

## WHITE PAPER

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# Business Value Pricing: Using IT Innovation to Power Business Results

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## IDC OPINION

From its first appearance in Harvard Business Review in May 2003, Nicholas Carr's assertion that "IT Doesn't Matter" created a significant stir in the information technology (IT) industry. It has almost certainly caused many businesses to reexamine their commitment to IT solutions. While the debate continues today, there can be no disputing the relative importance of IT. This is exemplified by the emergence of technology-oriented knowledge and know-how to many Canadian companies, companies that are using IT to optimize business processes and functions.

The continued importance of IT lies in its ability to facilitate innovation — both in terms of the products and services that providers bring to market, as well as the application of IT within the corporate setting. Innovation is ongoing and it continues to provide competitive differentiation to buyers that establish an innovative mindset. The biggest business challenge is overcoming the status quo or the willingness to forgo innovation in deference to traditional solutions. These are the conditions that, at one point or another, many businesses find themselves dealing with. This demonstrates the importance of utilizing external reference points and vendor partners as objective sources that can gauge the need for renewal or change and the means for achieving desired outcomes.

Innovation is the underlying feature of business value pricing solutions, the topic of this IDC white paper. As readers will readily determine, innovation takes on a variety of contexts throughout the proceeding discussion, all of which serve to complete the picture that is business value pricing. In one sense, the pricing mechanism of business value pricing represents an innovation, one that bases the cost of the service on a specific business metric that is quantifiable and strategically important to the business and its operations. It drives competitive advantage by enabling a cost structure that is predictable yet has the flexibility to adjust to business volume fluctuations. In another sense, the business value pricing method applies technology solutions to business challenges in an innovative way — by making the resolution of the business problem paramount and the technology itself secondary. Finally, business value pricing solutions are innovative because they strive to apply new and emerging IT knowledge to business problems. Web-based solutions, software on-demand, and utility computing represent the flexibility of business value pricing to any system, as the case studies in this white paper demonstrate.

Business value pricing solutions clearly demonstrate that the importance of IT lies in its applicability to the resolution of real business challenges and issues. The application of new knowledge and emerging skills are vitally important to the success and future growth of businesses in Canada and worldwide.

## **IN THIS WHITE PAPER**

Business value represents an advancement in the provisioning and positioning of IT services. As a pricing and services execution strategy, business value-centric solutions make the customer's business problem the central focus. This results in the design of results-oriented projects that emphasize business consequences rather than IT targets. While "business results" may seem like a nebulous concept, the strength of the business value pricing approach is that it is task-oriented and uses innovative methods to get a job done. That is, it is highly adaptive to a wide variety of business processes and/or issues for which information technology can improve, create, or replace existing or sub-optimal solutions. The key feature of business value pricing solutions is that the actual price reflects a quantifiable business metric of a specific unit of cost such as a user (either a customer or an employee), a service provided to a customer (e.g., a call to a service desk or automated systems), or a business outcome (e.g., an invoice or a bill of lading).

An important innovation contributed by business value pricing solutions is its task or process orientation. The focus on specific business processes allows buyers to clearly assess the value of the business function under consideration and the extent to which business value pricing solutions can optimize its functioning. The emphasis on the improvement or replacement of sub-optimal business processes allows buyers a great deal of flexibility in working with external service providers to design solutions that reflect the value of the process to the business. If there is a recognizable or quantifiable business metric or outcome for a given business function that is not being achieved, business value pricing and the application of IT solutions can resolve these issues and improve the worth of the function to the business — creating areas of responsibility for the buyer (business outcomes) and the supplier (IT delivery).

The application of business value pricing solutions by the buyers profiled in this white paper exemplify a critical lesson: the use of business value pricing mechanisms created obvious benefits, and the rapid execution and deployment of these solutions facilitated and hastened competitive advantage. The unifying feature of the case study participants was a forward-looking approach to solving their individual business challenges and avoiding the tendency to maintain obsolete or sub-optimal processes. These companies discovered that the disadvantages of being early adopters (or first movers) are drastically reduced in the business value pricing paradigm. Unlike comparable outsourcing solutions, companies engaged in a business value pricing solution do not have the same up-front capital spending requirements, and the ongoing expenses are operational rather than capital. Business value pricing solutions are geared towards the attainment of business objectives and are priced accordingly. Consequently, the customers' business is the strategy of business value pricing, not the vendor-sold IT components.

As competitive forces continue to mount and companies experience increasing pressure to optimize business models and underlying business processes, advantage will accrue to businesses that internalize the application of innovation to business challenges. This white paper will provide a framework from which buyers can assess the need for process-oriented innovations, the conditions required for the successful implementation of these practices, and the means by which external providers can bring these innovations to life. Business value pricing is a clear demonstration of an innovative solution to the resolution of long-standing IT and business alignment issues.

The white paper includes an examination of the issues that buyers should consider in sourcing IT and business solutions from external service providers and the applicability of business value pricing solutions to existing business and IT issues. The second half of the white paper provides three practical examples of companies that have applied business value pricing solutions to their IT issues. The first case study examines The Co-operators Group, one of the largest consumer and commercial insurance companies in Canada. The company is now contracted to IBM to manage its Lotus Notes system. BMO Financial Group, a highly diversified North American financial services organization with assets in excess of \$300 billion and more than 33,000 employees, is the subject of the second case study. The bank is in a contract in which IBM provides an application on-demand solution for its contact centre intelligent voice response (IVR) solution. The final case study summarizes IBM's contract with Hydro Ottawa. Hydro Ottawa is a midsize electricity distribution company with approximately 275,000 accounts under management. Currently in the second year of a multiyear contract, IBM is managing Hydro Ottawa's customer information and billing systems, as well as augmenting its customer contact centre.

## **SITUATION OVERVIEW**

In business, as in life, the only constant is change. This well worn adage is equally applicable to the information technology industry. The IT market is reaching a tipping point in terms of the penetration of technology in corporate environments. Companies that have purchased IT solutions with the intent of improving business processes and competitive positioning are changing the rules of the game. They are doing so by acquiring information technology products and services on an as needed basis, just as electricity and telephone services are today. The transformation of the means by which an industry as large as information technology changes the way it provides services does not happen quickly. The signs of this shift are emerging and illustrate the extent to which technology solutions can evolve and provide even greater benefits in the coming years.

