November/December 2005 Issue

This issue's offerings include a Q&A with Oracle's Todd Forsythe, who's reshaping his group into a performance-driven marketing machine; Robert Cohen of eChannelLine reveals survey findings that highlight the importance of resellers; in The Download, *The Economist* uncovers a surprising outsourcing destination; and more. Enjoy!

Editor's Cut

As we move closer to the end of the year, companies are putting the finishing touches on plans and budgets for 2006. Here at the CMO Council, we expect a report we're releasing this week called "RENOVATE TO INNOVATE: Building Performance-Driven Marketing Organizations," will have a significant effect on companies' strategic and marketing planning in 2006 and beyond.

RENOVATE is an initiative near and dear to me, since I've been working on it since its inception early this year. We've conducted qualitative interviews with a dozen task force members from name-brand companies like IBM, Xerox, Intel, Avaya and Oracle. We've also polled more than 400 marketers across a variety of industries and company sizes on their current marketing organizations and pain points, as well as over 400 CEOs for their view of marketing's value and role in the corporate hierarchy.

The results are revealing. On the one hand, marketers feel that they could use more influence and credibility within their companies, especially with top management, but on the other, CEOs say they are counting on marketing to drive results. To gain credibility and respect, marketers must transform their organizations into agile, strategic, process and technologically driven, revenue-producing machines. The RENOVATE initiative can help start this transformation. The complimentary report is available for download. (Please note that it may take a few moments to load.) You can also catch a replay of the RENOVATE Webinar—featuring the marketing transformations of Oracle and Avaya.

Another study we're about to release is Remote Revolution, which explores the uptime issues, challenges, threats and strategies faced by mobile workers and the enterprise. Fielded by the Forum to Advance the Mobile Experience ™ (FAME™), a member advocacy group that strives to accelerate marketing programs and research around the wireless user experience, the Remote Revolution report is due out next week, along with Remote Revolution Web Conference, set for Tuesday, December 13, 11 a.m. to 12 noon PST. Be sure to register for what promises to be an informative event.

Lastly, it was great to finally meet many of you in October at the CMO Council Summit in Monterey. The event was highlighted by excellent presentations from a top-notch group of marketers. Not to be outdone, last month's first-ever CMO Summit Europe proved a rousing success, as over 100 top marketers convened in London to hear dynamic presentations from representatives of companies such as Cisco, Akamai, Microsoft, Unisys, Symantec and Kodak, and more. That lineup will be hard to beat next year, but we'll try. Look for a whole lot more interactivity and networking opportunities next year at both events. As a special bonus for our membership, check out the U.S. Summit presentations and the European Summit presentations.

Safe and Happy Holidays!

Scott Van Camp, Editorial Director of the CMO Council and Editor of Marketing Magnified, can be reached at scottvc@globalfluency.com.

Get To Know: Todd Forsythe, VP of Corporate Marketing, Oracle Corp.

Marketing Magnified: Since you've been at Oracle, what are your biggest successes?

Todd Forsythe: Our biggest success has been in the alignment between sales and marketing organizations. Two or three years ago, the relationship between sales and marketing was not very good, and we really weren't generating ROI. Marketing would focus on one market segment, while sales harvested another. We realized that in order to create value, we needed to work together to identify market opportunity, build sales and marketing strategies and jointly take ownership of a plan. Now each organization shares metrics that are frequently tracked and plans that are adjusted every six months.

So now that you're pretty well aligned, what are your biggest challenges?

One challenge is becoming more scientific as to how we're managing this aligned group. We take our current sales pipeline, forecast it out, and compare it to the sales target, then we look at where there are gaps that require building more market demand**.** As a result, instead of reacting to a trend our business is more predictable. Our goal has been to operationalize this in a more systematic way, aligning marketing efforts to the sales forecast.

All of this is enabled with a bottom-up and top-down planning process. At a strategic level we will launch initiatives that support our corporate strategies. These strategic campaigns are launched globally and, yes, are measured based on pipeline impact. At the local, field level, our marketing, sales and channel teams prioritize business initiatives that are required to meet our revenue forecasts. The demand generation initiatives are aggregated globally so we can leverage economies of scale by building the campaign components centrally. Our field marketing organizations will adapt these campaigns and launch them locally to support their business plan with sales. Through this process, we've been able to achieve global alignment and have the necessary outlook to satisfy all constituents, and we're making all the right investments for the company.

How is your marketing group structured, and how satisfied are you with your team's current skills and competencies?

We used to have different groups for different disciplines, and we realized that this inhibited our ability to move dollars across the mix to maximize pipeline growth. Some organizations had integrated marketing teams but were more of an overlay function with no budget responsibility or ROI accountability. So we collapsed many teams into campaign teams. These teams have the budget and are empowered to make marketing decisions across the entire mix. I make sure we staff those teams with blended skills. I needed more well-rounded marketers. We also realized that to be data-savvy we had to have teams that were really data-literate. It's a hard blend to find, and it took a while to transform those teams.

