



Can Big Blue Succeed In BPO?

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This isn't your father's IBM. After decades of specializing as a computer manufacturer and provider of computer-related services, Big Blue in the past year or two has been heading into some not-terribly-technical fields. Today's IBM processes thousands of insurance claims, ensures that Procter & Gamble employees get paid, and takes charge of repairing televisions and CD players sold by Philips Consumer Electronics.

Taking on tasks such as customer service and human resources management is part of a broader shift among traditional information technology companies to get into what's often called business process outsourcing (BPO). BPO is a fertile market, expected to grow from about \$405 billion last year to \$682.5 billion in 2008, according to research firm IDC. Interest in such operations - and especially in their migration to countries such as India - continues to ride high. On November 19, for example, the [Wharton India Economic Forum](#) in Philadelphia has a panel devoted to discussing this phenomenon.

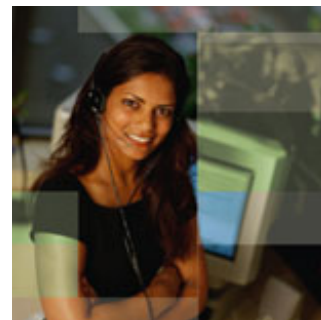
IBM CEO Sam Palmisano thinks the intersection of technology and business process services holds great promise. As he sees it, IBM is poised to help customers with a new set of services that includes technical assistance but adds strategic advice about business methods. Palmisano dubs the concept "business process transformational services," and claims it represents a massive market nearly a third as large as the \$1.2 trillion spent annually on IT. "It is a \$500 billion opportunity," he told analysts earlier this year. "We plan to exploit this opportunity to drive revenue and growth rates beyond those which are traditionally available in the information technology industry."

In essence, the new Big Blue sees big bucks in focusing on the "B" in International Business Machines. But the strategy carries some risks. They include competing against new foes, handling novel tasks and explaining a grandiose vision to customers. What's more, the business process push requires a thorough understanding of different industries. Staying on top of specific industries and their changing trends should be a challenge for IBM, says longtime industry analyst John Jones. "Historically, that's not been one of IBM's strengths," Jones notes.

From Business Machines to Business Methods

IBM's direction marks a shift from its storied history as a computer industry bellwether. For decades, IBM concentrated on machines to carry out accounting and computing tasks. IBM was behind the curve on the emergence of the personal computer, and though it later gained ground against companies like Apple Computer, IBM was slow to adapt to the changes it brought in the marketplace. By 1993, the company's annual net losses reached a record \$8 billion. Lou Gerstner, who took the reins of the company in 1993, is credited with emphasizing services as a key to the company's turnaround. Nearly half of IBM's \$89 billion in revenue last year came from its services unit. (Gerstner's turnaround strategy is highlighted in a new book from Nightly Business Report and Knowledge@Wharton titled, *Lasting Leadership: What You Can Learn from the Top 25 Business People of Our Times.*)

IBM became a leader in IT outsourcing, which refers to a company farming out work such as managing central computer centers or handling technical support calls. Big Blue began extending its services reach from the technology arena to business tasks about the time the company acquired the consulting wing of accounting giant PricewaterhouseCoopers, in late 2002. The roughly \$3.9 billion deal was a landmark move. IBM combined the roughly 30,000 employees from PwC Consulting with about 30,000 IBM workers to form a new division called Business Consulting Services. The idea behind the acquisition and



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new unit was to generate revenue by joining IBM's technology prowess with PwC Consulting's business expertise. Analysts say the PwC Consulting deal has helped IBM compete in the BPO arena.

The India Connection

A more recent acquisition further demonstrated IBM's commitment to business process services. Earlier this year Big Blue snapped up Daksh, an Indian BPO provider with 6,000 employees. Daksh, which also has a facility in the Philippines, gives IBM an army of lower-wage employees ready to handle services such as telemarketing and transaction processing.

IBM is beginning to nab business process contracts. In April, it announced a deal to manage after-sales services for TV maker Philips Consumer Electronics in North America. The contract is valued at about \$300 million and runs for seven years, according to a source close to IBM. Under the agreement, IBM is to provide consulting to help Philips improve its customer service methods. IBM also is handling services including product repairs, some of which are to take place in an IBM center.

