reksoft’s selection is important for the whole Russian IT market. ‘FSC often chooses its partners on where it plans to sell into in the future, so this is good news for Russia,’ he says. ‘While the western press continues to give a mixed review of Russia, it is important companies such as FSC invest in the region.’

After winning this contract and the recent $2m (€1.7m) cash injection from pan-Baltic private investment firm MartinsonTrigon - becoming the first Russian technology vendor to receive western funding - Egorov claims Reksoft is now an ‘established tier two supplier’.

Venturing to Russia With Funds

By Alexander Yankevich
23.03.2006
The St.Petersburg Times

The Russian IT market has begun to attract the interest of foreign investors. When the Baltic state ventures fund MartinsonTrigon became a co-owner of St. Petersburg’s Reksoft, which specializes in software outsourcing and business integration, many regarded this as a landmark event for the local market. Venture capitalists on the Russian market are few and far between, and the big news on this front usually comes from Moscow. The fact that such a major deal had taken place in St. Petersburg created extra interest, though analysts warned that the deal should not necessarily be seen as venture capitalism, as Reksoft is already a well-established company. A founder of the MartinsonTrigon fund and its

president, Allan Martinson spoke to The St. Petersburg Times about plans for the development in Russia.

What is MartinsonTrigon and how was it formed?

MartinsonTrigon was organized by an investment bank in Central and Eastern Europe, Trigon Capital (it has offices in Warsaw, Tallinn, Riga, Vilnius and St. Petersburg) and myself in the summer of 2005. The fund's resources come from private investors in Northern Europe — for the most part Finland — who account for 60 percent of the capital. The fund is managed by AS Martinson Trigon Venture Partners. The main recipients of the investments are telecommunications and IT companies. The head office of our organization is in Tallinn.

What kind of companies attract your funds - offshore centers, system integrators, on-line projects, developers of new technologies?

We're interested in TMT – telecoms, media and technology. In terms of priorities, we're looking at service IT companies, programmers and telecommunications companies working in innovative spheres – for the most part that means wireless and media projects. As far as our ongoing activities are concerned, in the space of about a year and a half we've looked at about 200 companies, and we're now actively working with about 10. We've already signed three agreements, and we'll be announcing another two in the summer. We're defining our investments as venture undertakings – we work with individual companies for a maximum of 5-7 years.

Your fund is based in the Baltic states. What is your interest in Russia? After all, one of your first major undertakings was an agreement with a Russian company.

In principle, we're positioning ourselves as a Baltic-Russian fund – we're planning to invest in these countries. We spoke about that in our first official announcements, which covered not only Reksoft but also the Estonian companies Microlink and TVCorp. Microlink is a computer services company and a leading player on the market in the Baltic states which I took a direct part in creating. TVCorp is the local branch of the MTV Corporation in Estonia. We're planning on "taking in" another five to seven companies, after which, according to our calculations, we'll have used up all our resources for this stage of the process.

What do the IT markets in Russia and the Baltic states have in common and how do they differ? What's your take on the investment potential of the Russian IT market?

Overall, the IT markets in Russia and the Baltic states can be described as developed and fairly large. Of course, Russia is bigger in terms of territory and in certain other ways, but in hard figures the Baltics are also fairly big. They're also united by the fact that they have a lot of potential, but you need a lot of capital to open them up. A difference is that service companies are highly developed in the Baltics, whereas it's the technological sphere that is more highly developed in Russia. You can't overlook another big difference – the companies in the Baltic states are more ordered, which makes working with them a lot easier. In Russia, you have to be prepared for the fact that, in order to get the company into a decent state from financial, legal and other points of view, you have to have a significant amount of money ready to put into an audit, and that can amount to tens of thousands of dollars.

Recently there have been reports from the IT markets of interest being shown by new major investors, such as the Russian company Renova. Do you see yourselves as being in competition with other investors?

Yes, we can definitely see that process at work. There's no doubt that there are strategic investors on the Russian market who can boast of possessing key assets in spheres that interest us. For the most part however, and in the regions in particular, it's private business that's working in the IT sector. Often, money is coming from companies that work in more traditional sectors of the economy – trade, real estate, and so on. It's not a fact that these investments will work effectively – the people behind them don't have the expertise or the contacts and so, often, an innovative business doesn't have any additional value, which can result in it leaving the marketplace. There's another tendency which shouldn't be overlooked. As we know, the major western companies are actively working to open software development centers in Russia – Motorola, Sun Microsystems and the like. We

can also see that as being part of the investment process. These players usually buy up a 100 percent stake in Russian enterprises or create them from scratch.

What do you think of the Russian government's idea of creating technology parks and special economic zones? Will they help the Russian IT market? What are the prospects for development?

In view of the growing competition on the global IT market, the Russian government definitely had to do something. Technology parks are an effective tool which have proved their value in many countries. The way it's all being implemented raises some questions though. As far as I can see, a specific characteristic of the Russian project is that firms will get benefits within certain geographical zones, which is to say certain links will be built in. In my view, that contradicts the whole essence of IT, which is free of all those conditions – at the end of the day, the programmer could be working from home, using the internet. And that's without even mentioning the fact that these zones will attract firms looking for benefits that have nothing to do with IT. Companies should get benefits, but they shouldn't be dependant on their geographical location. We should note another initiative from the Russian government – the creation of venture funds. Their appearance was unavoidable, as such initiatives have been undertaken in almost all the countries of Europe, and Russia just had to keep up. But its effectiveness will be directly dependant on the people that manage it and there really aren't that many experts in this sphere in Russia.

VC Firm Plans Fund For Russia, Eastern Europe

By Peter Clarke
EE Times
27.03.2006

Finnish venture capital company Amanda Capital plc is planning to establish a limited partnership fund to invest in unquoted companies in Russia and Eastern Europe through private equity funds.

Amanda (Helsinki, Finland) said it would make a 10 million euro commitment from its own balance sheet to help establish the fund, but did not offer any indication of the what size it expected to close the fund.

The private equity market in Russia and Eastern Europe has reached an "interesting phase" according to Amanda said that a positive climate for private equity investment has been created but with only moderate competition for access to good target companies compared to Western Europe.

"The essential factor for successful investing is to find reliable and skillful local private equity funds with whom to work." Amanda said in a statement. Amanda's personnel has followed the market and funds operating there for a long time and made investment commitments in this market. "The new fund offers an excellent tool for investors to diversify their private equity portfolio to an interesting market," said Petteri Ankila, chief executive officer of Amanda.

Amanda said it would use the same process to choose managers for fund that helped it achieve an average 30 per cent return on its other private equity fund investments.