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BRINGING TECHNOLOGY TO MARKET

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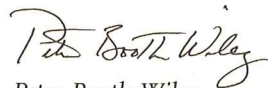
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Bringing Technology to Market

Trends, Cases, Solutions

Edited by
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4 The Services Shift in the IT Industries Case: IBM/SBS

Olaf Plötner

In the 1960s and 1970s, the IT market was dominated by hardware producers (HW), a business branch marked by relatively complex projects, most of which were ordered by public institutions and a few large organizations (e.g., NASA). Normally in those years, the necessary software (SW) was also produced by HW companies according to the requirements of individual clients. The resulting IT solution was sold as a package, including product-related services such as installation and maintenance.

In the 1980s, two technological developments caused major changes as far as those industry structures were concerned: the emergence of personal computers and the possibilities of client-server architecture. These developments resulted in a dramatic increase in IT technology users; in addition to generating private buyer groups, they above all revolutionized the use of IT at the workplace. Continuously new application areas were discovered where IT could support the daily tasks of employees in various functions. Even small and medium-sized companies were suddenly able to afford their own IT solutions.

With the increasing application areas, more and more SW products entered the market, while at the same time improved HW allowed for the introduction of increasingly substantial and useful software programs. In the course of this development, many new companies emerged (e.g., Microsoft). In contrast to companies from previous decades, these focused exclusively on the development of specific SW products. When it came to marketing, these suppliers wanted their products to be compatible with those of different hardware producers. In addition, clients insisted that different SW products be compatible with each other. Technologically, this became possible through an abandonment of proprietary solutions in favor of “open standards.”

The possibilities of complex product integration, however, often exceeded a client's technological know-how, which led to suppliers designing, installing, and maintaining the entire architecture of their clients' system solution. The demand for these integration services was enormous. It grew much faster than the demand for HW, and in 2001 the turnover of IT services was higher than SW and higher than HW. HW and SW companies and consulting firms eagerly entered the market for integration services.

In the 1990s, numerous client companies experienced cost pressure; very often concentration on core competencies became their strategic motto. This was accompanied by a desire to no longer provide personnel for the increasingly complex IT solutions. In order to manage with variable costs, companies

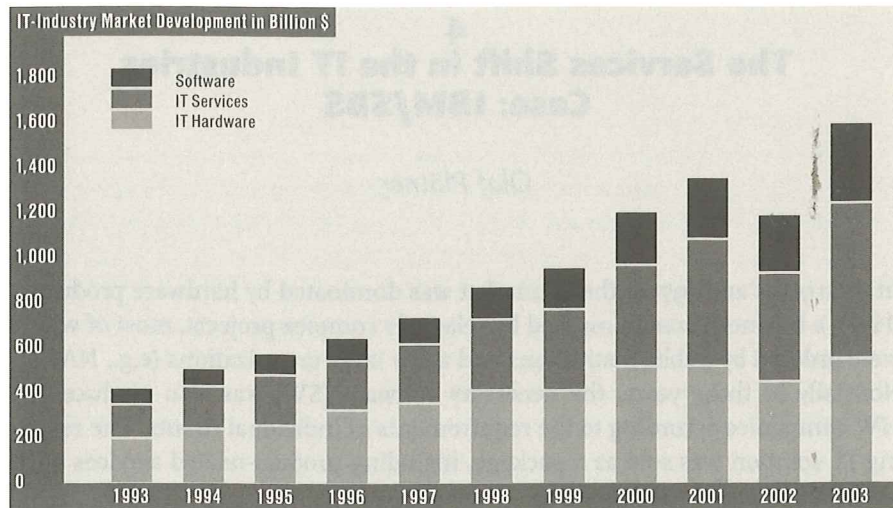


Fig. 1: IT Industry Market Development¹⁷⁸
Source: EITO and IDC

started to look for specialists to handle these IT activities more efficiently. In this period, many client companies followed the example of the few that had already decided to outsource their IT departments. This meant largely dissolving internal IT departments and offering their workload to external suppliers.