Last year, consumer products titan Procter & Gamble signed a 10-year contract worth \$400 million for IBM to manage employee services such as payroll and benefits administration. About 800 P&G employees around the world moved to work for IBM when the contract took effect in January. More recently, IBM inked a deal with business information specialist Dun & Bradstreet. That seven-year, roughly \$180 million pact involves D&B outsourcing to IBM certain portions of its customer service and financial processes. IBM will also help D&B gather its data. D&B said it expected outcomes including reduced costs and an improved level of customer service. For its part, IBM said it will help D&B get these results partly through global process expertise and advanced technologies.

While IBM makes these efforts to build its presence in the outsourcing market, new research into these issues offers insights into the challenges it will face. In a paper titled, "Outsourcing Outcomes: Orchestrating Platforms, Processes and People" by Wharton operations and information management professor [Ravi Aron](#), Siddharth Jayanty and Ying Liu, the researchers found that yanking a process out of a firm and delivering outcomes back to that company - in the form of services - is by no means a commodity business. The researchers classify processes that can be outsourced into three categories. First, some processes are foundational in nature, i.e., they account for most of the man-hours and have relatively high volumes and low value (such as transaction processing, claims administration in life insurance etc.). Second, some processes are "value originators", since they require expertise in process execution and managing complexity (such as research support in investment banking, F&A and invoice management for large supply chain firms, financial statement analysis and so on). Finally, some processes are value differentiators, i.e., they have considerable strategic importance. Such services can only be outsourced to specialist firms, and they include services such as market research, pricing and customer analytics, risk management etc.

What does this framework have to do with IBM's BPO strategy? According to Aron, "Processes at the volume end can be taken over by a third-party BPO service provider. Here, IBM's ability to manage the platform and process layers well will pay dividends." He explains, however, that in its quest for seeking to take over such processes, IBM faces competition from overseas firms such as Wipro and HCL. The researchers show that Wipro and HCL have been able to re-engineer processes and deliver 15% to 30% productivity gains (reduced headcount) and improved quality of execution within a year of taking over the processes from the client. In order to compete with them, "IBM will have to find ways of automating the processes and migrating at least some parts of the process execution to off-shore locations to remain competitive in these segments. This is where the Daksh acquisition gives IBM a way of leveraging its traditional strengths," says Aron. He adds that competition in this segment will heat up as firms with an off-shore delivery capacity acquire consulting capabilities or partner with firms in the U.S. and Europe. Companies such as Infosys, Wipro and HCL are already making inroads into this segment in the U.S. and Europe by offering a combination of off-shore, on-shore and near shore facilities.

Aron also points out that when firms outsource the second kind of processes (value originators) they do not necessarily look to an IT behemoth as a potential provider. An example of a successful firm in this segment is OfficeTiger, a 5000-employee firm based in Chennai, India, whose service capabilities span sell-side equity research, financial accounting and statement analysis, research support for investment

banks and electronic document production services. "The value that Office Tiger brings to the table is in managing complexity and creating seamless interfaces with its clients," says Aron. "While OfficeTiger has used technology to integrate itself with its clients and to measure and manage risk, not being a technology company is not a handicap to it. This is a highly profitable industry segment, and if firms can scale up and deliver these processes cost-effectively, the revenues can be as much as three to four times that of the less complex processes. Indeed, for such processes, it is not clear that buyers will turn to firms like IBM or Accenture." Firms like OfficeTiger have a clear edge in this business, he adds.

What's In a Name?

IBM insists that it isn't just targeting BPO deals, which often are focused on cutting costs. Instead, IBM says it is pursuing a market for more comprehensive services - what Palmisano called business process transformational services. During a speech earlier this year, Palmisano took a stab at defining BPTS. "It's about increasing a business's effectiveness and strengthening core competencies," he said. "It's not just a question of taking the cost out. It's about transforming the process, embedding the technology and integrating."

More recently, IBM has tweaked its language slightly - saying BPTS stands for "business performance transformation services." To John Jones, IBM's label amounts to semantics. IBM and rival Accenture both are offering essentially a more sophisticated version of BPO, with consulting added to improve a business process, according to Jones, who was an analyst at Schwab SoundView Capital Markets until it folded operations last week. BPTS is "their twist on the same market opportunity," he said.

Aron has a different view. He argues that as the process complexity and its strategic value to a client increases, "it is not clear that the usual re-engineering and consulting techniques work. Industry specific expertise and process-level specialization are often required to create significant value," he says. "It is easy to underestimate the importance of execution and the challenge of managing complexity and scaling up simultaneously. Companies may enter this market thinking that there are cookie-cutter solutions that once perfected can be rolled out in scale across multiple clients. This is generally not the case."

