IBM under Lou Gerstner: Lessons learned

Karunakar B*

IBM's dramatically slowing growth and poor performance in the late 1980s is a well-chronicled tale of management's inability to keep up with key market developments. In the early 1990s, Lou Gerstner was named chairman of the company in a desperate bid to get the computer giant back on track. Gerstner has succeeded by cutting costs and revitalizing IBM's overly bureaucratic culture, leveraging its technological capabilities and size in the new software and service markets. Studying how Lou Gerstner of IBM succeeded in restoring faltering Big Blue, offers several useful lessons to budding CEOs.

In 1991, IBM was a $65 bn company of which less than $6 bn was derived from services. Ten years later, the total revenues stood at $86 bn with services accounting for $35 bn. Services had become the single largest source of revenue in IBM's portfolio contributing to more than 40% of the revenues. How did that happen?

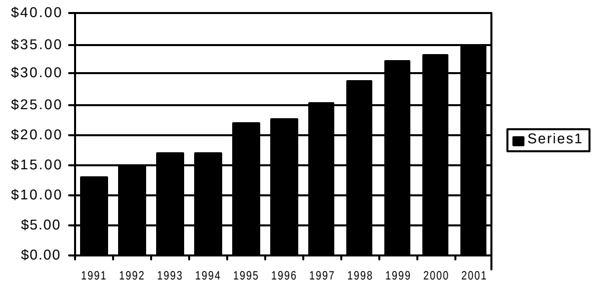
The success came from a clear understanding of customer's needs. IBM could clearly see the convergence of technology and business, and had the deep experience in both the areas to help its customers bring them together effectively. The second reason for the success came from hard work and commitment: Growing customers, building systems and investing in people.

Background

During the 1990s, businesses began to understand the importance of IT. Earlier businesses and IT were disconnected. Further, the relationship between the

* *Karunakar B is a Senior Faculty at ICFAI Knowledge Center, an affiliate of ICFAI. His areas of interest include Strategy, Leadership and Organizational Development.*

Figure 1
IBM Services Revenues 1991-2001(in billions)



Source : www.ibm.com.

two is not one-way. Today it has reached a point where it is difficult to distinguish between business strategy and the IT strategy. Customers are demanding solutions, not "speeds and feeds". Customers look for integration and refuse to accept seperate parts that do not integrate.

IBM had both the technical expertize to make products and the business knowledge to become a trusted partner for its customers. It had the capability to put the "e" into the customer's businesses. With customer focus as the guiding light, IBM resolved many of the seemingly intractable internal debates and delivered e-business solutions. IBM came up with a handful of strategic bets on the future drivers:

- Innovate or Integrate (New Industry Model).
- Services Led (New Business Model).
- Infrastructure Plus Ubiquity (New Computing Model).
- Open playing field (New Marketplace Model).

With the above models put together, IBM transformed into a new type of enterprise with a whole new type of corporate culture.

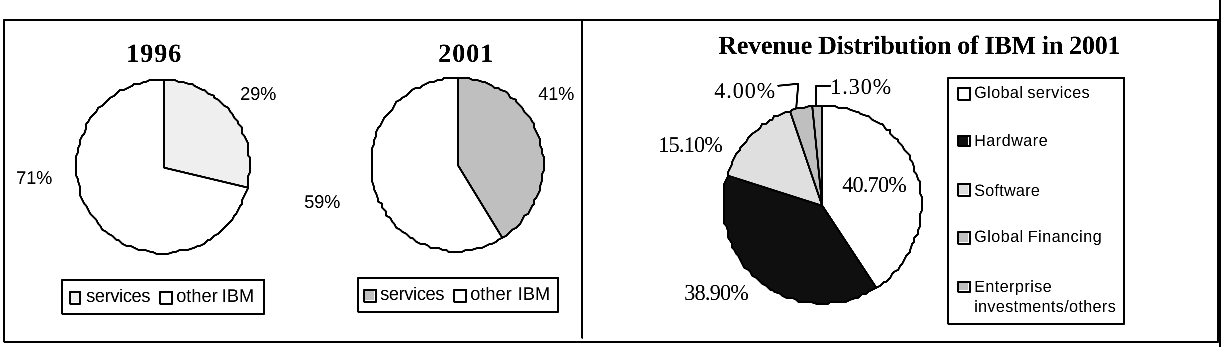
Under Lou Gerstner

IBM went through rough times during the 1980's and the early 1990's. Distracted by the 12-year anti-trust investigation that ended in 1982, IBM, inventor of PC, then failed to spot the device's significance and allowed others to reinvent the computing industry. During the first three years of 1990s, it made losses of nearly $18 bn. But thanks to luck and intuition of Lou Gerstner, hired from RJR Nabisco in 1993, IBM once again became a force to be reckoned with.

