IBM Services

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revenue and a 22 percent increase over the previous year. More than half of IBM's current 240,000 employees work in the services division. "The services area is clearly the fastest growing area, not only for us, but in the industry," says John Bukovinsky, an IBM spokesman.

In order to grow, the division has had to substitute greater acceptance of non-IBM products for its previous "not invented here" attitude. Today, Global Services delivers solutions regardless of the source of hardware or software, according to Andrea Minoff, a spokeswoman for IBM's Global Services division.

While that might be what customers demand, it isn't necessarily good for IBM, according to Richard D'Aveni, professor of strategic management at the Amos Tuck School at Dartmouth College (Hanover, N.H.), who studies why large enterprises fail. D'Aveni says that vertically integrated companies like IBM need to take advantage of that integration to offset their relative inflexibility compared with smaller competitors. "To the extent that services help with the sale of software, I think that's useful," D'Aveni says.

The division may be able to increase sales of IBM hardware and software in the long run. But in the meantime, it may have a hard time propping up Big Blue's bottom line, because its gross profit margin is much lower than margins from other products. Gross profit margins from services have hovered between 20 and 21 percent since 1994, while overall margins have ranged between 39 and 43 percent. IBM acknowledged the discrepancy in its 1996 annual report: "[Services and PCs] have lower gross profit margins than the company's more traditional high-end hardware offerings." But IBM's Bukovinsky argues that overall margins have decreased only slightly while the percentage of income from services has increased. "Our full year net [profit margin] was about stable compared to 1996," he says, adding that the company believes it can offset lower profit margins with fast growth "to continue to grow our overall net margin."

Regardless of the impact of lower profit margins, other factors, such as continuing weakness in overseas markets, may prevent IBM's services division from continuing to grow at current rates. Almost 64 percent of services sales were logged overseas in 1996, even more than the company's overall overseas sales rate of 61.3 percent. These sales must be reported in U.S. dollars. As a result of the dollar's recent strength against foreign currencies, services revenues increased only 18 percent in the fourth quarter, instead of the 24 percent increase that would have been logged in "constant currency." Bukovinsky acknowledges that "the biggest issue we see right now is the effect of currency." However, he says the effects of the strong dollar should diminish by the second half of this year. Since the global outsourcing market is growing at about 12 percent a year, according to the U.S. International Trade Commission, the potential for income from overseas sales contracts remains large.

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But IBM isn't the only company that will be competing for those contracts. Competitors loom on all sides, from the likes of EDS and Digital Equipment Corp. to individual Web designers working out of their basements. In fact, in the largest merger in the computer industry's history, Compaq Computer Corp.'s acquisi-on of Digital for $9.6 billion largely have been to obtain Digital's services group, which is the world's third largest. "Digital's enterprise-level services have turned out really to be a key piece [in the acquisition]," says Tom Harris, a former Digital employee who is now director of software development for Foxboro Co. (Foxboro, Mass.). "Digital has a services group that can go into large companies, big accounts, and manage those accounts, something that Compaq has just not been able to do."

Computer Associates had also launched a hostile takeover of computer services provider Computer Sciences Corp. (El Segundo, Calif.), with the intention of creating what Computer Associates' chairman Charles Wang called "the next-generation, world-class information technology services provider."

Both Compaq and Computer Associates recognize what IBM seems to have seen several years ago — that services are essential to acquiring and keeping customers, according to Steven Foote, vice president of research strategy for the Hurwitz Group (Framingham, Mass.). "[Services are] what Compaq really sees at Digital at the end of the day," Foote said, "and that's what Computer Associates sees at Computer Sciences Corp." He explains that companies are having a harder time differentiating their products these days for two reasons: because technology is becoming more of a commodity, and because the largest companies are saturating customers with their marketing efforts. "Large companies have laid down such a sustained amount of noise, it's very difficult to get above that noise," Foote says.

Not everyone agrees these new combined companies will pose much of a threat to IBM, however. By trying to emulate IBM's size and scope, companies like Compaq are paying IBM a compliment, according to Bruce Raabe, senior equity analyst at Larkspur, Calif.-based investment firm Collins & Co. "I think that [the mergers] are going to create more competition," Raabe says, "but IBM's been dealing with competition for a long time." ■