This trend was accompanied by a decrease in the purchase of IT equipment by the client companies, which by then were more interested in buying certain IT processes. In these cases, suppliers often re-employed the IT personnel of a client company, even though – given the advantages of their efficiency – they did not need the same number of employees. Rather they expected to employ their newly acquired workforce for a different outsourcing client – provided, of course, they were able and willing to be so employed. The suppliers of outsourcing services were often the same companies that sold overall system solutions. There were, however, many (such as EDS) that had pursued this kind of business model since their establishment.

At the end of the 1990s, new application areas for IT solutions continued to be developed. In particular, the broad acceptance of the Internet and the increasing potential of e-business provided further possibilities for company use. Accordingly, the outsourcing business grew considerably.

By then IT outsourcing was often no longer limited to IT processes as such. With increasing frequency, administrative activities such as factoring and sending monthly salary slips or client invoices were also being outsourced. More and more suppliers were being asked to handle production processes that were highly IT-related processes, such as account transactions in banking. Payment by the outsourcing supplier frequently depended on the market success of the products sold by the client. Companies, for example, that had outsourced the handling of payment transactions to a bank paid according to the number of

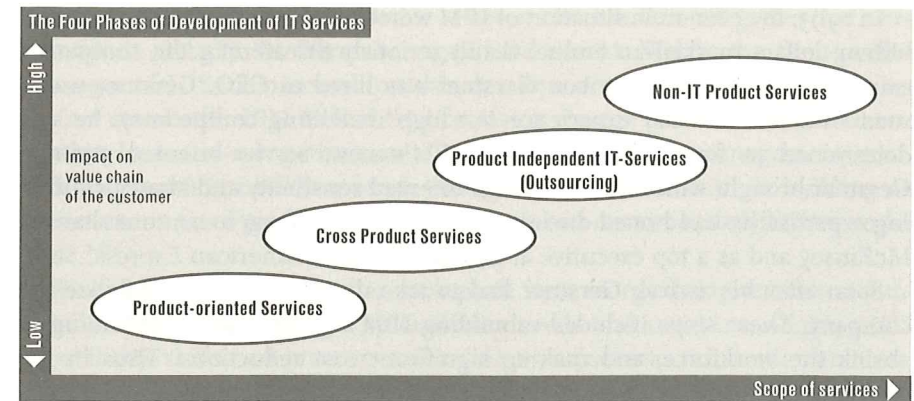


Fig. 2: The Four Phases of Development of IT Services

transactions. This meant that if the bank prospered and acquired more customers making a lot of transactions, the outsourcing partner prospered as well. (The same process of course took place inversely.)

IBM Global Services

First appearing in 1924 under the name International Business Machines Corporation, IBM soon turned into a major, internationally renowned company, responsible for the development of many patents leaving a permanent stamp on IT technology, along with discoveries sometimes leading to a Nobel Prize.¹⁷⁹ In the 1960s and 1970s, IBM was the biggest IT company in the world.

As we know, however, IBM was not able to participate in the enormous boom the IT industry enjoyed in the 1980s. Although there was still no other company boasting such comprehensive IT competency, IBM's economic situation increasingly worsened at the end of the 1980s and beginning of the 1990s. In 1991 the company was still the market leader, with a turnover of 64.8 billion dollars, about 9 percent of which fell to the marketing of IT services. Nevertheless, the turnover had decreased compared to the previous year, with a net loss of 2,861 million dollars.

Since the growing market of IT services looked promising, the managing board of IBM decided in 1991 to strengthen this business line, announcing a "new worldwide services strategy." The explicit goal was to turn IBM into a world-class services company by 1994. At the same time, IBM restructured its Systems Services Division into the Integrated Systems Solutions Corporation. The expectation was that the large number of installed IBM solutions worldwide would mean a large advantage in successfully installing this services business.