Louis V Gerstner joined as the seventh CEO of IBM. In 1993, IBM made a loss of $8.1 bn. Gerstner was given a clear though daunting objective: Save the company. Gerstner came to IBM with the mindset of a customer. Before his stint at Nabisco, Gerstner had run American Express at a time when IT became increasingly important. As one of the customers for IBM then, Gerstner realized that IBM was increasingly out of touch with its customer needs. When he was shown the Internet for the first time, his reaction was how to make the Internet a new channel for business, how to make Internet real for customers, how to make money on it? The order of these priorities—customers and then profit—is perhaps the vital lesson from his business philosophy.

IBM lost good people. John Chambers, now CEO of Cisco systems, left IBM in the mid-1980s because he felt that he was being paid to impose solutions on clients that he felt were not in the customer's best interests. It was also the time when IBM faced severe competition in coming up with new technologies from Microsoft in operating system for PCs; from Oracle in relational databases; from Sun Microsystems and HP with the RISC chip architecture. In 1990s, IBM had 4,00,000 employees

Figure 2
Global Services as a % of IBM Revenues



Source : www.ibm.com.

against today's 2,70,000 with a high cost structure, stifling bureaucracy and outdated sign-off procedures. John Akers, the then CEO, decided to split the company into autonomous operating divisions and sell each business under a new brand name. This plan had a certain logic in that it was replicating the model of the then new disaggregated computing industry which would allow a business to be closer to its markets, lower the overheads, and motivate the best people with stock options.

Gerstner, however, had other ideas. He felt that IBM would be more worth than the sum of its parts. His key insight was that technology was now more than just a productivity tool. He saw technology as a central source of their company's competitive advantage.

Strategies and tactics

Gerstner asked the top dozen managers to answer five questions about their businesses: "What business are you in? Who are your customers? What's your marketplace? What are your strengths and weaknesses? Who are your main competitors?"

Three distinct phases characterize IBM's evolution into services business.

The early 1990s

When Gerstner assumed charge in 1993, there were 20 largely independent units. Each unit had its own strategies and was in the process of moving towards spin off or sale. Gerstner decided not to dismantle the various units and instead stay together. The decision was made on the bet that the customers needed a partner who could both create technologies and integrate them. He was convinced that the customers were looking for solutions. The challenge was to get the different parts of the company working together. IBM Global Services thus became the focal point of this "integrator" business model in 1995.

He was convinced that the customers were looking for solutions. The challenge was to get the different parts of the company working together. IBM Global Services thus became the focal point of this "integrator" business model in 1995

Gerstner's formula was: The customer comes first, IBM comes second and the business unit comes third. Customers were entitled to best-of-breed solutions. If IBM did not have the right product or could only offer something inferior, the IBM Global services division was under an obligation to offer third-party alternatives. The industry was moving to open standards; in fact being rejected by IBM Global Services Division was like a red alert to any product idea of IBM which was under performing.

Another strategy was to focus on "network-centric computing" by harnessing the networking capabilities with the objective of capitalizing on the Internet explosion. IBM Global Network in 1994 brought together the multiple internal networks, the mainstay of which was the electronic data interchange services. IBM caught up with the importance of the Internet an year earlier than Microsoft. What the Internet brought to IBM was a dramatic vision of networked computing that was based on ease of use and the open standards that IBM is now committed to.

Thus during the early 1990's, IBM positioned itself as an integrator, established its future around networks and acquired resources to strengthen itself in the services business.

The mid-1990s

To make the jump into networked desktop computing, IBM took over Lotus Development Corporation in 1995. Lotus had been a success for IBM. Lotus had also been at the forefront of IBM's Java development with eSuite. Java, the programming language invented by Sun Microsystems, like the internet became another huge stroke of luck for IBM. Its "write once, run anywhere" capability makes it ideal for a networked world in which different hardware platforms and operating systems must be made to work with each other.

IBM Global Services rationalized its offerings by reducing its 2,500 offerings worldwide down to about 100 solution categories that were consistent globally. It aligned its capabilities, skills and practices around three major areas of innovation and integration, infrastructure support and strategic outsourcing. It ramped up its practices to help clients implement and manage standards-based environment.

Further restructuring took place in terms of its sale of IBM Global network because IBM could acquire connectivity from other providers at less cost and investment. Concomitantly, IBM elected to focus on managing information and data that was streaming into networks by connecting business processes across enterprises and across the industry's value chains.

Customers needed advice on a coherent strategy for e-business and IBM provided it. Capitalizing on its in-house experience in e-business, IBM could translate it into commercial opportunities

In addition, IBM merged the Consulting Group, which was previously tied to its sales units, into Global Services. It forged the marketing experts with the integration experts to deliver high value solutions to the customer.

Late 1990s and beyond

IBM expanded its portfolio to offer many more e-business services with the rapid growth of Internet. Customers needed advice on a coherent strategy for e-business and IBM provided it. Capitalizing on its in-house experience in e-business, IBM could translate it into commercial opportunities. For example, its own in-house experience in Business Intelligence and Knowledge Management tools were incorporated into many solutions. Further IBM's expertize in using the Internet and building similar Web environments was applied to customers with mutually rich rewards. The aim was to show companies how they could form Internet-based virtual trading communities where buyers and sellers could meet and transact every kind of business surely.

