

IBM Earnings Show Resilience in Its Service Business

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The strength of IBM's service business in the difficult economic environment of 2008 makes it the vendor to watch during 2009 as a key indicator of industry performance and opportunity.

NEWS ANALYSIS

Event

On 20 January 2009, IBM reported its 4Q08 and year-end financial performance. In 4Q08, services grew 2% in constant currency to \$14.3 billion; for the year, 9% to \$58.9 billion. Services' pre-tax profits in 4Q08 increased 32%. In the same week, IBM also made changes in the executive leadership for Global Business Services (GBS).

Analysis

IBM services' performance during the challenging 2H08 economic environment proves that its business model is resilient and agile and that it is executing well to maintain market share and profit. That said, the slowing momentum of its service revenue during 4Q08 was indicated by:

- Total service revenue (\$14.3 billion) decreased 4% (up 2%, currency adjusted).
- GBS's revenue (\$4.7 billion) was down 5% (flat, currency adjusted).
- Global Technology Services' revenue (\$9.6 billion) was down 4% (up 3%, currency adjusted).

Notably, IBM services started 1Q08 with 17% growth but ended the year at a 4% decline. However, profits accelerated in services due to IBM's disciplined execution, resource optimization and improved operating efficiencies. In 4Q08, IBM reported services signings of \$17.2 billion (up 2% in constant currency year over year). The highlight was strategic outsourcing signings, which rose 23% overall and 45% in North America year over year. IBM signed 24 deals at a value of greater than \$100 million each.

Slowing demand at year-end 2008 indicates buyer ambivalence. Enterprises rely on external providers but have tightened their budgets in a cautious market — hence IBM's focus on profits. We are encouraged by IBM's prediction of a reacceleration in demand mid-year, though we suspect its timing may be off. We also do not believe that all service providers will be able to weather the storm.

IBM's success is based on value creation and its model of making strategic adjustments. The leadership "swap" at this critical time is an example of leadership cross-pollination in segments key to IBM's long-term success. Frank Kern, who has a strong sales leadership background, will lead GBS, while Ginni Rometty, who has led GBS since its integration with PricewaterhouseCoopers Consulting, will lead global sales and distribution.

RECOMMENDATIONS

- **IBM service customers and prospective customers:** Seek help with cost reduction initiatives through lean processes, tools, automation and standardization — and moving more work into IBM's global delivery network.
- **All buyers of services:** In evaluating providers, be wary of contractual terms (particularly in pricing) that seem "too good to be true." Scrutinize the financial stability of your partners; if seeking IT cost reductions, find providers that deliver cost-competitive services through creative, disciplined approaches within acceptable quality levels.

- **Service providers:** Increase levels of transparency — financial, management, governance, and execution — in provider-buyer relationships.

RECOMMENDED READING

- "Dataquest Insight: Ten Ways to Position and Sell IT Services in Uncertain Times" — To overcome the challenges of the current economy, service providers must earn revenue growth and client loyalty and decide whether to stay focused or change their focus. **By Christine Adams and others**
- "SWOT: IBM, Application Services, Worldwide" — To inform competitive strategies, Gartner examines the application service capabilities of the largest provider in the global IT service market. **By Matthew Goldman and others**

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