In 1993, the economic situation of IBM worsened dramatically. The loss of 8 billion dollars marked an annual result seriously threatening the company's existence. In this situation Lou Gerstner was hired as CEO. Gerstner was a man with low industry experience but high marketing competency; he was determined to forcefully implement IBM's new, service-oriented strategy. Gerstner brought with him a customer-oriented sensibility and strategic thinking expertise he had honed during years both as a management consultant at McKinsey and as a top executive at RJR Nabisco and American Express.

Soon after his arrival, Gerstner had to take dramatic steps to stabilize the company. These steps included rebuilding IBM's product line, continuing to shrink the workforce, and making significant cost reductions. Thus in the course of the 1993-94 re-engineering processes, 36,000 employees were dismissed, equaling 14 percent of the workforce. On the other hand the company put additional funding into its consulting group, which was unveiled in 1992. This build-up reflected a shift in IBM's services philosophy from focusing merely on after-sales activity such as maintenance to a broader stress on assisting customers in every facet of their ongoing business operations. Parallel to the restructuring of human resources, expenditure for training courses and executive education was substantially raised.

Despite mounting pressure to split IBM into separate, independent companies, Gerstner decided to keep the company together. The 2001 annual report of IBM put it as follows: "We were on a fast track [in the early 1990s] to being dismantled from within." "We believed niche players weren't the future," the report continued, then explaining that "in fact, breaking up the company would have been the end of everything IBM stood for. We made a big bet that customers needed a partner who could both create technologies and integrate them – with each other, and with the customer's business processes. At the time it was a gutsy call. They always are when you're alone. But we decided that we should be true to ourselves. It all started with that."¹⁸⁰

The 1993 decision not to break up the company became the basis of an "integrator" business model for IBM. IBM Global Services has become the focal point of this model, bringing together hardware, software, and services. Gerstner decided that IBM would be vendor-neutral and recommend any products of rivals like Microsoft, HP, Sun, and other major competitors if they happened to be the best solution for the customer.

A second strategy devised in the early 1990s built on the client/server phenomenon of the late 1980s and predated the explosion of the Internet for commercial use. IBM initially called it „network-centric computing". In 1994, harnessing the company's substantial networking capabilities, IBM brought together multiple internal networks under a single organization to form the IBM Global Network. Its mainstay was electronic data interchange services.

In 1995, IBM formed a new unified organization, IBM Global Services (IGS), to provide customers with worldwide reach and more consistent service levels. To this end, Global Services rationalized its offerings, moving from an

ungainly 2,500 offerings worldwide to about 100 solution categories that were consistent globally. In December 1996, Dennie M. Welsh, the first general manager of IGS, commented on this development as follows: "It is clear we cannot stand still. IBM Global Services must change because our customers, marketplace, and competitors are all changing. Our new management structure will enable greater teamwork throughout IBM and continue building on the momentum of profitable services growth and customer satisfaction worldwide."¹⁸¹

Among the changes that then took place were reorganizing services around clear business lines mapped to customer needs and concerns; aligning IGS capabilities, skills, and practices around three major areas (innovation and integration, infrastructure support, and strategic outsourcing); and gearing up consulting group practices to help clients implement and manage standards-based environments.

IGS was growing customer by customer and investing to hire and train experts in everything from IT consulting to systems architecture and web services. IBM used its financial strength to fund its expensive push into outsourcing, and the company placed informed bets on the future in areas such as IT utility services (e-business on demand) and hosted storage. In fact, IBM had already started its outsourcing business in 1989, when it not only designed and installed an IT solution for Eastman Kodak in the United States but for the first time took responsibility for running such a system. The success of this project encouraged those in charge to provide additional outsourcing services by exploiting the excess capacity in their own data centers.