IBM Global services had increased its focus by concentrating on 16 industries grouped into five sectors. It enhanced its knowledge, skills and capabilities on client's specific business issues and building an inventory of reusable assets to speed response time.

The e-business strategy stretches right across IBM and like the Global services division provides glue to

Box 1: Biography

Louis V Gerstner, Jr

Louis V Gerstner, Jr., has been chairman of the board of IBM Corporation since 1993. He served as chief executive officer of IBM from 1993 until March 2002. Prior to joining IBM, Gerstner served for four years as chairman and chief executive officer of RJR Nabisco, Inc. This was preceded by an 11-year career at American Express Company, where he was president of the parent company and chairman and CEO of its largest subsidiary, American Express Travel Related Services Company. Prior to that, Gerstner was a director of the management consulting firm of McKinsey & Co. Inc., which he joined in 1965.

A native of Mineola, New York, Gerstner received a bachelor's degree in engineering from Dartmouth College in 1963 and an MBA from Harvard Business School in 1965. Gerstner is a member of the National Academy of Engineering, a Fellow of the American Academy of Arts and Sciences and has been awarded honorary doctorates from Boston College, Brown University, Notre Dame University, Rensselaer Polytechnic Institute, and Wake Forest University.

A lifetime advocate of the importance of quality education, Gerstner is co-author of *Reinventing Education: Entrepreneurship in America's Public Schools* (Dutton 1994). At IBM he has established 'Reinventing Education' as the company's program in support of systemic school reform. Through 'Reinventing Education', IBM initiated strategic partnerships with 21 states and school districts, which are utilizing IBM technology and technical assistance to eliminate key barriers to school reform and improve student performance.

He has received numerous awards for his work in education, among them the Cleveland E Dodge Medal for Distinguished Service to Education—Teachers College, Columbia University, and the Distinguished Service to Science and Education award from the American Museum of Natural History. Gerstner is also the first recipient of Washington University's combined Excellence in Business, Engineering and Technology Award, and the first to receive the Visionary Award from New Visions for Public Schools.

Source: www.ibm.com.

unite disparate business units behind shared goals. It also had a huge impact on IBM's software division.

Leadership development

Gerstner introduced many of the company's best practices. His handpicked successor, Sam Palmisano, continues to carry them out and is adding new ones of his own. Palmisano says he personally reviews the talent across every major business unit, function and geographic division of the company, as well as all personnel changes among the top 300 executives. He participates in the company's assessment as well as development program for high-potential employees. He spends time talking to colleagues in various classes and education sessions at IBM's learning centers.

Lou Gerstner's tenor at IBM provides ample proof that simple but robust management techniques lie at the heart of corporate success. His techniques are undoubtedly the right ones if the company is to avoid repeating its decline into arrogance

IBM is committed to identifying potential leaders and ensuring that they get a broad range of experiences to fully prepare them for more complex senior-level positions. In doing so, IBM maintains an "unwavering focus on bench strength and people management skills". The Senior Leadership Group (SLG), a set of 300 executives, are chartered as the change leaders. This is not an entitlement position based on rank and seniority. There is a nomination process that IBM goes through twice a year and this process makes sure that the 300 top leaders are the ones who are charged with running IBM, beyond their day-to-day jobs. At this level, IBM looks for people who understand the breadth of its business and who have the capability to think of the whole. IBM has been able to convince its senior leaders that the company's interest is best served when they exchange great talent and move people around the business to gain experiences.

Superior leadership drives performance through people. Leadership development contributes to outstanding business results. The top 300 executives are expected to be great leaders and IBM pays extra for that. IBM does not pay extra for good managers, which is the role expected out of senior level managers.

With all the pressure to address customers, products, issues, the marketplace, IBM never skips a talent review of a business unit or a function. There are 14 separate reviews a year ranging from an hour to nearly half a day with an unwavering focus on leadership development. At IBM, long-term investment in leadership does not take a back seat to short-term business needs.

Lessons learned

What lessons can we draw from the growth of IBM's services business over the past 10 years?

Gerstner engineered IBM's turnaround, remaking the company into a services powerhouse. Gerstner made IBM profitable again. His tenor at IBM provides ample proof that simple but robust management techniques lie at the heart of corporate success. His techniques are undoubtedly the right ones if the company is to avoid repeating its decline into arrogance.

The first lesson is to commit onself to business and cultural change in the long run. Even though, the services business was unprofitable until 1994, IBM stuck to it.

The second lesson is to invest in people and processes. In services business, people are the key. IBM invests $1 bn a year in education and training.

The third lesson is to align resources closely to customer demands.

The fourth lesson is to stick to your core competencies and remain focused on your strategy. IBM did not get distracted by the dotcom craze. The company strongly believed that e-business was about commerce and not about clicks. It was about business and not browsers.

The fifth lesson is to build and leverage multiple value chains. Competitive advantage comes from identifying the role that you can do well and combining it with what alliances and "co-opetition" can do better and quicker.

The last lesson is to adapt, anticipate and innovate. ■

Reference # 15-02-11-01