How are you improving your marketing systems, processes and practices?

I mentioned that a few years back we had trouble demonstrating ROI for our total marketing spend. So we took all of our marketing spend over the last three years, plotted out sales revenue and sales pipeline and did statistical correlation across the two, using it to understand how we should be allocating dollars to reach our marketing goal. This allows us to calculate total profitability of ALL marketing spend, including advertising, demand generation, events and so forth. I know the optimal mix by product, solution and market segment to maximize pipeline growth. I also know which print vehicles lift pipeline versus which ones don't. Most B2B measurement methods, and dashboards, only calculate ROI against direct marketing budgets. And, given that most direct marketing budgets are only 15% to 30% of the total mix, that is simply not good enough for me. I need to know the elasticity of my total marketing investment, period.

Beneath that, when we implement a campaign, we have campaign-to-cash tracking. This gives us a good read of revenue generation at the campaign level and at the activity level, globally. We're also introducing a new metric called "influence revenue." When an opportunity is created, we'll look backwards at that customer experience and what led up to it and determine the appropriate sequence of marketing activity to accelerate the buying process. We look at it from the customer's perspective.

How credible is your marketing organization within Oracle? Do you believe those at headquarters and in the field are fully aligned with strategic business goals?

We've gone through a major transformation. The historic view of Oracle marketing was very tactical, not well aligned with other parts of the company, and not strategic. Now we're viewed as more analytical, more focused on revenue, and definitely more strategic. I'd say our overall reputation is outstanding.

What are your top three strategic objectives or deliverables going into next year?

The first is jointly going to market with our channel across all segments of the business. That's a top priority. Our partners are important to our business and our customers. We believe there's a greater opportunity to collaborate on joint marketing campaigns. Secondly, Oracle Fusion Middleware is the fastest growing solution. We've just launched a global branding campaign with significant demand generation spend. We'll use our measurement approach to make sure we continue to accelerate revenue growth for this category.

You've implemented a lot of cutting edge processes and tools—do you have some advice for other marketers who are thinking of doing the same thing?

The key to enabling this level of sophistication is having a single view of your customer. This must be priority No. 1. If you don't have your organization focusing on customers—and with an understanding the health of the overall relationship and health of any active buying process—then you're not going to maximize your return. Our marketing and sales organizations have the same business objectives, same view of the customer, and are mutually measured to achieve a shared outcome. To create a high-performance marketing organization you first need to achieve internal business alignment and secondly you have to be able to measure your complete marketing budget against ROI.

Channel Chat: Planning for 2006

By Toni Clayton Hine

Moving into the fourth quarter of the year presents an opportune time for vendors to examine how their channel activities set the tone for partner performance in the upcoming year. This could mean revisiting some existing channel fundamentals and refreshing areas that may have been overlooked for quite some time. Here are some tips for evaluating and updating your channel activities so that you maximize partner engagement strategies and set your partners on a profitable course.

Review and understand your partners' evolving business models

Is your partner data up to date with existing market dynamics? Are you aware of how new trends effect your partners? What was relevant in the channel one or two years ago, may be outdated and obsolete to your partner's business today. Make sure you have accounted for the shifts in your partner's business models both technologically and economically. As many solution providers have moved to increasing service revenues, they are constantly seeking business opportunities into new verticals or emerging markets. Evaluate business propositions vs. product propositions and show them how your products tie into profitable revenue streams and how they can integrate their current core competencies with yours.

Fine tune partner recruitment and partner retention strategies

Whether you are looking to recruit a new set of solution providers or deepen relationships with existing partners, it's important to regularly fine tune partner communications to stay up with the times. While it’s likely that your messaging is aimed at attracting new partners and motivating existing partners, you must be in-tuned to your partner’s internal and external needs in order to do so. In some cases it calls for a two-pronged audit approach which consists of 1) Knowing how your company and partner programs are perceived in the market and 2) Understanding how your partners are performing in the field in relation to selling your products versus your competitors.

Understanding solution providers perceptions of your company and how you manage your existing partner set, provides insight into luring prospective partners into your channel. You may be unaware of brand perception issues that have pigeon holed your brand. Or you may be touting specific program elements as benefits (such as lead generation, or technical training) that are no longer appealing to target partners. Solution providers look for demand generation opportunities and ways they can proactively manage their customer base. The influence they have on their customers helps to redirect thinking on IT deployments, which in turn becomes invaluable to you as a vendor. Clear and concise partner communications that show a partner how they can enter new markets, increase share with their customer base, or reduce costs by deploying your products into solutions enhance your ability to attract and keep quality partners.