IGS made other adjustments as well. It moved out of the network infrastructure business by selling Global Network because it could acquire underlying connectivity from other providers at less cost and investment. As a corollary, IBM chose to concentrate on managing the information and data that was streaming into networks by connecting business processes across enterprises and up and down industry value chains. In addition, IBM merged its consulting group – which had been tied to its sales units – into Global Services. Ginni Rometty, general manager of IBM Global Services, Americas, has observed that "what this did for services and for IBM was to join at the hip our best market-facing thinkers with our integration experts who knew how technology fits together to deliver higher value solutions to the customer."¹⁸²

At the start of the new century, IBM Global Services expanded its portfolio to offer many more e-business services, in a reflection of the powerful effect of the Internet on commerce. Customers needed help in sorting out the new range of technology choices. They wanted advice on a coherent strategy for e-business and a better understanding of the impact of technology on their overall enterprise strategy, especially advice relevant and specific to their own industries. Much of what IBM learned and applied to customers was derived from the company's own transformation during the late 1990s into a leading e-business in its own right. IBM converted its in-house experience in e-business

into several commercial opportunities. For example, internal advances based on business intelligence and knowledge-management tools were incorporated into many solutions; and IBM's expertise in using an intranet as its primary internal communications channel paid dividends when many customers asked the company to build similar web environments for themselves.

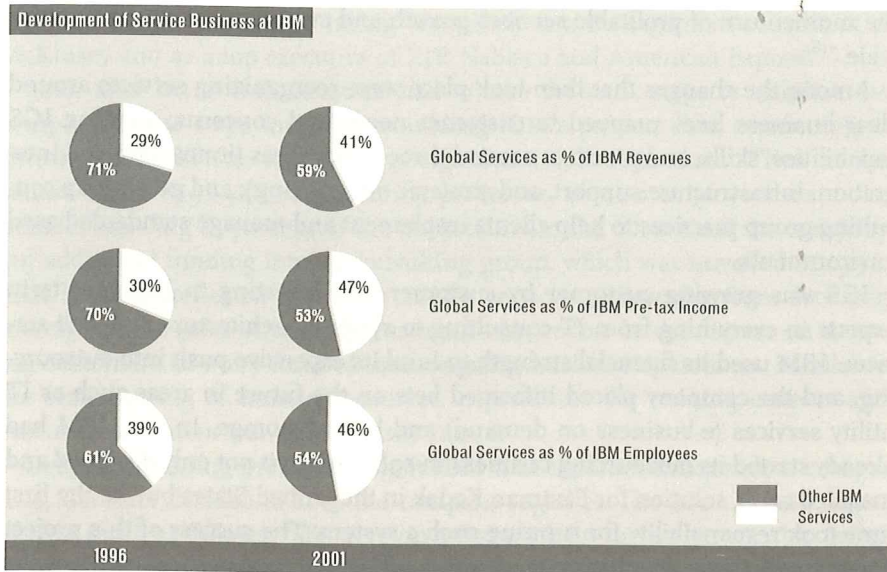


Fig. 3: Development of Service Business at IBM¹⁸³
Source: IBM Annual Reports 1997 and 2002

In 2001, the business of IT services alone generated more than 40 percent of IBM's 86 billion dollars in sales. That business had thus emerged as the single largest source of revenue in IBM's portfolio (see figs. 3 and 4). But despite this heavy increase in the service business, IBM continues to own a strong R&D unit, into which the company annually invests more than 5 billion dollars. The general orientation of this unit, however, has changed considerably. In the late 1990s, for example, management began to encourage its researchers to make regular visits to customers—in some cases to help solve a particular problem; in other cases simply to better understand how enterprises actually use information technology.¹⁸⁴ Research efforts were oriented to help solve problems in areas such as business design transformation, process integration, advanced supply chain management, and risk analysis.