One clear value proposition of information technology is the linkage between the cost of IT solutions and the benefits attained by the customer in the form of key business outcomes such as increased revenue and improved customer service. Consequently, the principal benefit of the value-based pricing option is the emphasis placed on the customer by crafting solutions that address specific business problems. The crux of the value lies in the pricing of the solution, which provides the customer with options on how to pay for the service.

## **Evolution of Pricing**

Price is the culmination of the relationship established between a service provider and its customers. It expresses the agreed upon value the supplier and customer place on the product or service provided. Different pricing models reflect different buyer/supplier relationships and the willingness of both parties to accept joint responsibility for the management — and success — of critical business processes. The movement towards business value pricing reflects the transference of value to the buyer of the product or service.

### ***Examination of Different Pricing Models***

#### **Fixed Price**

Fixed price contracts are, arguably, the most common pricing schemes available in the market. They reflect a market in which services are well understood and the scope and the scale of the services are well known. In a fixed price arrangement, the largest share of risk is transferred to the service provider because it has to supply the service and manage its resources to deliver on the contract and produce a profit. From the customer's perspective, there are two likely outcomes or drawbacks of choosing the fixed price option: the buyer is either quoted a very high price that covers every contingency, or the buyer is quoted a very low price — for which only the minimum specifications are covered.

#### **Cost Plus**

The cost plus pricing options are preferable to buyers and suppliers for differing reasons. First, cost plus pricing is used when the decisions around resourcing and time expenditures remain at the discretion of the buyer. Second, cost plus pricing is the preferable alternative for suppliers when excessive risk or ambiguous rewards create non-trivial uncertainties. The potential for uncertainties and the assumption of excessive risk are clearly characteristics that most vendors would choose to avoid.

#### **Management Fee**

As an example of a pay for service pricing mechanism, the management fee option noticeably retains almost complete control in the hands of the buyer. This option is best applied to situations or projects with short time frames and where the buyer's own management can implement (or reject) the provider's recommendations. This option can be a valuable tool for vendors that have excess (and short-term) capacity as the rates applied to these resources will be higher than they would be under an outsourcing contract.

#### **Pay For Performance**

The pay for performance pricing model includes performance clauses through which vendors can earn bonuses in addition to the baseline price negotiated with the customer. Under this arrangement, vendors accept a larger proportion of risk that is offset by a solid understanding of the rewards and an understanding that the risks are manageable.

### **Gain Sharing**

Gain sharing is a variant of the pay for performance pricing model in which the baseline price is augmented with bonus payments derived from the savings produced by operational improvements. The gain sharing model emphasizes the benefits attained by the customer, while pay for performance emphasizes the operational capabilities of the supplier. Similarly, the gain sharing model places a disproportionate amount of risk on the vendor but it also begins to move the balance of power towards the customer.

### **Value-Based**

The final example of pricing models is the value-based example. This option moves further towards the customer by binding the price the provider charges (and its subsequent profit) to the attainment of a specific business-oriented metric (either financial or organizational). These metrics are, in general, key performance indicators of the overall health and well-being of the customers' organization. As a result, the use of value-based pricing mechanisms encourages suppliers to help customers meet their critical business objectives.

The above discussion reflects the order and direction of the pricing options present in the market based on its maturation. The list moves from the well established options to those that are lesser known. Buyers of IT products and services are beginning to demand that suppliers put their own resources and profits at risk in order to ensure that IT solutions achieve their intended objectives. Business value pricing is an example of the movement towards the primacy of the customer and the need for suppliers to deliver solutions that meet critical business objectives.

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## **Business Value Pricing as a Market Innovation**

The advantage of business value pricing lies in its utility — it enables customers to satisfy their objectives in their own way. For vendors, business value pricing is an example of structuring an offering that clearly asks customers what a true service is to the customer — what makes the service truly convenient to them not only in terms of pricing, but also in terms of delivery and support of the solution.

The innovation of business value pricing is timely and effective because it delivers three important customer-centric attributes:

### **By adapting to the customer's unique circumstances**

The end product for any business is to cultivate new customer relationships and to retain these relationships for the long-term benefit of both parties. From a business value pricing perspective, a key innovation is the recognition that the customer's status is a reflection of the product itself. This innovative pricing strategy has created mechanisms in which the price meets the buyer's unique circumstances and makes their purchases more relevant to their business needs.

The case study examining BMO's contact centre operations illustrates the importance of adapting to a customer's circumstances. The bank was facing significant structural changes to its contact centre requirements and the fulfillment of its contract obligations was becoming increasingly untenable. IBM altered its service offering to reflect the bank's new operating conditions, which created a more satisfied customer and an extended contract for IBM.

☒ **By delivering a customized version of value for a particular buyer**

Business value pricing delivers value to customers by making customer requirements the central feature of the product. As the central feature, the environment in which the customer operates is examined in order to deliver a highly tailored solution. The innovation of this attribute lies in the placement of customization at the operational level rather than the IT application/infrastructure level.

This attribute is characteristic of the solution IBM provides to Hydro Ottawa, an electricity distribution company. IBM is working with Hydro Ottawa to optimize its customer information and billing systems and to equate the cost of the services provided with the number of customers Hydro Ottawa invoices. The customization provided by IBM addressed Hydro Ottawa's business need for stable and reliable customer information and billing systems that improved risk management.

☒ **Pricing**

The price of the solutions offered in the business value pricing paradigm creates an explicit link between what the customer buys and the way in which the service is experienced. Business value pricing is an example of a pricing mechanism that allows customers to pay for what is purchased rather than what the supplier produced. In effect, the cost of the solution is based on the value to the customer, rather than traditional pricing mechanisms that reflect producer costs.

The Co-operators case study exemplifies the importance of pricing as a key solution attribute. Under its agreement with IBM, The Co-operators pays a fee for the provisioning of Lotus Notes email IDs. The company is buying support and operational services for a set number of users, a metric that is controlled by the buyer and one that accurately reflects its costs.