For existing partners, explore ways to increase revenue by understanding the total number of products sold to their customers by divisions, regions or lines of business. Revisit the economic discussions that drive partners to your value proposition and how "in your partner's view" the competition stacks up. Give them incentives to consider your brand as more than a single part of the solution and demonstrate profitable revenue streams from incorporating your technologies. Drive home compensation plans that are aimed at clearing out well-entrenched competitors with suggestions for identifying and closing cross-sell and up-sell opportunities.

Toni Clayton Hine is the Managing Director of the IPED, a division of the CMP Channel Group that leverages over one million data points and 20 years of experience to deliver customized channel education and market intelligence to the technology community. She can be reached at tclayton@cmp.com or 212 600 3113.

RSS has tremendous potential from a marketing perspective and every marketer needs to be aware of what RSS can do. According to Forrester's Marketer Online Survey (in February), 57 per cent of marketers are interested in using RSS as a marketing channel – even though penetration to date has reached barely two per cent of North American online adults.

The combination of reduced e-mail marketing effectiveness and growing consumer advertising backlash will convince marketers to test RSS.

Given that RSS feeds are becoming easier to subscribe to, and that more and more online services are becoming RSS enabled, this trend will inevitably force us to understand and leverage the potential of RSS as a tool in customer relationship management. RSS has profound implications for several marketing-related industries and specifically for relationship marketing agencies.

The weak link in RSS as a marketing tool is, undoubtedly, measurement. As Forrester says, measuring RSS-based marketing efforts is like Web measurement in 1994 — there's limited technology in place and the standards don't exist today. They will soon and there are already a range of techniques from the very basic, that all marketers should use, to metrics that enable marketers who are RSS experts – yes, there are some – to analyse the overall impact of RSS marketing.

RSS will get even simpler: browser makers are already working on adding a one-click button to add RSS content to their applications, and marketers who ignore this increasingly important element of consumer choice are forfeiting a powerful opportunity to reach their consumers.

Mark Taylor is chief operating officer of digital marketing at Wunderman EMEA. He can be reached at mark.taylor@wunderman.com

Permission-Based Dialogues, RSS Show Evolving Power of Personalized Online Marketing

The writing is on the wall for the one-way e-marketing message

By Mark Taylor

Speaking at the recent Internet Advertising Bureau's Engage Conference in London, Bill Gates declared "the future of advertising is the Internet." And he is right. In many senses, technology is no longer at the service of marketing; it increasingly defines it.

And his three central observations around technology-driven changes – consumer empowerment, personalization and interactivity – have recast marketing. Yet these are elements of what any relationship marketing company's DNA since well before the arrival of the Net.

Individually, these changes are not new, what is new is the convergence of change and the acknowledgement that traditional marketing needs an overhaul – the targets of such marketing are voting with their feet.

The changes in technologies and mediums such as blogs, RSS feeds and podcasts have given consumers more control of the messaging and content they receive and as marketers we have to work more creatively to reach them. The most searching impact of the internet for marketers, however, is in the real-time dialogues that the medium offers.

Permission-based dialogues go far beyond the one-way communications many marketers have adopted and continue to practise – even on the Web. By definition, dialogue involves listening. Smart marketers are doing so, and the internet and the related, evolving marketing technologies are providing more channels via which to do so.

Using these new tools, we are better able to tune into behavioural differences, into how prospects react to the online marketing and to accompany our prospective customers further along the sales funnel. This is why it is more appropriate to use the term online marketing rather than online advertising – the online marketer uses the tools at his or her disposition to change consumer behaviour, not simply attitudes.

Gates noted that media and internet content will become personalized, allowing us to view what we want, when we want. Actually, that's already happening – on television with personal video recorders (PVRs), and on the internet, with a technology that is rapidly becoming mainstream. It goes under the – for once – aptly descriptive name of really simple syndication (RSS) and, just as TiVo allows you to watch what you want when you want, so RSS allows you to choose the Web content you want to see – and updates it automatically.

Moreover, just as PVRs have revolutionized TV viewing, RSS is set transform the way we use the Net. Unlike TiVo, though, it also represents transformational opportunities for marketers who use it wisely. As people take more active control of the messaging and content they consume, reaching them gets tougher. Marketers need to understand that consumers who want a relationship with a company or site will increasingly subscribe to RSS instead of e-mail.

But first we need to understand what RSS is and does. Fundamentally, it's a standard for publishing regular updates to Web-based content. Using this standard, online publishers provide updates, such as the latest news headlines or blogs. Whenever you see the RSS icon on a website, it means you have found content that can be syndicated or published.

Meanwhile, consumers use RSS reader applications called aggregators or, less impenetrably, news "readers" to collect and monitor their favourite feeds in one place. For consumers, RSS makes it possible to review a large number of sites in a very short time. For publishers, RSS allows instant distribution of content updates to consumers.

Register This: Consumers & Business Execs Increasingly Dislike Online Forms

By Anne Holland

For many marketers collecting prospect leads or consumer lists is the primary goal of their company Web site and online ad campaigns. Indeed many judge the success of online ad campaigns solely by how many names were gathered.