Samuel Palmisano, who after his successful years at IGS was made IBM's new CEO in 2002, has explained that "IBM Research has reinvented itself many times over the decade as technical challenges and customers' problems have changed. A generation ago, most of our researchers grappled with challenges in physics, materials science, and magnetics because so much of our business depended on devices. ... They understand that the business problems

we are trying to solve for customers are not elementary stuff—it's hard, hard, hard. ... Technical leaders want to make an impact, which means seeing that their work makes a difference in the real world. Sure, they thrive on publishing and going to conferences. But they understand that there's no better way to do that than working with real, live customers."¹⁸⁵

Going forward, IBM Global Services has increased its industry focus by concentrating its skills, knowledge, and capabilities on clients' specific business issues and building an inventory of reusable assets to speed response time. IGS has integrated at the industry level, where it concentrates on sixteen industries grouped into five sectors. In 2002, to strengthen its problem-solving capabilities, IBM announced the purchase of PriceWaterhouseCoopers Consulting (PWCC) for 3.9 billion dollars, signaling the biggest acquisition to advise customers on business strategy, not just run their IT systems. It combined 25,000 IT-focused consultants in IBM's Global Services arm with a roughly equal number from PWCC (there were 3,500 layoffs) and created IBM Business Consulting Services, a 13-billion-dollar business comprising almost a third of the overall services group. PWCC was organized around the industries it served.

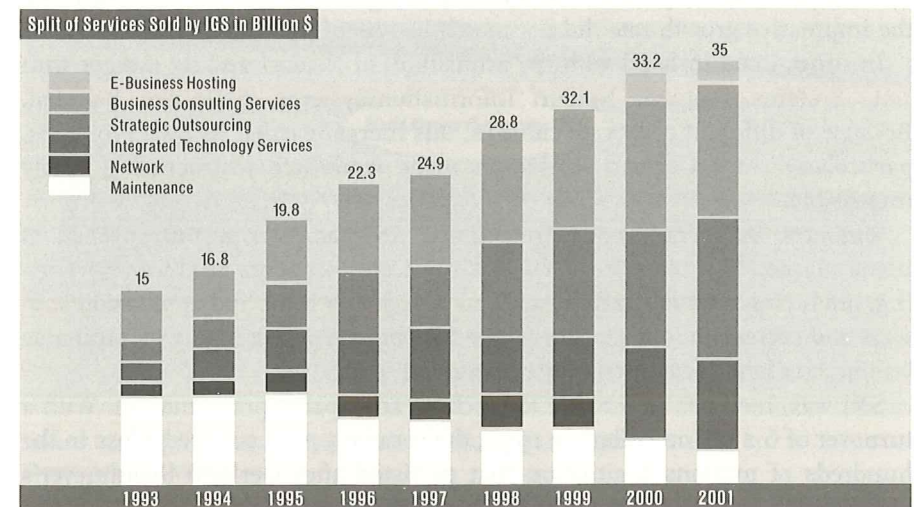


Fig. 4: Split of Services Sold by IGS¹⁸⁶
Source: IBM Annual Report 2005

Siemens Business Services

Siemens Business Services GmbH (SBS) was established in 1995, even though its roots go back to the 1990 merger of Nixdorf AG and Siemens Business Unit Data Systems.

Nixdorf AG had been founded by Heinz Nixdorf in 1952. Until the mid-1980s he was in charge of an organization that had become the fourth largest

computer company in Europe. Like its charismatic owner, the company was thought of as possessing first-rate engineering acumen and being innovative and creative. Nixdorf produced a large assortment of hardware and software and marketed such products together with related services. These marketing activities were mainly in Germany but also were in several other Western European countries. Large clients consisted above all of banks and business enterprises with a widespread system of branches; these enterprises bought comprehensive IT systems to optimize their business processes. In this manner Nixdorf AG acquired, for example, an excellent reputation for installing nationwide grids for servicing automated tellers.

Siemens Data Systems had been one of the seventeen business units of Siemens AG. During its 150-year-old history, the company had turned into an internationally renowned organization, which was due—together with its data systems—to its technical products and its success in areas including telecommunication, energy, transport, medical equipment, and automation. With a turnover of 40 billion dollars, Siemens belonged to the fifty largest companies worldwide as early as 1990. Compared to the other units, the turnover of Data Systems was relatively small, but it had clearly grown at a faster rate. However, the impressive growth rate did not match its rate of profitability.