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## **When Does Business Value Pricing Make Sense?**

The emergence of business value pricing has coincided with a growing maturity with respect to the placement of information technology solutions inside the corporation as well as the availability of solutions from vendors in the marketplace. The issue is not solely one of core versus non-core competencies and/or processes. The issue that firms are now identifying through the use of business value pricing solutions is: what is the best possible means, for this particular company, to deliver highly valued and high-quality goods or services to employees and, most importantly, customers?

In this emerging context, business value pricing allows buyers to directly relate the cost of the service provided to key performance metrics that, in turn, contribute directly to the success of the business. Importantly, the impact of the solution, in terms of its contribution to the attainment of business goals, can be immediate, because capital expenses hindering ROI are minimized. Customers of business value pricing solutions are at the forefront of the next wave of technology adoption. They have chosen a path that places price (or cost) within a framework of a larger discussion that incorporates a number of equally important variables including an examination of how the solution will be used and the performance metrics of the solution in terms of how its success or failure will impact the business.

One of the key trends that will affect the market for IT products and services, and, consequently, business value pricing solutions, is a continuation in the adoption of industry best practices coupled with the industry-specific solutions vendors are bringing to market. The implementation of industry best practices by buyers is not dependent upon the development of highly customized or proprietary solutions. Instead, companies today can benefit from the experience of IT vendors to capitalize on existing solutions and packaged applications to shorten implementation cycles and to lower capital investment requirements. Competitive advantage is now shifting towards the deployment and use of technology after implementation (i.e., it is not what you have, but how you use it). This is where business value pricing begins to play an increasingly valuable role. The best-practices approach is one of the hallmarks of the BMO Financial Group case study.

Alternative pricing mechanisms will emerge as the primary source of competitive advantage for companies that recognize the value of non-traditional technology sourcing solutions. The advantage of non-traditional alternatives lies in the ability to change the focus of operational and management responsibility for the users of IT. One of the clear advantages of the delineation of responsibilities is that the cost of application services is borne by the vendor. The "evergreening" of software and infrastructure systems to keep the technology current, benefits customers by removing the need to maintain costly internal resources or to spend money on hardware and software upgrades. User responsibilities begin (and end) with the effective use of IT solutions while vendors assume all of the roles/responsibilities required to support and enable users. See the Hydro Ottawa case study for an example of the competitive advantage of business value pricing on cost.

Rather than adding to the confusion businesses experience in selecting IT services and solutions, business value solutions should, in fact, simplify many options because they obviate the concerns and challenges associated with owning and managing technology internally. The selection criteria for this type of utility solution are essentially the same as purchasing other utility-like services: choosing a vendor that is reliable, experienced, and trustworthy. Turning over the major elements of responsibility to an external supplier is an activity that occurs daily for a number of different business services. Advancements in the maturity of information technology solutions now allow utility services to be applied to this area of corporate responsibility. The Co-operators case study demonstrates the value of reducing internal IT complexity and management in favour of simplicity and user-defined roles and responsibilities.

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## **What are the Characteristics to Look for in a Vendor?**

Unlike the established utility services markets (i.e., electricity, telephone, etc.), there are still many important characteristics for which IT vendors must be gauged in order to fully deliver business value pricing solutions. In addition to the various vendor attributes related to IT services including application expertise, network infrastructure services expertise, and vertical market expertise, vendor credibility will also be based on business process expertise and the intersection of business and IT requirements. Buyers are not simply purchasing IT solutions; they are acquiring business outcomes supported by IT products and services.

In order to truly deliver value to customers, vendors must understand the business functions that their IT solutions are supporting. Additionally, vendors must have the expertise that allows for improvements and refinements to the processes/activities being supported. The ultimate objective is to determine how solution providers can assist their customers in achieving their business goals.

The realization of these goals will rest on the vendors' qualifications and capabilities. Vendors should be able to clearly demonstrate that they currently possess the capabilities to deliver business value pricing solutions. These skills require demonstration at the business level, the process level, and the resource or employee level. The true test of these capabilities lies in the experience of the provider and the establishment of a successful track record, particularly as it relates to the application of new and emerging knowledge and service offerings. The business value pricing solution also requires the possession of collaboration skills on the part of vendors due to the intimate nature of the relationship required to execute these services. Not only is it important for vendors to demonstrate the ability to cooperate with customers, but it is equally important to find vendors that are committed to achieving a shared set of goals with their customers. Invariably this will be operationalized as a commitment to continuously improving processes, services, and delivery.

## FUTURE OUTLOOK

There are clear benefits to paying for a service that simplifies and streamlines the responsibilities of the buyer. While IT continues to play an important role in the competitive positioning of the majority of businesses in Canada, the context of the strategic value of information technology is subtly changing. IT value is no longer solely measured by owning and customizing technology solutions as the primary means of creating and sustaining competitive advantage. Rather, strategic advantage is accruing to organizations that work backwards by starting with business issues and then sourcing the appropriate solution that includes information technology. This strategy allows end users to judge options not usually considered, and requires users to assess how IT solutions can directly contribute to achieving business goals. As an added benefit of this strategic direction, the focus on business processes, supported by information technology, is less likely to suffer from rejection or underutilization by employees who feel threatened by or under-prepared to deal with new or reengineered processes.

One of the defining characteristics of business value pricing is that it is market innovation derived from business process requirements. The keys to process-based innovation include<sup>1</sup>:

- ☒ A focus on the task rather than the situation
- ☒ Perfection of an existing process
- ☒ Replacement of a weak link
- ☒ Redesign of an old process around new knowledge
- ☒ Occasionally making a process possible by supplying a missing link

The identification of a task that needs to be optimized illustrates the thrust of process-oriented innovation. The antecedents of the events outlined in the case studies below demonstrate many of the characteristics of process-based innovations. For the three companies profiled, the requirements for innovation were based either on the tasks of improving an existing process or reengineering an existing process in order to better fit the changing realities of the business within its operating environment. Rather than opting for traditional remedies, these companies sourced alternative solutions that provided the dual benefit of resolving the business issue and implementing a response that fostered greater flexibility and the attainment of business-oriented results. The business value pricing solution, in effect, provided the missing link that allowed these organizations to bind IT solutions to business results.

