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Why Krakow Still Works for IBM

For Big Blue and other IT services companies, Poland's skilled workforce makes up for rising wages with skills that offset Bangalore's low costs

by Jack Ewing

Krakow, Poland, is a nice place to live and work, with a charming old quarter and a lively club scene driven by the city's population of more than 150,000 students. In fact, Krakow seems almost too nice to compete with the raucous, traffic-jammed cities of India as a location for outsourcing—especially when wages are quickly catching up to Western European levels.

Yet IBM (IBM) is one of several large corporations massively building its presence in the historic city in southern Poland. IBM's commitment to Krakow is particularly surprising considering that the Armonk (N.Y.)-based computing and services giant is well established in Bangalore and other Indian cities where labor costs remain much lower.

Since 2002, IBM has boosted staff in Krakow tenfold, to more than 900 people, at a facility that provides finance and accounting services to business customers. Another 200 people work at an IBM software lab founded in 2005.

University Town Provides Able Employees

Part of the reason Krakow makes sense for IBM, as well as for Cap Gemini (CAPP.PA), Motorola (MOT), KPMG, and other multinationals is that the university town churns out a steady supply of well-qualified graduates. They include not only computer scientists but also accounting and business grads able to manage accounts payable or tax compliance for customers in countries such as France and the Netherlands.

Salaries, which are lower than in Western Europe but rising 7% a year, are only part of the equation. "Cost may make your investment decision sweeter, but today you really invest in skills," says Pawel Molenda, manager of IBM's software lab in Krakow.

The fact is, major outsourcers have learned that no one location provides everything they need to be competitive against Indian outsourcing juggernauts such as TCS (TCS.BO) or Wipro (WIT)—and even the Indian companies are setting up operations in Europe and the U.S. "You need a multi-geography footprint," says **Peter Schumacher**, chief executive officer of offshoring consultancy **Value Leadership Group** in Frankfurt. The best companies, he says, are those that can draw on expertise around the world.

Tough Competition from Indian Companies

Outsourcing companies that were slow to learn this lesson are now feeling the consequences. Among the hardest hit are European outsourcers that mistakenly believed that their customers would never farm out work to India or Eastern Europe on the same scale as U.S. companies have. France's Atos Origin (ATOS.PA) or Finland's TietoEnator

(TIE1V.HE) are among the outsourcers that have struggled to maintain profit. "Most of the European companies have the same problem—they have the majority of their workforces in Europe and are facing really tough competition from Indian companies," says Panu Laitinmäki, an analyst at EQ Bank Ltd. in Helsinki.

Ironically, part of the answer to the European outsourcers' troubles was just across the German border in the new members of the European Union. Yet it seems to be the U.S. companies such as IBM that have moved most aggressively into Central and Eastern Europe. Hewlett-Packard (HPQ), which has major centers in Wroclaw, Poland, and Sofia, Bulgaria, is another example.

Not all European outsourcing companies missed the boat. Paris-based Cap Gemini has major operations in Krakow as well as India and other global locations. Partly as a result, analysts say, Cap Gemini has been able to hold its own against Indian competition, more than doubling profit in the first half of 2007, to \$235 million.

Local Experts in Six Sigma

As is typical of outsourcing centers in Central and Eastern Europe, IBM's operations in a modern, high-rise building outside the Krakow city center emphasize services for European clients. The company hires university grads with knowledge of European languages, and sometimes trains workers in languages such as Dutch.

But Krakow also has experts in disciplines not specific to Europe, such as compliance with U.S. securities laws. The idea is to develop "centers of competence" less vulnerable to competition based on labor costs alone. "Even if you're a very well-organized company, it takes time to build a team with experienced people," says Aleksandra Lichon, human resources director for IBM business consulting services in Krakow.

Moreover, IBM needs to challenge its employees to retain them in an increasingly competitive job market. Polish workers don't want to be seen as cheap labor, but as full members of the team. At the Krakow software lab, computer scientists work on global projects in cooperation with labs in places such as Rome and Austin, Tex. Says software lab manager Molenda: "The best talent will not stay with you without challenging projects."

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