However, indicators that Marketing Sherpa's research team has been watching for a few years now reveal that everyone in all age groups and most industries are absolutely fed up with filling out forms online for complimentary offers (sweeps, white papers, etc.)

No, they do not want to give you their email address. Or their phone number. Or their name and address. No thank you very much indeed!

Breatheinteractive Media Director Erin Greenwald noticed this trend emerging in the teens and young adult category 18 months ago when she told us, "Younger people are very reluctant to give data. People are just frustrated with spam, and this is a demographic that's online a lot. They're constantly being bombarded with forms and profiles to fill out."

This summer open source software firm Red Hat tested removing the registration forms in front of its white papers. Director of Marketing Communications Chris Grams told us, "We found, in our estimation, it makes more sense to open it up in most cases. If we do not put a capture form in front of it, let's say we'll get 1,000 people to view it. If we put a capture form there, we'll get 50 people to view."

Some marketers wonder if they can beat the anti-form trend by "adding value" to the offer. Example: To entice email newsletter sign ups, offer a complimentary e-Book as a bonus. However, as The Motley Fool told us, they discovered in tests earlier this year that the extra offer can actually depress responses. With the bonus offer they got a 2.99 percent sign-up rate versus 4.50 percent sign-up without it.

Fact No. 1:Typing contact info is a boring pain everyone can live without.

We've done multiple case studies showing if you pre-fill a form so prospects don't have to type their name and address, your conversion rates will double, plus responders will be cool with answering a few more qualifying questions. Of course this only works for prospects who will not be disconcerted by seeing their info pre-populating a form from you.

Fact No. 2: It's about control.

By registering, consumers are giving the marketer control over them again. They are no longer quite as in charge of what information they see, and when. With forms, the paradigm of Web surfing has switched so the marketer is in the driver's seat to some degree—and consumers don't like it.

Typical data: ThomasNet's Industrial Purchasing Barometer study, released in August, revealed "industrial buyers are growing increasingly frustrated with the lack of privacy they are experiencing online."

Although 90 percent of industrial buyers shop online, they are increasingly demanding "anonymity when they search for products online, and in many cases, that desire for anonymity is not being respected."

ThomasNet also noted:

- 77 percent of respondents have a “Don’t call us, we’ll call you” philosophy online.

- 56 percent of respondents do not want vendors to contact them until they have made the initial contact

- 81 percent of respondents said they would not return, or would be unlikely to return, to a Web site that reveals their identities to suppliers.

- 21 percent do not want to be contacted at all.

Does this mean I'm saying that you should remove all registration forms and cease offering newsletters? No, that's silly. However, I am saying that perhaps marketers have to relax a little on the registration front.

Are registrations so incredibly valuable to you that you are willing to forgo the brand-building power of simply placing high-quality content openly on the Web, where it can be seen by prospects who want to see it?

We've all acknowledged an ad that's viewed but not clicked on still has power to influence the marketplace. Plus, we all know the evangelist impact of consumers and bloggers telling the world about great content they've discovered. (More than 60 percent of white paper downloaders pass copies to colleagues.)

Perhaps, for some campaigns, it's enough to have gotten the highest quality message out to a broad swath of your marketplace ... instead of limiting yourself to the 3-6 percent of people who are willing to fill out a form in response.

Anne Holland is President of Marketing Sherpa Inc, a research firm publishing Case Studies and Benchmark Guides for its 173,000 weekly readers in the marketing, advertising and PR professions. The company's latest research in the areas of Search Marketing and Email Marketing is available at www.sherpastore.com.

Co-Op Marketing Dollars Available!

By Robert M. Cohen

Good news: According to the Engaging The Channel Q3 2005 Survey, 71 percent (about $530 billion) of the $750 billion of IT products and services sold in the U.S. and Canada will go through the IT channel—an increase of about 6 percent over the past six years. During this period, the number of reseller organizations has decreased from about 150,000 to 85,000.

Of the 71 percent of sales that flow through resellers, 90 percent of the time the reseller's recommendations regarding which brands to purchase are accepted verbatim—equating to the channel being responsible for the brand selected in 64 percent of all IT sales.

As vendors focus more energy and resources on reaching small- and mid-size businesses, the importance of resellers will continue to grow.

However, before the group hugs and singing and dancing begins, we need to remember that operating costs have increased and margins have been dramatically reduced during this period. For the most part, the resellers who are thriving are those that have successfully gravitated towards a strong service model. In contrast, box pushers are going out of business at an alarming rate.

The survey, conducted by Integrated mar.com (publishers of eChannelLine) in conjunction with Vision Events, a Gartner Company and the CMO Council into issues relating to channel sales and services in order to better understand how IT vendors develop, implement and measure the success of their channel marketing expenditures.

Most vendors are implementing a hybrid model (direct and channel) based on leveraging available value at every step. A simplistic look at the growing hybrid mode shows that many vendors are gravitating to a model that is designed to leverage resellers in order to reach, service and support customers.