In 1990, hand in hand with the acquisition of Nixdorf and its merger with Data Systems, Siemens Nixdorf Informationssysteme (SNI) was founded. Because of different corporate cultures, this merger carried its own problems, particularly since German legislation made workforce restructuring nearly impossible.

Similar to Bull (France) or Olivetti (Italy), SNI had its largest turnover in its home market. SNI regarded itself as a full-scale computer producer, developing, producing, and marketing hardware along with basic and application software and corresponding services. Since SNI worried about losing its profitable leasing business, outsource projects were not permitted.

SNI was, however, never able to reach its anticipated profit margin. With a turnover of 6.2 billion dollars in 1994, the company even suffered a loss in the hundreds of millions—a situation that persisted after Gerhard Schulmeyer's appointment as new chairman of the board that same year.

In 1995, the Siemens central board agreed to establish Siemens Business Services GmbH (SBS) as a daughter of SNI AG and Siemens AG. The company was meant to advise clients on IT matters, in other words the design, installation, and operation of the necessary system solutions. Friedrich Fröschl was appointed president and CEO. Fröschl was a 43-year-old executive who came from CSC, the American IT services company, and had not worked for Siemens previously. That same year, Siemens turned its German main computer center into the business responsibility of SBS. Likewise, all departments in SNI that were not clearly focused on hardware or software were transferred to SBS. In the process, less profitable units were shed and the company's portfolio consolidated. The turnover of SBS in its first year amounted to 628 mil-

lion dollars. Ninety percent of this turnover was due to purchases by Siemens AG.

Other than was the case for SNI, outsourcing projects were explicitly open for SBS. Several IT organizations were thus acquired from companies purchased by proprietary systems of SNI, the customer group thereby being limited to Germany and several western European countries. Following the outsourcing approach, either the responsibility for all internal Siemens IT organizations was assigned to SBS or the employees reported to SBS.

In 1997, the solutions business was transferred from SNI to SBS, which meant that the old SNI was more or less dissolved. The challenges of this merger were comparable to those of the 1990 merger, particularly since not only were all SNI central departments integrated into SBS, but software application as well. In 1998, the turnover of SBS increased to 3.5 billion dollars. But in the same year losses had to be reported for the first time, after initial years that had been profitable. Based on its turnover, SBS had climbed to become the ninth largest provider of IT services worldwide. Table 1 shows the 1998 provider structure.

Leading IT Services Companies and Their Market Share, 1998

World Market IT-Services 1998

Position	Market Share	Position	Market Share
1. IBM	8.0%	6. Fujitsu	1.7%
2. EDS	6.0%	7. ADP	1.6%
3. Anderson	3.0%	8. Cap Gemini	1.5%
4. CSC	2.5%	9. SBS	1.2%
5. First Data	1.7%	10. HP	1.1%

Table 1: Leading IT Services Companies and Their Market Share, 1998⁸⁷
Source: Analysts' Meeting 1999

Finally in 1999, the Technical Services SNI unit was transferred to SBS. The continuously strong growth of SBS, however, was basically due to a strong increase in outsourced business. For example, SBS won a 1.5-billion-dollar outsourcing contract with the National Savings Bank in England, running for 15 years. In 1998-99, this was the third largest outsourcing project in the world. (The biggest was a 3-billion-dollar contract between IBM and Cable&Wireless.)

To enhance the growth rate of SBS, the synergy potential of SBS and other Siemens units had to be exploited. Very good opportunities were seen in the highly successful telecommunication grids, where IT had by then acquired paramount importance. The same was true for power plants (where the client demand for complex invoicing services increased) and transport (where there

was an increased demand for IT-based ticketing systems). New business for SBS, in other words, was meant to be generated through the high expertise and first-rate customer relations of the various Siemens units. The Siemens Central Board explicitly supported this development, but a comprehensive incentive system for cross-departmental cooperation was not installed.