BPO, BPTS -- the exact terminology ultimately isn't very important to customers, suggests Don Schulman IBM vice president for global finance and administration solutions. Schulman said IBM doesn't talk about "BPTS" when trying to sell its new services to clients. Instead, Big Blue discusses the clients' business problems and what it can do to help. "CEOs get this right away," he said.

Business process services may be a relatively new market for IBM, but Dun & Bradstreet viewed IBM as a well-known, veteran outsourcing partner. "They're not newcomers to this game," D&B spokeswoman Yvette Rudich said. Rudich also noted IBM's "state-of-the-art call centers." IBM's call center capabilities expanded significantly with the addition of Daksh. And Daksh itself is projected to grow to 10,000 employees by 2005, according to its web site.

That sort of growth abroad puts IBM squarely in the middle of the hot-button debate over so-called offshoring, when services jobs get sent from the U.S. and Western Europe to lower-wage nations like India. In addition to the Daksh workers, IBM has thousands of other employees in India.

Apart from making IBM more of a lightning rod for offshoring criticism, the Daksh acquisition represents what could be a formidable hurdle in terms of integrating a foreign company and workers from a different culture. But IBM is familiar with bringing on workers outside the United States, says IDC analyst David Tapper. "They've done this. They've been in Latin America. They're in Asia. They're in China. These guys are all over the world."

"This plays to IBM's strengths," says Aron. "The company has not only been able to integrate foreign operations but it has also managed well the integration of large acquisitions such as Lotus Notes. It has a diverse workforce that draws from some of the best talent in the world. If somebody can pull this off, I expect IBM would be that firm."

Pitfalls Ahead?

IBM's Schulman says the Daksh acquisition "has gone extremely well." But he acknowledges another

potential pitfall in Big Blue's big business process plans. In creating business performance transformation services contracts, it's difficult to arrive at standard, easy-to-duplicate arrangements, he suggested. "Every deal takes its own shape ... Sometimes it's hard to figure out how to shape it."

"Customers will want to hear, 'how do I get that in smaller steps today?'" Jones notes that IBM's size can get in its way as it pursues business services deals. With more than 300,000 employees, IBM is not as nimble as small outfits can be in serving customers, he said.

Then there's the issue of IBM stepping into unknown territory. The company now effectively competes with specialist services firms such as Hewitt Associates, which concentrates on human resources outsourcing and consulting. IBM is adding to its payroll hundreds if not thousands of workers not versed in computer technology per se but in tasks such as benefits administration and accounts payable. To IBM, though, the business process services arena is a logical extension of the old IT world. The company says the BPTS market stems partly from the rise of open technological standards that allow data to move easily within businesses. Also a catalyst, IBM says, is the "ubiquity of the Internet" and web technologies, which lower the cost of transactions within and among businesses.

In the case of the Philips deal, IBM argues its responsibilities are not such a stretch, given that TVs and other consumer products covered in the deal now incorporate digital technology. In addition, consumers buying high-end TVs will expect a high level of customer service akin to that of computers, says Bob Zapfel, general manager of IBM Global Services for the Americas. "These are products that have the requirement for more of an IT system-like support model," he notes.

Aron sees two other challenges ahead for IBM - "one is to be able to deliver high quality outcomes for clients and the other is to capture some of the value that the firm creates - i.e. make money doing so. While IBM may be able to deliver value to its clients, the competition can pose a significant barrier to revenues. The combination of specialists with a mix of off-shore and on-shore delivery capacity can be a formidable challenge for any firm to face," he says.

IBM's Schulman says Big Blue's size has its advantages, such as the ability to bring a mathematician in to help with a client's problem. As for the claim that IBM has done poorly at tracking industry trends, Schulman points out that the company is organized according to different industries and argues IBM has shown leadership in the financial services field in particular. IBM also says its PwC Consulting acquisition brought it specialists in areas such as automotive, retailing, and media and entertainment.

If nothing else, IBM under Palmisano is on the move, rather than resting on its laurels as the biggest IT services provider. Will Big Blue succeed in its business process services quest, dramatically streamlining customers along the way? Jones gives IBM good odds, and says the battles among it and competitors should be intriguing. "There's a lot of upside in an area (in which IBM has) historically not been involved," he said. "It will be interesting to see how this segment of the market plays out."

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