IBM under Sam Palmisano—Challenges ahead

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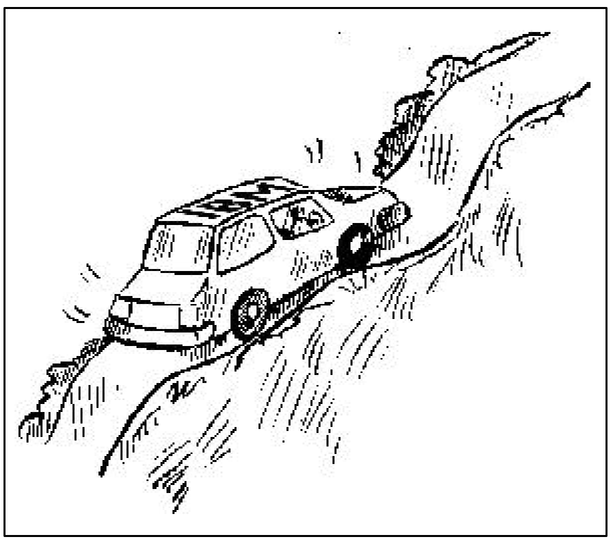
Sam Palmisano became CEO of IBM in early 2002. He has taken charge of a much healthier company than Gerstner did when he came into the scene in April 1993. But Palmisano does face serious challenges. Palmisano has to steer the mammoth company through a slumping market and revamp IBM's money-draining PC business.



Samuel J Palmisano was named as the eighth CEO of IBM on Jan 29, 2002, replacing Louis V Gerstner. He took over the stewardship of the Big Blue on March 1, 2002. Although Palmisano has been at IBM for 28 years, he is not well-known in the computer industry, having kept a very low profile.

Turnaround under Gerstner

The tenor of Gerstner at IBM resulted in one of the most impressive turnarounds in business history. From a loss of $8.1 bn in 1993, Gerstner engineered IBM's turnaround and made it into a services powerhouse. In his 9-year stint, IBM's share prices has risen eightfold and its market value has increased by $150 bn. More focused than ever before, IBM has weathered the technology downturn better than most of its rivals. Gerstner has stepped aside and will stay on as the Chairman till end 2002 to ensure a smooth transition.

Gerstner's winning strategy involved rebuilding the company around its services arm. Gerstner realized that services could act as the glue to bind IBM's disparate divisions together, packaging hardware and software together to provide complete systems for customers. IBM Global services unit is now the fastest growing and accounts for 40% of the company's revenues, up from 21% in 1996. The emphasis on selling services, rather than shifting boxes, helped insulate IBM from the demise of the dotcoms. Gerstner never believed in dotcoms and instead preferred to push the benefits of the Internet to established firms. The multi year contracts that such firms take out with IBM to manage their networks or host their websites provide a reliable source of revenue.

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The eighth CEO of IBM

The success of the IBM Global Services can be attributed in no small measure to Sam Palmisano. He was involved with another of IBM's important strategy: Its adoption of Linux, the free, open source operating system. While in charge of IBM's server division, Palmisano renamed the company's various product lines to reduce customer confusion and pushed the idea of getting Linux to run on all of them with the objective of enhancing compatibility. He helped reshape IBM's entire business by backing Linux, a direct competitor to Microsoft's long-dominant Windows.

As a home-grown IBMer, Palmisano represents IBM's return to tradition. Earlier, Gerstner remained the only outside steward in the company's 91-year history. In the past, Palmisano has shown that he can grow revenue as well as cut costs. Ten years ago, the services division was a small contributor to the overall company's revenues. By signing McDonnell-Douglas to a long-term contract worth \$3 bn, Palmisano gave a fillip to the services division. IBM consolidated and ran the aircraft maker's entire technology infrastructure—27,000 stations among six different sites. Using that as a referral, Palmisano quickly signed up a number of new customers including Hertz, Target, Equifax, Amtrak, Chase Manhattan etc. Today, IBM's \$35 bn Global Services constitute more than 40% of IBM's revenues.

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Palmisano grew up in a middle-class household in Baltimore and attended a Catholic high school. His father was an auto repair shop owner. He entered John Hopkins University in 1969. He played center on the Johns Hopkins football team and was the co-captain.

He joined IBM in 1973 as a marketing trainee associate in the data-products unit in Baltimore. The division handled IBM's mainframes and other servers. Palmisano headed a variety of IBM's large units, including the server business, the services division and outsourcing. He had two stints in Japan, as well and was the only American IBM executive to mange IBM Japan, as opposed to running the company's Asia-Pacific division. The first sign that he would be an IBM standout came in 1988. He was working on the launch of a new computer, the AS/400. Against tough competiton from Digital Equipment, he went into top gear meeting with software companies until he signed up 1,000 developers. That success put Palmisano on the radar screen. In 1989, the then sixth CEO, John Akers asked Palmisano to become his executive assistant.