The legitimacy of business value pricing as a process-based innovation is further evidenced by the five criteria required for process needs innovation<sup>2</sup>:

- The process is self-contained
- There is one weak or missing link
- There is a clear definition of the objective
- The specifications for the solution can be defined clearly
- There is widespread realization that "there ought to be a better way" or high receptivity to the efficacy of an alternative approach

In addition to these five criteria, there are three caveats or necessary conditions for the effective application of process-based innovation<sup>3</sup>:

- The need must be understood
- The process may be understood but the knowledge to do the job or effect change must be present
- The solution must align with the way in which people work

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### **The Self-Contained Process**

In each of the case studies referenced below, the service outsourced to IBM reflects the execution of a single (or self-contained) business process or activity whether it is the administration of IBM/Lotus Notes IDs, the support and maintenance of a customer information system, or a contact centre's application environment. Another common trait of these organizations is the ability to equate the functionality and cost of the service provided with a specific business metric that is measurable and quantifiable, whether it be the number of email IDs, the number of customer accounts, or the number of dedicated IVR ports.

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### **The Weak or Missing Link**

The weak or missing link, at least at a macro-level, is related to the difficulty in substantiating the relationship between IT solutions and business-issue resolution. In the era of business value pricing options, the link between IT solutions and business value has been broached through the creation of solutions designed for the way customers purchase, rather than the way in which vendor's sell. The utilization of business value pricing solutions allows buyers to establish a direct, quantifiable link between IT and business goals.

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## **Clearly Defined Objectives**

In addition to specific business unit goals, the direct linkage between IT and business goals is a common objective that unifies the three case studies described below. Business value pricing solutions effectively bundle service offerings and service provider advantages (economies of scale, scope, and specialization) into a package that simplifies and streamlines the roles and responsibilities of the buyer and the supplier.

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## **Clearly Defined Specifications**

IBM's business value pricing solution is innovative because it clearly defines success and value. It does this first and foremost in business terms, and secondarily in IT terms. From an IT perspective, the business value pricing solution bases its worth on how individual components contribute to the whole (i.e., attainment of the customer's business results) rather than serving, or being priced, for their unique contributions. In other words, value is not specific to infrastructure (hardware and software) components. From a business perspective, the innovation of business value pricing lies in fundamentally specifying business outcomes as the key success metric.

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## **The Need for Alternative Approaches**

Finally, the acceptance of business value pricing is rooted in a growing recognition that information technology continues to provide better tools and methods for resolving business challenges and achieving business opportunities. The innovation brought forward by business value pricing is based on new perspectives of how IT can contribute to the realization of improved processes as well as improvements in process execution methods.

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## **The Forward-Looking Nature of Business Value Pricing**

The barriers to the business value pricing methodology are rapidly dissipating as the benefits of the solution become increasingly clear to both buyers and suppliers. The need for alternative IT-oriented business solutions is becoming more widespread as more companies search for flexible options that allow for the avoidance of costs related to customized or proprietary systems with limited strategic advantage. In some cases, businesses, rather than benefiting from customization, end up held hostage to their application environment, in need of specialized skills to maintain effective use.

From a technology perspective, one of the defining characteristics of business value pricing is the maturation of infrastructure services that support the delivery of vendor-supplied offerings. The technical knowledge has now caught up to the level of business knowledge for suppliers and buyers. Recognizing the importance of business process optimization, buyers are beginning to appreciate the possibility that vendors can deliver a superior process/activity experience.

From an end-user perspective, one of the clear benefits arising from a business value pricing solution is that the key features reside "behind the scenes" and the user experience remains largely unchanged, particularly in terms of how the service is used.

## CONCLUSION

The consideration of business value pricing, or any other sourcing solution, should be based on the customers' perception of value and the ability of vendors to deliver in line with that perception. In terms of the key benefits of business value pricing solutions, the most significant feature is the primacy of the customer. While it is rare that vendors will not claim that their solution directly responds to customer needs, business value pricing solutions justify the claim by providing three critical elements:

- ☒ The creation of a true customer-oriented utility service
- ☒ Payment is structured to meet the needs of the customer
- ☒ The customer (not the product and/or service) is the strategy

These are the three characteristics that customers should include in their assessment of vendor proposals.

The creation of a utility service is accomplished by the enablement of a service that serves the purpose of the user. While price is an important factor in the overall decision to use an external service provider, the business value pricing strategy ultimately works because it allows customers to choose an option that best serves its requirements. IT service firms are clearly adept at providing a service to customers. The ability to provide a utility to a customer is, in fact, more difficult and far more complex. Increasingly, however, suppliers will have to demonstrate the utility of IT solutions to customers as a means of achieving the next source of IT-enabled competitive advantage. Customers should evaluate competitive bids on their alignment to the specific needs of the business.

The case study of The Co-operators Group ably demonstrates the effectiveness of IBM's business value pricing solution to deliver a utility service to its customer. IBM was capable of providing a secure, stable, and highly available email platform for The Co-operators. The solution recognized that the email system, while a highly important service for The Co-operators' employees (as a means of serving its customers), was not a core business service that provided the company with a strong competitive advantage. The company believed that its IT resources would be better spent on projects and systems that provided the organization with meaningful sources of competitive differentiation. In taking over the Lotus Notes system, IBM created an email utility for The Co-operators because the system allowed The Co-operators to satisfy its business needs for a reliable email service, according to its own IT and business requirements.

Pricing is always a difficult subject to resolve between buyers and suppliers. Historically, the price of product or service has reflected one reality — the cost of a good or service was based on what the supplier offers and its production or servicing costs. For the IT services market, business value pricing is one of the early examples of a solution offering whose pricing is based on another reality — what the customer buys. The value, as represented by the price of the product and/or service, then shifts from the costs incurred by the supplier to the value the customer assigns to service.