The hybrid model tends to look somewhat like:

- Under 20 seats = small: vendor Web site, retail, etail.
- 20 - 1,000 seats = mid: channel via open source distribution.
- 1,000 - 5000 seats = large: specialty channels.
- Over 5,000 seats = very large: direct.

The survey showed that 78 percent of vendors have a Channel Partner Program and another 20 percent plan on building a program in the near future. The problem is that most vendors are always in reseller recruitment mode. However, the reality is that only 37 percent of reseller partners are active in any given quarter. This is because resellers sign up for more programs then they can possibly support, while vendors recruit but then fall short on the engaging, education, reminding and win-back programs where necessary.

Of significant interest to resellers, vendors want to see a greater percentage of their channel marketing dollars going into creating end-user demand. Translation: they want to divert channel marketing dollars from distribution programs to programs that support their reseller partners in developing end user leads.

The survey found that vendors are interested in working with resellers to help them generate leads. Of the items that a significant portion of the vendors are involved in, the survey found the importance and satisfaction in implementation, are:

Marketing Activities	**Importance**	**Satisfaction**
Cooperative selling	90%	81%
Public relations	86%	76%
Events	78%	66%
Success Stories	78%	72%
Webcasts	77%	66%
Collateral	69%	66%
Advertising (in industry vehicles)	67%	53%
Extranet (Portals)	67%	68%
E-Marketing	66%	56%
Advertising (in their vehicles)	66%	58%
Usage of other company's logo	65%	63%

Message for resellers: take advantage of the situation. Work with your key vendor partners to create marketing programs that will drive sales back to you and thus to your vendors. As the vendors start seeing results, they will start investing more and more marketing dollars with you.

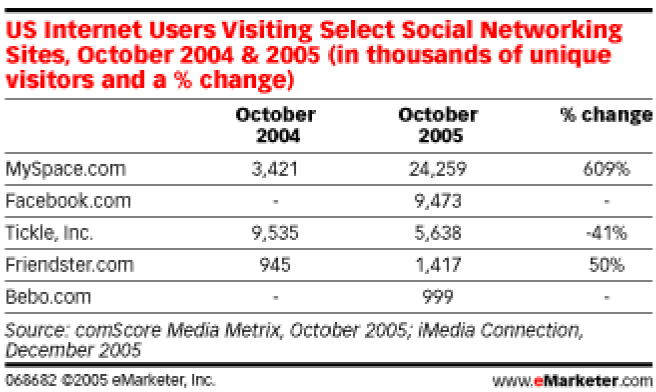
Robert Cohen, a well-known channel advocate, is the Founder and President of Integrated mar.com, publishers of eChannelLine. Since 1980 he has helped hundreds of vendors, distributors and resellers develop and implement strategic go-to-market programs, using a variety of direct, channel and hybrid models.

Turning MySpace into Ad Space
From eMarketer

Not many significantly-sized sites have experienced growth of 609 percent in audience size over the last year. That's just one reason MySpace, with nearly 25 million members, is attracting so much attention.

Social networking Web sites like MySpace, Facebook, Friendster and Xanga allow users to set up personal Web pages listing biographical information about them, from what they look like (including the option, taken by most, of posting a picture) to their favorite TV shows, foods, places and much more. Users can then link up with their friends, and potential friends, through the Web site, creating a huge personalized online community and network.

The popularity of MySpace has exploded in the past year. Numbering under 3.5 million members in October 2004, it had over 24 million one year later, according to comScore Media Metrix. A crucial aspect of MySpace's success has been its tie-in with music and, increasingly, other forms of entertainment. By allowing bands to easily set up pages, including templates for uploading pictures, displaying upcoming shows and streaming songs, MySpace gives users another reason to surf through pages besides just looking at profiles. It has also created online fan clubs for various groups, bolstering membership and creating a feeling of being at the ground floor of building a group's fanbase.


US Internet Users Visiting Select Social Networking Sites, October 2004 & 2005 (in thousands of unique visitors and a % change)

	October 2004	October 2005	% change
MySpace.com	3,421	24,259	609%
Facebook.com	-	9,473	-
Tickle, Inc.	9,535	5,638	-41%
Friendster.com	945	1,417	50%
Bebo.com	-	999	-

Source: comScore Media Metrix, October 2005; iMedia Connection, December 2005

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The people using these sites are primarily young — in October 2005, visitors to MySpace were 139 percent more likely to be under the age of 17 than among the general Internet population, while Facebook, which caters to a college-age crowd, had an audience with a 283 percent greater incidence of 18 to 24 year-olds than among the overall online populace.