In 1992, Palmisano got the call that changed everything. Dennie Welsh, a senior executive who was pushing IBM into services, asked him to become president of Integrated Systems Solutions Corporation (ISSC), the group that became the core of Global Services. Welsh is credited with creating IBM's services business. But it was Palmisano who figured out how to make the business grow profitably. At the time, IBM paid sales commissions based on a deal's size. Palmisano decided to base pay on how profitable the deal was. From 1993-96, when Palmisano was president of ISSC, revenues grew from \$14.9 bn to \$22.9 bn.

Management style

As executive assistant to John Akers and as one of the architects of the company's current strategy, Palmisano embodies IBM's past and future. While Gerstner was brusque, autocratic and ideal for the company's turnaround, Palmisano is more gregarious and a good salesman. Where Gerstner tends to be aloof, Palmisano is approachable. Gerstner sparked controversy on his appointment when he was asked what his vision for the company was and responded that "the last thing IBM needs now is a vision".

Palmisano is bold. He backed IBM's exit from the consumer PC business. He has been the primary advocate behind IBM's \$1 bn investment in Linux software, a radical move away from the company's history of proprietary computer operating systems.

He does not believe in forecasts longer than a week. Instead of reviewing 90-day sales forecast, he asks managers what business they plan to close in a week.

Box 1

E-business within IBM: The best way to learn is by doing. IBM has first learnt to apply "e" into business and become e-business. By moving purchasing onto the Web in 1999, IBM reaped savings worth $240 mn on purchases of $11 bn.

Similar moves to put customer support online bring more savings. Getting customers to use the Net to help themselves means big savings. For every service call handled through ibm.com, the company saves 70-90% of the cost of having a person take that call.

E-commerce revenue from the selling of PCs to Mainframe software totaled more than $10 bn in 1999.

IBM estimates that for every 1,000 classroom days converted to electronic courses delivered via the Web, more than $4,00,000 can be saved. IBM does more than 30% of its internal training online with significant savings of more than $120 mn.

E-business strategy for the customers: The Internet is about innovation and integration. Innovation is about cost structures, selling, marketing, supply chain etc. But one does not get innovation unless one integrates Web technology into the processes. True revolution comes from the Web when it can be integrated with the business processes.

Internet will have a major impact will be on the traditional markets. The emergence of electronic marketplaces will have powerful effects, real discontinuities, in the existing structure of markets. The delivery of traditional software and services and hardware over the Net will redefine the rules of conducting business. In fact, that's a form of electronic marketplace.

This is where IBM sees e-business heading. Companies will use the Internet to cut costs, turning for help on how to do it. Companies will need help from Web design to hooking older corporate databases into new online systems. Companies not having the expertise may want to outsource the task of running Web business.

IBM provides the products/services filling the above gap opportunities. IBM offers everything from laptops, PCs to mainframes that plug easily into the Internet. Its software such as MQ Series is becoming the glue that allows machines from different manufacturers to pass messages over the Internet. Other programs such as Net.Commerce handle huge amounts of e-commerce transactions.

Competition to IBM: The table captures the competitive landscape for the different products/services segments in which IBM operates.

S No	Segment	Products/Services	Competition
1	E-Services	Website design to hook older corporate databases into new online systems.	Big companies like Sun, Intel, HP and EDS and upstarts like Lante and Scient.
2	E-Engineering	Use the Net to cut costs.	Accenture and other big consultants.
3	E-Outsourcing	Host the mega data centers.	EDS, Intel and Exodus.
4	Internet software	Internet-related products. For instance, Auction software, MQ Series for messaging.	Microsoft, Cisco and Intel and upstarts like BroadVision.
5	Hardware	PCs and Server.	Sun Microsystems, Dell Computers.

When a division is not doing as well as expected, he intensively reviews its performance through early-morning teleconferences, sometimes several times a week. He keeps hit-lists of rival firms' largest clients and monitors how well IBM is doing at poaching them.

He keeps meetings of 15 minutes and tries to schedule them in the early evening when business winds down. And to top it all, Palmisano is a very customer-focused person.

Palmisano is a man of the people. When IBM shipped its mainframe and storage devices two weeks early in the fourth quarter of 2001, he visited the Poughkeepsie (New York) plant, spending hours walking the shop floor, buying employees coffee and shaking their hands.

E-engineering segment

Like Accenture, Cap Gemini, Ernst & Young and KPMG Consulting, PWC earns most of its money from consulting on IT projects, a business that has slumped with technology spending. With the collapse of Enron and the passage of a new law through

Box 2

Theme: Growth, Execution, Cost cutting, Services push, Hardware hot spots, Boost software.