The customer orientation of pricing is exemplified by the Hydro Ottawa case study. The value to the customer in this case is represented by the number of customer accounts (or hydro meters) billed by Hydro Ottawa. This is a clear example of a customer paying for what is purchased, rather than paying for what a vendor produces and sells. Engaging IBM allowed Hydro Ottawa to avoid capital expense related to building and supporting an internal solution (and traditional outsourced options), and it provided the company with a robust solution that improved functionality, reduced customization, and rationalized internal technical requirements. The business value pricing solution provided by IBM for the customer information system established a direct link between customer support costs and revenue. In a market whose operating environment continues to change, that linkage allows Hydro Ottawa to benefit from a higher degree of certainty in understanding its customer costs and its associated IT costs.

A further refinement on the pricing strategy is actually making the customer, not the product or service, the strategy. In this regard, vendors adapt solution offerings to fit the customer's reality. By representing the customer and understanding how the product or service is, or will be, used, vendors' perceptions move beyond their own boundaries to gain an appreciation of the customer's issues. It is the actual fulfillment of vendors selling complete solutions rather than components or inputs to a solution.

IBM adapted its service offerings for BMO Financial Group, refining its solution to reflect the changing business conditions within the bank's contact centre. IBM's response to BMO's changing business realities allowed the bank to reduce its technology requirements, lower its operating expense within the contact centre environment, and improve the utilization of existing infrastructure products. By taking the perspective of BMO, IBM not only protected a source of valuable revenue for itself, it freed up additional capital that the bank could use to make further information technology investments.

## CASE STUDIES

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### **The Co-Operators**

#### ***Company Overview***

The Co-operators Group Limited, incorporated under the Canada Cooperatives Act, is a cooperative primarily involved in the sale of insurance: property and casualty, life, home-owner, automobile, farm, travel, and commercial. The Co-operators' products are primarily sold through agents located throughout Canada. A portion of the commercial business is distributed through independent brokers. Other businesses undertaken by Co-operators companies basically support or are ancillary to the insurance business. These activities include investment counselling services, property development, and brokering insurance products.

#### ***Background***

In the spring of 2004, The Co-operators General Insurance Company came to a crossroads: its current email environment had reached a stage where the demands placed on it exceeded its ability to adequately support its user base. The company wanted to migrate its email system from its costly mainframe environment to a more flexible Unix-based server environment. To operationalize this transition, The Co-operators was faced with three alternatives:

- Purchase a new server or servers to manage the Lotus email system internally
- Purchase a new server (or servers) and outsource the operations of the email system
- Outsource the email system in an ASP/software on demand model

The first two options failed to address The Co-operators' requirements. The first option did not improve the situation because it required additional investments in resources, both IT and personnel. The second option was an improvement on the first, but it did not offer a significant cost advantage. The third option provided The Co-operators with the opportunity to pay for the resources it was consuming from IBM and it allowed the company to avoid the costs associated with the first two options.

#### ***The Business Issue***

The most pressing issue for The Co-operators was to establish its Lotus Notes email environment on a reliable platform that resolved the issues it was having with growing capacity, increased reliance on email as a business tool, and the challenges of dealing with an email platform resident on a mainframe. Of equal importance to The Co-operators was the provisioning of redundancy into the email solution. In addition, The Co-operators wanted to implement a solution in which the cost of operating and maintaining the email system was commensurate with its business objectives: linking its employees and agents across Canada with each other and with

customers. The resolution of these issues had to be accomplished without overburdening internal IT resources.

The Co-operators recognized that the investments required to internally own and operate the email solution exceeded its value to the company in terms of the resource requirements; as a result it solicited the input from the IT vendor community. The key attribute that was required of vendors was the ability to price their solution based on the number of users as it signified the closest representation of value assigned by the customer.

A decisive factor for The Co-operators was the estimated cost of a traditional outsourcing solution. In the traditional model, The Co-operators was required to purchase expensive IT hardware that would subsequently be managed by an external service provider. The IBM solution allowed The Co-operators to avoid this capital expenditure, immediately lowering the company's total of ownership over the lifecycle of the solution.

### ***Why The Co-operators Chose IBM Canada***

There were numerous reasons why The Co-operators chose IBM to operate its corporate email system. The motives reflect the importance for vendors to have multifactor responses to the needs of customers. IBM was able to tailor a service that was unique and met The Co-operators' requirements.

IBM distinguished itself, in the estimation of The Co-operators, in three key measures:

- ☒ **Project management services.** The Co-operators was satisfied that IBM's project management capabilities could effectively manage the risk factors associated with the platform transition and ongoing management issues.
- ☒ **IBM's track record.** Drawing on its experience implementing many other projects of similar design, IBM was capable of crafting a solution quickly and efficiently, allowing The Co-operators to receive the benefits of its new solution immediately. A key feature for The Co-operators was that the solution offered by IBM was already commercially available and operational.
- ☒ **Price.** Because the IBM solution did not require upfront capital spending in IT hardware, the cost to The Co-operators was very competitive — lower, in fact, than the other competitors' bids.

The technology components that impressed The Co-operators included:

- ☒ **IBM's ownership of Lotus Notes.** As the owner of the email system that was being implemented, IBM was uniquely qualified to manage and support the Lotus Notes and Lotus Domino systems for The Co-operators. By choosing IBM, The Co-operators could be certain of an evergreening application environment.
- ☒ **An end-to-end solution.** IBM was able to demonstrate its experience to integrate hardware, software, and IT services.

- ☒ **Scope and scale of IBM's technical capabilities.** The Co-operators required a vendor capable of supporting its corporatewide Domino environment — a condition that limited the number of qualified suppliers.
- ☒ **Redundant environment.** IBM was able to include in the price, automatic fail-over between IBM's Toronto and Montreal datacentres, eliminating the need for a separate disaster recovery solution, as well as delivering a high availability solution.

### ***The Results***

According to all measures, The Co-operators believes that the Lotus Notes on-demand project has turned out better than expected. In fact, The Co-operators was able to achieve significant savings "out of the box" as a result of the engagement. IBM has exceeded The Co-operators' expectations for three key targets:

- ☒ Project time lines including design and implementation were met, allowing the project to proceed according to plan.
- ☒ All service level agreement (SLA) objectives have been met or surpassed.
- ☒ The conversion of the system was flawlessly executed and the switchover of the system to IBM management did not produce any disruption to email users.