US Internet Users Visiting Select Social Networking Sites, by Age, October 2004 & 2005 (composition index*)

	MySpace.com	Facebook.com
12-17	239	143
18-24	160	383
25-34	69	32
35-44	89	58
45-54	87	88
Total audience	**100**	**100**

*Note: *Composition index represents the proportion of the given group within a specific site audience, compared to the proportion of that group in the total online population. A composition index of 100 represents parity*
Source: comScore Media Metrix, October 2005; iMedia Connection, December 2005

While these Web sites offer an attractive opportunity for marketers, comScore notes that peers often have greater influences on these site's members than corporate entities. Employing alternate marketing techniques that spread praise for a product through users rather than traditional visual advertising could be more effective on social networking sites. Since many bands have used these sites to connect with listeners, and now companies are partnering with music groups, movies and television attractive to a young audience to get directly connected to social networking users, sometimes setting up their own profile that can become a "friend" of network members.

That being said, there is also plenty of opportunity for youth-oriented text, image and rich media advertising on MySpace, Facebook and other sites. Most band and personal sites on MySpace, for example, include a banner ad at the top, often including rich text, and the MySpace front page where users log-in has additional image and text ads. With the acquisition of MySpace by Rupert Murdoch's News Corp. earlier this year, it remains to be seen how much the advertising environment on the site will change. As it stands now, the it seems to have found the recipe for success, and advertisers are very interested.

To learn about other new methods marketers are using to advertise on the Net, read eMarketer's Online Video Advertising report.

The Download
The Rise of Nearshoring
Ex-communist Europe is grabbing a lucrative niche in the global outsourcing business
From *The Economist* print edition

In a nondescript Soviet-era building in a suburb of Estonia's capital, Tallinn, is one of the telecommunications world's most important research outfits. It is the development centre for Skype, a software product that allows free, or very cheap, phone calls from any internet-connected computer. Skype is a global company recently bought by eBay, an internet auction site, for $2.6 billion. Its Scandinavian founders used programmers not from pricey Silicon Valley or faraway India, but from a small east European country that has barely figured on the business landscape in software, or anything else.

That is one face of what those involved like to call nearshoring: the business of moving production, research and business processes to countries that are quite cheap and very close rather than very cheap and far away. On the other side of Tallinn is another face: the factory of Elcoteq, a Finnish firm that makes mobile phones for Nokia and other companies. Whereas Skype employs more than 130 highly paid people, around a fifth of them foreigners, with an average age of 28, Elcoteq's factory workforce is big (more than 3,000), middle-aged, performs repetitive, semi-skilled tasks, is modestly paid and entirely local.

The story of outsourcing in central and eastern Europe these days is that Elcoteq's model is struggling to stay competitive, while Skype's is booming. The region's most obvious advantage, low labour costs, is diminishing, partly because of the even greater price advantage in China and partly because of the upward drift in wages brought by the march of prosperity. That is leading companies to hunt much harder for lasting advantages—based on talent and geography, rather than low wages and plentiful labour.

By the standards of the former captive nations' rocky past, that is still a nice problem to have. In the early 1990s, when Elcoteq opened in eastern Europe, even owning a factory there seemed risky; outsourcing crucial development work would have seemed mad. Bureaucrats were capricious, logistics dreadful, telephone lines bad, business manners eccentric. Doing deals needed strong nerves, iron-clad innards and relentless patience. “It's like Africa, but closer,” was the dismissive view of one western executive, struggling in the Lithuanian textiles industry in 1993. In those days simply getting a lorry to Poland could involve a weeklong wait at the congested and corrupt border crossing.

Now eastern Europe is beginning to look different: much more like China than Africa, closer geographically and culturally than either, and easier to do business in. Since the collapse of communism, habits, attitudes and values have changed out of all recognition. Economies that were teetering on the verge of hyperinflation only 15 years ago are now preparing to adopt the euro. The European Union has imposed a familiar legal environment; even those like Romania and Bulgaria, still outside but hoping to join, are at least heading in the right direction. Politics may be murky, but are rarely worrisome.