In 1999 and 2000, the SBS turnover continued to grow. Profit was made, but the contribution margin did not meet the corporate target. The year 2001 produced losses, which were above all due to high provisions tied to the National Savings Bank project. After six years as managing director of SBS, Friedrich Fröschl was replaced in October 2001. At that time, SBS had a turnover of 6.8 billion dollars, 33,000 employees, and branches in more than sixty countries. Fifty percent of the company's turnover was made in Germany, 25 percent of this by Siemens. Whereas Siemens units like Power Generation or Medical Systems clearly made it back into the profit range after a difficult time, SBS would remain a problem of the Siemens Central Board over the following years.

The author is grateful for the valuable input offered by Friedrich Fröschl.

Interview with Friedrich Fröschl¹⁸⁸

Olaf Plötner

Mr. Fröschl, looking back what is your view of the success of SBS and IGS between 1995 and 2003?

IGS was and remains very successful. It is the most important benchmark for many companies in the industry. From an economic perspective SBS saw a convincing growth in sales, but with regard to profits the central board's expectations were higher than what was actually earned.

What for you was the most important difference between the starts of SBS and IGS?

A decisive difference in the opening phase was certainly that for IBM the success of IGS was directly tied to survival of the entire firm. In contrast, for Siemens AG SBS was always only one of many parts of the concern, meant to fit into its overall strategy and not endanger the big picture. When it comes to taking tough measures with restructuring personnel or a readiness to take financial risks, that plays an important role.

Surely a willingness to take financial risks is needed in the first phase of operating complex IT systems.

That's correct. Especially when – as was the case with us – employees have relatively little experience in the business. Until 1995 outsourcing with clients in the IT branch was even strictly forbidden – the belief was that the product business could be protected in that way.

In this respect, higher risk-taking willingness was not the only advantage IBM had over SBS. What was important above all was the fact that through its globally strong HW business, the company had a much larger installed base available worldwide. Its product know-how gave it advantages in building an international network of customers.

As a customer SBS could in any case use the other divisions of Siemens AG from the start. It more or less had a purchasing obligation. Wasn't that an advantage?

With regard to the first sales numbers, definitely. But together with the purchasing obligation come claims and concerns that can be completely counter-productive. Internal customers are often more difficult than external ones, and it's interesting to see that the IT service firms that emerged from large industrial firms were less successful when they had high in-house participation.

Did this also contribute to SBS's inability to realize its synergies as hoped for in view of the worldwide customers of the other Siemens divisions?

Yes, high internal acceptance is a prerequisite for the development of external customer relations, especially when colleagues are supposed to make *their* customers available to another division.

Did the fact that a newly established division within a large firm first having to struggle for internal acceptance also have something to do with SBS having to simply take over all of Siemens Nixdorf's employees?

There are a number of other reasons for this – they are mainly tied to factors involving Germany's legal framework and an understanding of Siemens AG's social responsibility. But these points should be viewed by no means only in a negative light.

In any case, in its decision to force through changes in its service business, IBM dismissed 36,000 employees of the workforce active in the product business. Doesn't a change of business focus have to be linked to a change of employees?

Certainly not a change of all the employees – even IBM didn't do that. For IGS, the product know-how of the employees was an important advantage in the development of the service business. But alongside product know-how there's a need for other sorts of expertise that are not always present in product-oriented firms to the same degree.

What sorts of expertise do you mean here?

Above all there's a need for extensive process know-how. This must then be applied in a structured way according to customers' needs.

With regard to SBS's IT business, I distinguish four realms: designing, building, operating, and maintenance. The need for maintenance means providers have to offer superior logistics along with relatively standardized processes that provide a framework in which the employees work through their tasks. Operating mainly involves adapting to unexpected difficulties and promptly adopting the correct measures. Flexible employees who can grasp things quickly and are strongly committed are needed for handling such exceptions. On the other hand, building IT solutions for the customer calls for good analysts who have a sure sense of technical potentials and the possibilities of various process architectures. Finally, designing customer solutions works best with advisor types who understand customers' multi-leveled problems and can communicate in a suitable way that generates trust.