A long-term benefit for The Co-operators has been the simplification of the responsibilities for internal IT personnel working with IBM to support the Lotus systems. The Co-operators' IT staff are only required to understand the number of users on the system, their access privileges, and the data storage requirements for archiving email and corporate communications.

The ultimate endorsement of the IBM solution is the potential for The Co-operators to extend the offering to include employees and email accounts in subsidiary organizations. The extension of the solution would benefit The Co-operators by further improving its TCO on its email environment, while the larger number of Lotus Notes IDs managed by IBM would result in lower cost of user support based on volume discounts.

### ***Lessons Learned***

As was the case with vendor considerations, The Co-operators case study provides a multifactor example of the lessons learned. Firstly, this case illustrates the value that companies receive by focusing on their core business competencies. Email systems provide a good example of business systems that are important to business operations but they provide little or no competitive differentiation for companies that devote internal resources to their management. By allowing IBM to manage and maintain its email systems, The Co-operators is able to redirect its resources to critical revenue and profit generating activities. By tying its expenditure on its Lotus Notes system to the number of agents and employees it has, The Co-operators has the ability to directly relate the cost of its email support system to the revenue its employees and agents generate.

The Co-operators could have opted for a simple replacement strategy based on the product/service offering mix it had previously. However, an assessment of the situation determined that other options were more appropriate and provided better value for the company. Rather than limiting itself to old or outdated formulas, The Co-operators selected IBM for its ability to deliver an advanced solution that recognized the importance and primacy of business metrics as the key determinant of project success.

The third lesson is related to and expands on the second lesson: there is a significant pay-off to the search for alternative solutions (and solution delivery) that limit capital spending. There is even further value by choosing solutions that directly bind IT solutions to business outcomes. In the case of The Co-operators, the cost of supporting the email system is directly related to its workforce and those generating revenue for the company.

Finally, The Co-operators case study illustrates the advantages of limiting exposure to the risks and responsibilities of owning, managing, supporting, and maintaining IT solutions that are not critical to business operations. By limiting responsibility to only those services used by the company, The Co-operators reduced its support risks. With its experience and track record, IBM capabilities allowed it to assume and manage the risks and provide trusted services to The Co-operators.

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## **BMO Financial Group**

### ***Company Overview***

Established in 1817 as Bank of Montreal, BMO Financial Group is a highly diversified North American financial services organization. With total assets of \$306 billion as of January 31, 2006, and more than 33,000 employees, BMO provides a range of retail banking, wealth management, and investment banking products and solutions.

BMO Financial Group serves clients across Canada through its Canadian retail arm, BMO Bank of Montreal, and through BMO Nesbitt Burns, one of Canada's leading full-service investment firms. In the United States, BMO serves clients through Chicago-based Harris, an integrated financial services organization that provides more than 1 million personal, business, corporate, and institutional clients with banking, lending, investing, financial planning, trust administration, portfolio management, family office, and wealth transfer services.

BMO Financial Group is made up of three client groups:

- Personal and Commercial Client Group (P&C)
- Private Client Group (PCG)
- Investment Banking Group (IBG)

In addition, there is a technology and solutions group which manages, maintains, and provides governance over information technology, operations services, real estate, and sourcing for BMO Financial Group.

## ***Background***

As one of Canada's largest financial institutions, BMO has a large customer base that needs support, advice, and information on a wide variety of financial products and services. In order to meet the needs of its customers, BMO maintained a number of contact centres with agents specializing in BMO products and services. Prior to engaging IBM, BMO was using a solution that was ultimately too expensive and inflexible.

The previous contact centre solution was more restrictive in terms of the number of IVR ports that BMO had to pay for. In addition, the previous solution included the expense of the integrated telecommunications costs, primarily, 1-800 toll charges. The costs of the contact centre solution were quickly exceeding the value of the expense to BMO, which led to the decision to pursue alternative options.

## ***The Business Issue***

The key business issue for BMO was cost. Under its previous vendor-provided solution, the service was costly and the company realized that there were other solutions that could provide comparable service quality at a lower price point. It also became apparent to BMO, after contracting the contact centre ASP service to IBM, that the business conditions of its contact centre were changing and that the cost of the service was becoming increasingly misaligned with a fundamental business metric — call volume. A reduction in the number and volume of calls into the contact centre was making it more and more difficult for the bank to reach the optimum pricing grid negotiated with their previous supplier, which meant that the solution was becoming increasingly expensive and that the customer would incur a substantial loss.

## ***Why BMO Financial Group Chose IBM Canada***

The choice of IBM as a replacement for the telco provided solution was multifaceted. At the most basic level, the IBM solution was less expensive than the previous solution and it allowed BMO to avoid certain costs related to the bundling of long-distance and data services charges. The IBM net Call Centre solution tied pricing to usage (number of IVR ports used, number of call minutes per month), allowing the bank to limit its capital expenditures in non-differentiating technology products and services.

The solution developed by IBM provides several advantages for BMO based on IBM's unique ability to integrate product and service offerings into a comprehensive package. From a product standpoint, IBM committed to guaranteed service levels that met industry performance benchmarks. The bank's call centre was also operating on IBM software applications which made BMO confident that IBM would maintain a stable and reliable platform. Overlaid on top of the IBM product suite was the IT services practices including hosting and application management. This distinguished IBM from its competitors in terms of the scale and the scope of the IBM solution.

### ***The Results***

In total, the proposed contact centre solution offered by IBM on an ASP platform priced according to the key business metrics of call volume and duration had three primary benefits:

- ☒ It saved BMO a considerable amount of capital.
- ☒ It brought expense into closer alignment with business value.
- ☒ It allowed BMO to pursue other strategic IT initiatives, the result of the cost savings initiatives.

As a further testament to the value of the IBM contact centre solution, BMO was able to:

- ☒ Reduce the number of call centres it operated from seven to two.
- ☒ Improve fail-over and redundancy by unifying the remaining contact centres under a single solution.
- ☒ Reduce the number of IVR ports required by 20%.
- ☒ Reduce the contact centre call volumes by 20%.
- ☒ Reduce per minute telephony charges by approximately 13%.
- ☒ Improve contingency planning and disaster recovery.
- ☒ Enhance security and vulnerability testing as a result of improved management services provided by IBM.

