CASE STUDY

India showing IBM the way?

Three decades ago IBM left India because of the difficult nationalistic policies. Only in 1992 did it return, but by 2007 it was holding its annual investors' day in Bangalore Palace rather than in New York. Why? Because it wanted to show that the firm's 'centre of gravity' was moving towards the big developing countries such as Brazil, China and Russia. By 2007 IBM employed 53 000 staff in India, one of the fastest growing markets for IBM, with revenues rising by 40–50 per cent per year. IBM announced that it was investing US$6 billion in India between 2007 and 2010 in addition to any planned acquisitions and it is expected to double its workforce there by 2010.

IBM's challenges

IBM faced a number of challenges. Firstly, emerging countries have posed threats and opportunities, because Indian services firms, such as Infosys, Wipro, Tata and Cognizant have been able to compete more aggressively with IBM and its rivals Accenture, EDS and Hewlett Packard. Now they are all increasing their Indian workforce. Secondly, IBM has to decide what makes a successful multinational company in a global market and as a result what the company must do to generate the growth its shareholders demand.

IBM's boss, Sam Palmisano, explained in a speech at Insead in 2006 that the model of an international company had passed through three stages. The first was the nineteenth-century international model where firms were based in one country and sold goods through sales offices in their international markets. The classic multinational followed in which the parent company created smaller versions of itself in its various country markets. The latest model is the 'globally integrated enterprise' in which the strategy, management and operations are developed as a single entity. It is based on having the right cost, the right skills and the right business environment, so that work flows to places where it is done best.

IBM's investment in India is not solely about cheaper workers but was about leading edge research and development in 19 offices across India, writing software and running low cost call centres. It was also about flexibility. Its financing back office is in Rio de Janeiro and call centres are placed around the world. When rioting disrupted activities in Bangalore in April 2006, IBM moved data centre services to facilities in Brazil and Colombia. In line with building a globally integrated enterprise IBM has replaced its separate supply chains, set up in different markets, with a centralised supply chain and the chief procurement officer John Paterson has relocated to Shenzhen in China in an effort to improve the quality of IBM's purchasing staff in the region.

But what will be the basis of IBM's future growth? Cutting costs will be crucial. Globalising the supply chain has already saved IBM US$8 billion a year. But IBM is a mature business with 330 000 staff in 170 countries and getting them to make the changes to implement the next strategy will be difficult.

IBM's recent history

IBM built its business on computer hardware but when a previous boss, Lou Gerstner, took over in 1993 it was on the point of selling itself off in parts as a response to a huge corporate loss, as its mainframe computer business on which it had built its past declined, and to personal computers becoming commodities. The mainframe computer business was stabilised and the business direction changed to focus not on selling hardware but on the fast-growing IT services market including outsourcing. Between 1992 and 2001 hardware declined as a percentage of revenues from 55 per cent to 30 per cent and services increased from 25 per cent to 42 per cent.

In 2002 IBM bought the consulting arm of Pricewaterhouse Coopers apparently to complete the services strategy by providing consultancy expertise and relationships with some key global firms, in theory enabling IBM to focus on higher value work solving complex business process problems. But as IBM moved upmarket Indian IT firms started to compete strongly at the lower end. Infosys with a market vale of US$28 billion is still less than a quarter of the value of IBM but it is growing fast as clients seek to make cost saving in their outsourcing contracts. Indian firms such as Infosys have started to win contracts that previously IBM would have considered their own. The competition is also forcing IBM to quote for contracts at much lower prices than they would previously have done.

Even though IBM signed up outsourcing deals with Vodafone, the German Army and the State of Indiana in 2006, the days of the 'mega deals' (US$1 billion one supplier contracts over several years) are drying up for IBM as clients realise they gave too much control to one outsourcing company. In future, contracts are likely to be split between a number of suppliers and be rather more aggressively negotiated. Total outsourcing was IBM's strength, being able to manage everything from simple call centres to remote infrastructure management (over 40 000 servers outside India are managed from India) to business transformation, in which the client's business is re-engineered and its staff managed through the process.

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Implementing the international strategy

In practice it has been IBM's investment in India and good management of the Daksh operation that IBM acquired in 2004 that has helped. Daksh was encouraged to carry on as it was before rather than try to operate in the IBM way. IBM initially paid the Indian workers too much which created problems in the IT labour market but now it is focusing on tapping into local talent and developing it through training, staff development and career progression to attract and retrain good staff. Cost reduction from its Indian operation is now helping IBM to increase profit margins.

IBM needs to continue to innovate. IBM draws licence fees, about US$1 billion per year, from clients and competitors alike that use its intellectual property such as in mainframe computers and its multi-core semiconductors that are used widely, including the three leading videogames consoles. It owns a patent on one-click purchasing and other patents fundamental to e-commerce. In 2007, for example, Amazon settled for an undisclosed sum IBM's claim that they were infringing patents.

IBM will need to continue to make bold strategic decisions. It seems to have had no regrets about selling off its loss-making personal computer business to Lenovo. It has invested US$16 billion in four years on 50 acquisitions, mainly software companies. Its software revenue in 2006 was 20 per cent of the total but profits from software were 40 per cent of the total and its ambition seems to be to become the next great software company based on 'middleware' that helps a firm's different software to run together.

The real challenge however is to produce synergies from its hardware, software and services to make it a global leader. To do this IBM staff must work together rather than stay in their business unit 'silos'. It has picked 17 industry sectors on which to focus and will use its research labs around the world to focus on specific sectors. In Bangalore the focus will be on developing software for the healthcare and insurance sectors.

QUESTIONS

1 What are key challenges faced by IBM in its global markets?

2 What recommendations would you make to ensure the firm's continued profitable growth?

SOURCE: ADAPTED FROM S HAMM, 'IBM'S PASSAGE TO INDIA', *BUSINESS WEEK* 8 AUGUST, 2005, 'HUNGRY TIGER, DANCING ELEPHANT: HOW INDIA IS CHANGING IBM'S WORLD', *THE ECONOMIST* 4 APRIL 2007, WWW.IBM.COM AND OTHER PUBLICLY AVAILABLE SOURCES