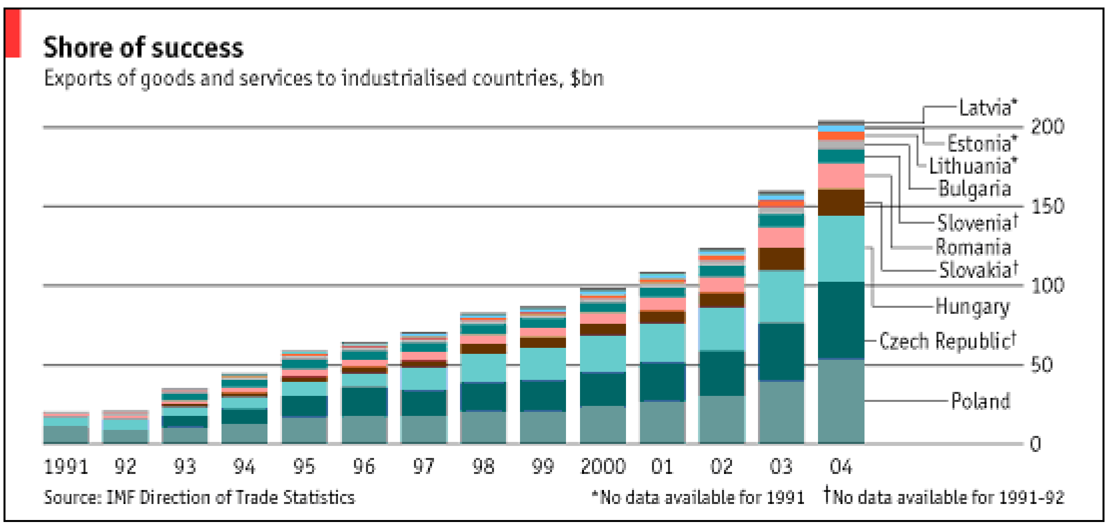
So western contracts and investment are flooding into eastern Europe. The annual value of outsourcing contracts is hard to estimate—it includes everything from big companies that own factories to small contractors doing one-off deals. But it's clear that the phenomenon is sizeable and growing. Clothing imports from the east European countries into the existing EU in 2004 were 2 billion pieces, with a value of €22.3 billion ($25 billion), representing a 19% share of the EU's clothing imports, according to Liz Leffman of Clothesource, a consultancy. Libor Krkoska, an economist at the European Bank for Reconstruction and Development, reckons that the best proxy for the growth in outsourcing is the post-communist countries' total trade (see chart) with the rich world.

So far, the biggest fuel for the boom has been wage costs that are typically still half western levels. Tünde Gulyás of Colling, a Hungarian consultancy that helps firms outsource backroom processes, chiefly accounting, reckons that wage costs are 50-60% below western levels in eastern Europe; in India they are 75% cheaper.

Best in class

In the Czech Republic alone, that has prompted companies such as DHL, Siemens and Lufthansa recently to move big data-processing operations there. “The quality of work is world-class. It matches and sometimes even surpasses the best we do in India,” says Amitabh Chaudhry, chief operating officer of Progeon, a division of India's Infosys IT group that deals with business-process outsourcing. It has opened a centre in the Czech city of Brno, with roughly 100 people working in 13 languages. Mr Chaudhry also highlights the friendly time-zone, good political and regulatory environment, multilingual workers and “cultural affinity”. “We couldn't have handled this from India,” says Ratnesh Mathur, who runs the Brno centre. Infosys has a further office in Prague, supplying around 100 IT support staff to multinational companies there.

That highlights an essential point: cost is only part of the picture. “If I want a huge English-language call-centre, or to design an aircraft engine using tens of thousands of man years, I will go to India,” says Stephen Bullas, whose company e CODE assesses outsourcing locations. “But if I want a small controllable team of telesales people, or back-office workers with a cultural fit to the continental EU or Britain, then it can be much more appropriate to choose an east European country.”



It is the same story in manufacturing, For time-insensitive goods and long production runs, China is still the clear winner for global factory relocation. But when businesses need products finely tailored and delivered quickly and flexibly, then eastern Europe scores highly.

In the garment industry, for example, foreign companies are doing a booming trade with east European countries in the business of “fast fashion”—ordered and manufactured in speedy response to sales trends. “Fast fashion is a pound or two more per piece from central and eastern Europe, but customers are prepared to pay,” says Ralph Goodstone, a textile entrepreneur who brokers deals between low-cost suppliers and rich-country customers. The product cycle for garments from China, he explains, is about three months—with four weeks of that time spent at sea. From eastern Europe, by contrast, it is just four to six weeks, including a day or two for delivery by lorry.

So, too, with fashionable electronic gadgets. “Every brand owner has several models; the lead time and the lifecycle of the product are shortening. So it makes sense to localise to the area of sales,” says Risto Gaggl, Elcoteq's boss in Tallinn. For the next few years at least, there are still big gains to be made in this field. Surprisingly, despite EU and NATO membership, many find the region unfamiliar and scary. “People still ask questions like ‘Will my mobile work?' and ‘Do you have a McDonald's?',” says Ms Gulyás of Colling wearily.

But there are disadvantages too. It is not just steadily rising costs: rising productivity can cushion that, at least in part, and labour may be only a small component of the ultimate price. The biggest shortcoming is a legacy of communism: a shallow talent pool, particularly for middle managers who need to be customerfocused and conscious of quality. These were not qualities that the planned economy demanded. Mr Goodstone's most recent deal, with a Latvian supplier, has been hobbled by the gulf between each side's expectations: “They throw up their hands and say, ‘Oh Ralph, we're only a couple of weeks late—our customers round here never worry about that'. When they run into problems they think: ‘Oh we'll sort it out', but you can't—you have to get it right first time.”