### ***Lessons Learned***

BMO was able to take a non-standard approach to IT and business services provisioning and realize certain benefits that are traditional hallmarks of the outsourcing services paradigm.

BMO's prompt realization that operating contact centre technology was not a business that represented a strategic revenue-generating offering allowed it to reassess its operating structure. This insight allowed BMO to identify IBM as the ideal service provider partner for its contact centre requirements. This was based, in large measure, to the use of IBM technology within the contact centre environment. As a consequence of the move towards outsourcing, BMO was able to transfer significant responsibility for the management of the contact centre solution to IBM, and to enact strict SLA clauses that reinforced the partnership that BMO and IBM had established.

BMO also found great value in utilizing an outsourcer that owned the products under external management. This was especially important for an ASP service where the application environment is the sole responsibility of the supplier. IBM's technological understanding and experience were unparalleled, allowing BMO a higher measure of assurance that it would receive the ideal, ongoing match between its technology requirements and its business requirements. The combination of IBM's technology and services also presented a desirable combination for BMO, as the economies of scale and scope allowed both it and IBM to benefit.

Finally, BMO derives significant value from structuring its contract with IBM to quantify key business metrics for its contact centre solution requirements and to use these metrics as the basis for the cost of the services provided. This reflects the fundamental value of IBM's business value pricing program. The direct correlation between the price of the service and the results experienced by BMO's contact centre allows the bank to obtain a high level of certainty that spending levels are closely aligned to its customer support needs. The resulting innovation from this contract is entering other areas of BMO's strategic sourcing group. It is becoming an example of a best-practice contract approach that can benefit the organization's other divisions in their attempt to rationalize spending or service requirements.

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## **Hydro Ottawa**

### ***Company Overview***

Hydro Ottawa Limited is the electricity distribution company serving the City of Ottawa. Hydro Ottawa Limited has two core responsibilities. First, it is responsible for the delivery of electricity to more than 275,000 customers in the City of Ottawa and the village of Casselman. Second, Hydro Ottawa Limited bills for its services and for the services provided by other organizations in Ontario's electricity system.

Hydro Ottawa Limited was formed on November 1, 2000, following the amalgamation of Gloucester Hydro, Goulbourn Hydro, Kanata Hydro, Nepean Hydro, and Ottawa Hydro. In May 2002, Casselman Hydro became the sixth utility to join Hydro Ottawa. Hydro Ottawa Limited is a wholly owned subsidiary of Hydro Ottawa Holding Inc., which owns and operates three subsidiary companies that distribute electricity (Hydro Ottawa Limited), generate power and provide energy services (Energy Ottawa Inc.), and transmit data (Telecom Ottawa Limited).

## ***Background***

The force that required Hydro Ottawa to restructure its customer information and billing system emerged over a 24-month period. Firstly, on May 1, 2002, Ontario's electricity market opened to price competition, with generators competing in an open marketplace. The price for the electricity commodity was set hourly, based on supply and demand. The second change occurred approximately six months later in December 2003, when the provincial government of Ontario moved to protect consumers from price increases caused by the gap between high demand and supply limitations. The provincial government introduced Bill 210, Electricity Pricing, Conservation and Supply Act which provided price relief by fixing the price of electricity at 4.3 cents per kilowatt-hour until May 1, 2006, for all residential and business customers whose consumption is 250,000kWh per year or less and other "designated consumers." The third force appeared on April 1, 2004, when Bill 4, the Ontario Energy Board Amendment Act, 2003, was passed into law. This act allowed the 4.3 cent price cap to be replaced with a new two-tiered price for the electricity commodity. Customers who were previously paying a capped commodity price of 4.3 cents per kWh would now pay 4.7 cents per kWh for the first 750kWh of electricity used in a month. The commodity price for electricity usage above 750kWh would now be 5.5 cents per kWh. This new pricing structure was established to more closely reflect the true cost of electricity and include a strong incentive to conserve energy.

The result of all of these structural industry changes was that Hydro Ottawa had to improve its visibility into its customer base and to co-ordinate its customer information requirements with its back office systems and the reporting capabilities of its systems with its ecosystem partners: the regulators and the third-party marketers.

## ***The Business Issue***

As a result of these competitive and organizational issues, Hydro Ottawa realized that its legacy infrastructure was incapable of achieving three key operational metrics:

- Performance
- Capacity
- Reliability

In a market fraught with new and emerging competitive challenges, Hydro Ottawa needed a billing and customer information system that was high functioning, stable, extensible, and flexible. As a customer-facing solution, the previous billing system was viewed as a negative attribute that was eroding customer satisfaction. Hydro Ottawa was becoming increasingly risk averse because the previous implementation was not achieving the desired outcomes and the solution was negatively impacting one of Hydro Ottawa's critical success factors: spending its capital on acquisitions and expansion rather than IT infrastructure.

Another significant issue facing Hydro Ottawa was the impact of deregulation and the shifting business model from a monopoly environment to a competitive environment in which the company is responsible for revenue and profit growth in addition to achieving a positive ROI on its investments. After operating in a monopoly environment in which some investments and customer service initiatives could be delayed or implemented gradually, Hydro Ottawa's principle concern became its customer service capabilities as a growth engine for the company to retain its customer base and expand beyond its current boundaries.

As an outgrowth of the realities of industry deregulation, Hydro Ottawa, as the primary source of electricity distribution, now has accountability in the marketplace to bill and collect for all market participants (i.e., energy retailers). In the new deregulated environment, as the amount of complexity around power purchases, energy sales, and multiple parties to settle transactions with has increased substantially, the need for a robust customer information and billing system with reliable operation is imperative.

Focusing on the core business — delivering electricity to customers — is the ultimate purpose for the contract between Hydro Ottawa and IBM. The underperformance of the existing customer information and billing systems had the potential to negatively impact Hydro Ottawa's primary source of revenue. Not only did the current solution present a potential disruption to revenue generation, it was creating negative consequences on the expense side of the ledger by requiring higher levels of spending to support its antiquated structure.