Gerstner's legacy: In 1993, IBM lost $8 bn. IBM kept growing at an average 5% sales growth over the next 8 years. Before Gerstner, IBM was a slow moving elephant unable to execute quickly. Today, it is lot more responsive. IBM introduces a new UNIX server every 12 months instead of every 2 years. Cut operating expenses from 37% of revenues in 1993 to 24% last year, using the Web to gain efficiencies. Last year, IBM purchased about $45 bn of goods and services over the Net, saving $400 mn. Turned IBM into a services powerhouse. With $35 bn services revenues, it constitutes 40% of the total revenues. There is a contract backlog of $102 bn. Faith in the big iron Mainframe paid off as e-commerce drove sales. Invested wisely in high-end server technology and became a custom-chip supplier to the rest of the industry. The 1995 purchase of Lotus did not make IBM a big application software maker. But in 1999, Gerstner emphasized heavy-duty software such as databases and server programs. IBM's WebSphere server software is No.2 in the market.

Palmisano's challenge: In the last two years, IBM's growth has stalled. However, IBM has fared better than its rivals. Nowadays PCs, storage and semiconductors are trouble spots. In PCs, for example, IBM's cost structure is too high. It has outsourced production of desktops, but it may have to outsource laptops, too, or slash jobs. Progress has stalled. While IBM buys big time over the Web, it sells only 25% of its goods and services online. IBM intends to sign up more small-to mid-size customers and get ahead of the next shift in corporate computing: Delivering technology as a utility like Web service. He must stay a step ahead of rivals in the server business while extending the life of the mainframe. To do that, he must find a way to push mainframes as a less expensive alternative to buying scores of smaller servers. Software division has averaged only 3% growth since 1993 and has fallen to No. 2 position. Palmisano has to make his $1 bn bet on Linux software for big corporate jobs to pay off.

Congress, has made it very difficult for accounting firms to sell audit and consultancy services to the same client. KPMG, Ernst & Young and Andersen had already sold or spun off their consultancy businesses.

IBM had reinvented itself as a services company. While it had a fine grasp of the technical issues, the same could not be said of its understanding of the higher-level strategic thinking. If it failed to dominate strategic consulting, it could lose control of its customers. If other firms put together the strategy and design, IBM risked becoming a subcontractor, competing with EDS, Fujitsu and other rivals for pieces of business that the likes of Accenture designed to farm out. In this context, IBM's recent purchase of PWC's consulting arm makes lot of sense.

The best way to learn is by doing. IBM has first learnt to apply "e" into business and become e-business, before advocating e-business strategies for its customers

Hardware segment

With uncertainity around HP and Compaq merger for the last one year, big customers in the hardware segment that needed a high-powered computer faced a straight choice between IBM and Sun Microsystems. The competition between the two has intensified over the last one year. IBM's mainframe business has been booming because of the growing trend towards replacement of entire room full of servers (many made by Sun) with a single powerful machine (usually an IBM mainframe). The advantage of using one large computer instead of many smaller ones is that it is faster, cheaper and easier to maintain and more flexible. Seeing the growing potential, Sun has started attacking the mainframe market.

Just as Sun is attacking IBM's stronghold, IBM is also attacking Sun's. IBM has unveiled a mid-range Unix Server called Regatta, that incorporates technology borrowed from its mainframes.

Challenges

Palmisano's to-do list and the challenges that he faces post-Gerstner period is discussed in Box 2.

The current environment is tough. The talk of an immediate recovery looks too optimistic. While in the last two years IBM growth has stalled, it has been performing better than its rivals.

Conclusion

Basically, IBM's strategy, e-business, is in place. Gerstner was an excellent strategist while Palmisano knows how to implement it. He is good at execution. The services stint catapulted Palmisano to IBM's upper echelons. While he will have a major impact on the services business, he will make a big effort to gain market share in the networking and server business. Soon he will have to make some hard choices and craft his own game plan. IBM is very big already and its rivals are grumbling that its dominance could herald a return to old, monopolistic ways, at least in services. IBM was once the villain of the industry, a role that it has since ceded to Microsoft. Palmisano must balance a drive for aggressive growth and a desire to prove himself as a worthy successor to Gerstner, with the risk that IBM could come to be seen as the villain once again. ■

Reference # 15-02-12-04

The Top Twenty Global Brands

Company	Rank	2001 Brand Value ($bn)	2000 Brand Value ($bn)
Coco-Cola	1	68.95	72.54
Microsoft	2	65.07	70.20
IBM	3	52.75	53.18
G E	4	42.40	38.13
Nokia	5	35.04	38.53
Intel	6	34.67	39.05
Disney	7	32.59	33.56
Ford	8	30.00	36.37
McDonald's	9	25.29	27.86
AT&T	10	22.83	25.55
Marlboro	11	22.05	22.11
Mercedes	12	21.73	21.31
CITIBANK	1.3	19.01	18.81
Toyota	14	18.58	18.87
Hewlett Packard	15	17.98	20.57
Cisco systems	16	17.21	20.07
American Express	17	16.92	16.12
Gillette	18	15.30	17.36
Merrill Lynch	19	15.02	NA
Sony	20	15.01	16.41

Source: www.BusinessWeek.com.