Within these four groups, provider-firms have to define sensible modules on the basis of available know-how, so that complexity and thus costs are kept under control. Beyond this the four groups are linked through a need for permanent customer orientation in thinking and acting. And precisely here, employees coming from a more or less product-oriented world often have difficulties.

In your view how can the thinking and acting of these employees be changed?

It's important that from the start the new demands are clearly communicated to the employees. Then they need to be asked if they'd like to develop in that direction, and you have to analyze the individual developmental needs, responding to the latter with concrete offers for further development. In this industry the process of continual learning and development takes on surprising importance. In the long term, an employer who doesn't offer the necessary possibilities in that respect has no prospects of success.

Can these developments be successfully dealt with by all employees whose employers are shifting their firms from product orientation to service orientation?

No, it's certainly the case that not everyone can change to the required degree. Leaving SBS aside, against the background of my experience with numerous firms I can say that with around a third of the employees such a developmental process takes place virtually by itself; with another third by managing it with support. The final third either cannot cope with the new demands in a lasting way or doesn't want to – which is entirely legitimate.

Looking back on your activities as a CEO at SBS, what have been the most important lessons learned from that period?

For one thing I'd certainly manage the expectations of the shareholders in a different way. As an aside I'll mention that I'd here make a rule of consistently documenting all commitments and agreements. At the same time I'd certainly steer things more closely and crack down more firmly – that includes more carefully controlling whether employees have realized what's been planned. Although that's not to my taste, it's still something I've come to see as extremely important.

What has changed in the IT industry since 2003?

Above all globalization has advanced even further. The Indian IT firm ITS has now outsourced a number of its activities to Romania. No one could have imagined that a few years ago.

The increased focus of many firms on their core competencies is especially important for the IT branch. Against that backdrop, for a long time now they've been letting outside companies take care of not only IT-related activities but others as well. They here use the term *business process outsourcing*, meaning something like moving the entire accounting or purchasing division or HR administration elsewhere. Even auditing firms and investment banks now have many of their analysis-based activities taken care of by firms in India. Deutsche Bank is only one example of this among many. Since a large number of these outsourced processes are dominated by IT, many new opportunities have emerged in this way for IT firms. I should mention that IGS has been using these opportunities in a very professional manner.

And what developments do you see in the industry over the next five years?

First of all I believe that the past years' developments – the increase in both globalization and focusing on core competencies – will advance even further.

Viewed technically, the long-predicted convergence will now become reality. IT, telecommunications, media, and other formerly separated industries will merge. In the process many new developments in technical application will become part of daily life.

On the provider side, rising price pressure will force service-oriented firms to work further on standardizing their processes. Through higher standardization, the possibilities will grow to individually fit the scalability of IT solutions to the needs of customers. Increasingly customers are receiving what is most sensible for them, in an efficiency-conscious framework.

With the growing technical and global possibilities on the one hand and the intensifying price pressure on the other, it is becoming increasingly important for provider-firms to keep costs under precise control. This will have a number of consequences; for example, the role of risk management in such firms will increasingly become more important.

OLAF PLÖTNER | ROBERT E. SPEKMAN (EDS.)

BRINGING TECHNOLOGY TO MARKET

“The book by Plötner and Spekman not only bridges the gap between technology and marketing, but also that between theory and practice. It is a must-read for B2B marketing scholars and practitioners.”

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“Successful introduction of new products and technology to the market is one of the least researched aspects of the entire new product development process. Plötner and Spekman have produced a scholarly applied work that highlights the synergy resulting from the successful marriage of products (technology) and services and the strong positive impact this has on the successful introduction of innovation to business markets. Drawing from some of the leading experts in B2B marketing and including several case studies and executive interviews, Plötner and Spekman present an effective approach to maximizing the return from product introduction strategies. This is a must-read for anyone tasked with bringing technology to market!”

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