### ***Why Hydro Ottawa Chose IBM Canada***

There wasn't a single factor that caused Hydro Ottawa to choose IBM over its competitors, rather IBM provided a multifaceted combination of benefits that addressed a wide range of concerns.

Chief among the benefits provided by IBM was the overall conception of the proposed solution and the vision it demonstrated in addressing the concerns of Hydro Ottawa. The IBM solution was unique in approach to addressing the management, support, and ownership issues of the technology components. Other competitors proposed more traditional outsourcing options that failed to meet the needs of Hydro Ottawa and failed to address its concerns for cost control and a positive ROI. IBM's innovative solution allowed Hydro Ottawa to take a different approach to sourcing non-core service delivery with greater alignment to key business metrics. The fact that this innovative solution was highly cost competitive further convinced Hydro Ottawa that IBM was the ideal solution partner.

The pricing model, which was closely tied to the overall IBM vision, was another key differentiator for IBM. The direct relationship between the cost of the service and the number of in-force customer accounts (meters read) addressed the issue of cost certainty (and control) and it allowed Hydro Ottawa to clearly link the spending on the customer information system with the value derived from its use — that is, the impact on customer satisfaction and revenue recognition.

Beyond pricing, Hydro Ottawa indicated that IBM's experience and delivery capabilities were also key determining factors in its successful bid. Hydro Ottawa determined that IBM could deliver all of the required solution components and lower its cost of operations. IBM was capable of bringing all of the solution elements together into a single package that created process efficiencies and improved economies of scale and scope. IBM's capabilities in these areas were proven by its ability to quickly establish its understanding of the existing application infrastructure and to develop an alternate support strategy. In a very short period of time, between the vendor selection phase and the end of negotiations, IBM rapidly digested its new commitments and implemented the necessary development and support plans.

### ***The Results***

The convergence of all of these previously stated selection criteria resulted in a number of benefits for Hydro Ottawa.

- ☒ **Direct correlation of cost to revenue.** In the business value pricing model, the cost of the solution to Hydro Ottawa relates directly to the number of customer accounts it supports and bills. With the costs proportionate to the baseline, Hydro Ottawa is freer to build its business by adding new customers either through organic growth or acquisitions.
- ☒ **Greater certainty around customer costs.** In this pricing scheme, the unit costs are clearly expressed in business terms and fluctuations in business volume do not have immediate and negative capital or operational spending repercussions. Reducing the variable portion of customer costs creates a better understanding of where costs can be further reduced or rationalized and where there are further opportunities for business value pricing programs.
- ☒ **Reduction in IT costs.** The externalization of the support and management of the customer information and billing system allows Hydro Ottawa to benefit from the assistance of dedicated resources without the need to pay the entire costs of these resources. Reducing IT costs means that Hydro Ottawa has more discretionary capital to support its core business operations. The company estimates IT costs were reduced between 20% and 25%.
- ☒ **Reduction in batch processing time.** The previous billing system would require almost one entire business day to process customer invoices. The new system, managed by IBM, has reduced this processing time by more than 80% (from 17 to 18 hours to 3 hours), which allows Hydro Ottawa to improve its invoicing system and shorten its bill to cash cycle.
- ☒ **Reduction in call centre agents per call time.** The new customer information system has also benefited the organization's contact centre response times by improving the visibility and accuracy of customer information for agents. With the contact centre operations managed by IBM, Hydro Ottawa benefits from professional management of its contact centre services with metrics designed to improve the customer experience.

- ☒ **Risk mitigation.** The benefit of lower risk pervades this entire business value pricing solution from IBM. The new solution is inherently less risky than it would have been for Hydro Ottawa to maintain the status quo with its obvious shortcomings. Risk was lowered further by reducing the complexity and responsibilities of the internal IT department to optimize, support, and maintain the customer information and billing system internally. The choice of IBM also mitigated the risk profile due to its proven track record in managing similar projects and complementary solutions.

### ***Lessons Learned***

The Hydro Ottawa case study presents an interesting lesson for other companies because it provides an ideal test case of what a company should do to effectively respond to changing business conditions that result in significant competitive strategy re-design. While a high level comparison may be difficult due to the formerly regulated environment that Hydro Ottawa operated under, there are instructive parallels based on decisions required to ensure the strength of the businesses competitive positioning.

Hydro Ottawa was very swift in its determination that the pre-existing customer information and billing system was sub-optimal and that its future success depended on its improvement. With its business on the line, Hydro Ottawa decided to contract with a different vendor (IBM) to secure the necessary services that would stabilize its operating environment and create the platform from which future growth would be possible. The key message is that prolonging difficult decisions will invariably lead to further problems. Hydro Ottawa's quick response allowed the company to identify its options and steady its systems infrastructure in a relatively short period of time.

The Hydro Ottawa case study also illustrates the importance of taking a holistic view of solution or service requirements. In working with IBM, Hydro Ottawa determined that the most prominent feature of its new customer information and billing system was not the technology itself. Instead, the key features were related to customer service and satisfaction. By tying pricing to the number of customer accounts in-force, the IBM solution places information technology within a larger, more comprehensive solution which accurately reflects business value and the attainment of specific business results.

Finally, Hydro Ottawa learned that its emerging operating environment (i.e the partially deregulated energy industry in Ontario) required it to pursue solution options that reflected a competitive environment in which cooperation among industry players is vital to the entire ecosystem. Hydro Ottawa is a leader in the adoption of a non-proprietary customer information and billing system. As a result, it is leading the industry in adopting best-practices approaches, lowering the TCO for its ecosystem partners, and enabling greater system-wide customer satisfaction. In an industry that continues to evolve away from its previous model, there are still advantages to being a first-mover. The adoption of the business value pricing solution from IBM means that Hydro Ottawa has chosen a cost-effective solution that lowers its risk by being an industry pioneer and aids in the creation of an industrywide best-practices program.

## APPENDIX

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### End Notes

1. Drucker, Peter F, Innovation and Entrepreneurship: Practice and Principles. HarperBusiness, 1985
2. ibid
3. ibid

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