Other industries are also short of managers. At a recent outsourcing conference in Budapest organised by Ms Gulyás's firm, a bunch of consultants and providers swirled round Jackie Raybould, a director of SCC, a $3 billion company that is considering moving its expert multilingual IT support for big international companies from call-centres in London and southern Europe to somewhere like Hungary. “There's a ready pool of IT-literate, multilingual graduates. But the management experience isn't as developed,” says Ms Raybould. “For programming it would be fine, but we're talking about direct services to customers. If we wanted to deliver this from central and eastern Europe, we would need to manage it ourselves.”

The big question at the cheaper end of the market is how to sort out middle-management. In manufacturing, the danger is that badly run businesses will perish before they have a chance to prosper. Mr Goodstone reckons that without better bosses, the mass-produced garment business in central Europe will be “dead in five to ten years”. Call-centres are rather better placed, as central Europe's language skills give it a big advantage over most other locations. German, French and English are all widely enough spoken to create a good pool of potential workers. And other languages can be learnt quickly. One Bulgarian call-centre, for example, reckons that it takes only four months to teach German-speaking employees to answer calls in Dutch as well.

It can be taught

Part of the problem is simply size. The top ten east European countries' combined population is around 100m. Vietnam alone is 81m. The answer is to go upmarket with better education. But that's something that every post-communist country is still grappling with. Schools and universities have still to reform Soviet-era pedagogy and curriculums, and are often short of both capacity and teaching talent. “We need a lot more engineers, yesterday,” says a senior Elcoteq manager. His company and others now sponsor university faculties in the hope that high pay will bring bright graduates back to dull-sounding, difficult disciplines such as computing and production engineering and away from soft subjects such as marketing, law and economics that flourished after the collapse of communism. But good east European managers tend to gravitate to such industries as information technology, which pays world-class salaries. Pawel Zak, who manages the Polish operations of IMPAQ, a German-owned IT outsourcing company, recalls: “in the beginning we had good programmers and the project managers were all expats. But we did a good job learning from them.”

A quick fix is to rely on expats from western countries to bridge the gap. But that is pricey. The new trend in central Europe is for investment by firms from other outsourcing locations in places such as China, India and Turkey. Firms there are eager to gain an edge on their rivals by moving closer to the customer. Turkish entrepreneurs, for example, have bought textile factories in neighbouring Romania, installing new management there. That takes advantage of local labour costs, and brings big productivity gains. A big Hong Kong-based trading company, Li & Fung, has opened offices in two east European locations. Infosys is just one of several big Indian software companies with newly opened offices in central Europe.

In the long run, says Mr Chaudhry of Progeon, “geography is history”. His company will sell where clients get most value, get capital where it is most abundant, find resources in the most cost-effective location and organise production where it is most convenient. That is true—but presents a demanding future for former captive nations still struggling with the basics of modern business life. The big question now is which of them best grasps the opportunities in outsourcing, and which will let them slip by. “The cost is pretty much the same,” says Ms Gulyás. “The difference is the impression they create.”

Location, location

Stephen Bullas of e CODE says that although no single country is ideal, Poland is “truly open for business”. The Czech Republic, though improving rapidly, “can still be too bureaucratic”. He recalls recently a firm there that “snatched defeat from the jaws of victory” by refusing to convene the early board meeting needed to close the deal (the contract went to the second-placed Polish company). Hungarians have “great technical ability”, he says, but can often be complacent, harking back to the imperial Austro-Hungarian era and “thinking the world owes them a living”. Despite impressive IT skills, the Baltic states will win only a niche in the business unless they start co-operating with other countries in the region. Romanians largely “still don't get it—they smoke in client meetings and cite official corruption as a competitive advantage,” he says. That's a pity: in e CODE's comparative analyses, Romania is the most multilingual country in Europe after the Netherlands for potential business-process outsourcers and it can also demonstrate above-average IT skills.

The good news is that pressure to stay competitive is slowly forcing governments to acknowledge and remove bureaucratic barriers. Czech and Polish officials promoting their countries at the Colling conference in Budapest shifted nervously when questioned about archaic, restrictive labour laws and intrusive bureaucracy. “They don't understand that a call-centre can't just close down because of a national holiday,” complained one outsourcer. In Estonia, companies such as Skype want the government to liberalise the country's tough visa laws. “We wanted to interview a Pakistani guy living in Stockholm and we couldn't get him over for a weekend—it was easier for us to go there,” complains Sten Tamkivi, Skype's boss in Tallinn.

A more business-friendly environment can help maintain an edge, but in the end the prosperity that it brings inevitably forces change. Allan Martinson, a Tallinn-based financier, reckons that Elcoteq has at most four more years before it will become necessary to switch production to Russia. The value-added it creates in Tallinn, he calculates, is only half that achieved by the country's notoriously inefficient timber industry. But by then another niche will have come along. The Estonians working at Skype, he says, have now seen how a world-beating young company works from the inside. Next time, they will want a big chunk of the action for themselves.