Assignment II: Mini case study on IBMs transformation to a service-oriented company

Elias Hewig
University of Amsterdam
EliasHewig@gmail.com
10652299

ABSTRACT

'*Adaptable organizations are the ones that survive since environments always change*'. (Fukuyama, 2011).

IBM did successfully adapt in their crisis in the 1990s and survived.

Keywords

IBM Crisis, Organizational Transformation, Adaptive Cycle of Change.

1. IBM – A SHORT INTRODUCTION

International Business Machines (IBM) is one of the few still existing companies with roots back in the 19th century. Initially founded for manufacturing for automated machines recording and counting punchcards, the company transformed its product range and corporate culture for several times over the decades. The company culture was initially characterized by Thomas J. Watson, Sr., who headed IBM from 1914 to 1956, towards a strong sales orientation and community among employees. Afterwards to his formative managing period, IBM underwent two major transformations, which were owned to ICT innovations: first, from the 'mainframe' to the 'service-orientation' phase in the 1990s; and second the transformation from 'service-orientation' to 'global integration' after the year 2001. Semiconductors, scalable computer systems for business applications, CMOS technology and RISC architecture were the ICT-based innovations for the mainframe phase. The transformation to the service-orientation phase came along with ICT innovations as the open UNIX-architecture, personal computers and the rise of the World Wide Web. The transformation to the global integration phase emerged with ICT innovations as open source networks, the commoditization of IT products or the development of the web2.0. [1]

This paper focuses on IBMs transformation towards service-orientation, which had its starting point at the IBM crisis in the 90s. The main purpose of this study is to illustrate how IBM transformed and thus was able to survive. IBM constitutes an interesting and representative case regarding a radical and simultaneously, successful transformation of a big, complex enterprise.

The transformation will be evaluated based on the development path in the adaptive cycle of change as recognized by Parson and Abcouwer (2011). [2] The adaptive cycle of change includes four main transformation phases: (1) from equilibrium to crisis – the release transformation; (2) from crisis to new combinations – reorganization; (3) from new combinations to entrepreneurship – exploitation; and (4) from entrepreneurship to equilibrium – conservation. In short, equilibrium describes a known situation for companies with minor uncertainties; crisis is a highly unknown situation; new combinations defines new alternatives emerging out of the evaluation of the unknown situation; and entrepreneurship stands for the choice of alternatives which are implemented, which can lead to a new equilibrium phase.

The following case description of IBM is based on the book "Who says elephants can't dance" (Gerstner, 2002).

2. IBMs TRANSFORMATION

2.1 Changes in the environment

The disruptive technology around 1990, which affected the operations of IBM dramatically was also responsible for the company slipping into crisis: the development of the World Wide Web, which constituted a milestone in the acceleration of the globalization. According to Jetter et al. (2011), the data and information exchange through the World Wide Web provided completely new capabilities in the market. [1]

Another change in the environment was the newly rising customer demand for systems bundled with software and services both for enterprises and the consumer market. In other words: integrated systems. IBM did not recognize those shifts in their environment early enough, which lead to enormous losses in the beginning of the 1990s.

Moreover, the rise of UNIX and therefore open-source standards affected IBMs core businesses.

2.2 Release: IBM slipping into crisis

IBMs business looked promising until the end of the 90s: revenues could incrementally be increased and IBM PC, as leading computer manufacturer, was well developed with a wide range of complementary products. Thus IBM seemed to be prepared for new customers and users. [3] But the business almost disappeared in the early 90s. In 1993, IBMs losses reached $8.1 billion, after a $4.97 billion loss in 1992 and a $2.8 billion loss in 1991. But how did it come so far?

IBM - as rationally managed and in its complexity growing company before the 90s - was aiming on stability and avoiding risks. IBM performed in the stage of equilibrium and stick to the strategy 'business as usual' as pioneer in the computer technology domain. Stability and predictability of environment combined with market power characterized the situation before 1990.

This lead to a "tunnel vision" as described by Abcouwer & Parson (2011). IBM was at that point a perfectly vertically integrated company, carrying out almost the whole supply-chain in-house: beginning with the design, over manufacturing and commercialization - this included for instance hardware, operating & application software as well as sales and distribution. [4] Furthermore, IBM was producing at a higher price than its competitors. Thus IBM had an expense problem. All in all, IBM had to face new challenges and hence had to align to new environmental shifts, otherwise the company would run bankrupt. The company was now in the middle of a release phase in means of the adaptive cycle of change.

2.3 Management changes as solution approach

External influences as the disruptive technology of networking computers and the rise of the internet lead to a deep crisis at IBM. Describing the term by means of the adaptive cycle if change, the company was in a situation of uncertainty of what they want to do and what can be done. A need for a new direction was no longer deniable. The existing management reached its limit in the crisis situation. According to Abcouwer & Parson, changes may take place by a new management, search for new markets, new partnerships or coalitions and mergers. IBMs' solution approach to the crisis: gain inspiration by a new external manager in order to find a new set of alternatives. The decision for the right alternative and its implementation would be a subsequent challenge.

Louis V Gerstner was hired externally and took up the position of the CEO in 1993. He took over the full responsibility for the reconstruction of IBM. He 'right-sized' the company and changed the core business from manufacturing products to offering services. This took place in a period of almost 10 years, from 1994 until 2001. IBM went through the cycle of change as whole enterprise, calling for change in the management structures and direction across all business units.

2.4 Reorganization and Exploitation

Louis V Gerstner's decisions included cutting expensive business sectors, in which IBM had lost significant market shares to competitors as Hitachi, Fujitsu or Amdahl. This included for instance changing from bipolar to CMOS technology, which lead to enormous returns from 1997 onwards; another example was the selling of unproductive assets as the corporate aircraft fleet. Moreover, Gerstner didn't see any future for IBM in the telecommunication market and sold its data network to AT&T for $5 billion.

The next decision had an enormous significance in the transformation: to align to customer demands instead of developing the most advanced products. As example, senior managers had the assignment to visit and consult customers in order to recognize and to align to their demands. Gerstner explained this action as "a customer is running IBM".

Another action was to dissolve the power of the IBMs Management Committee. Gerstner took over all decision rights. Further strategic decisions introduced an improved communication between business units, creating a global organization for meeting customer demands instead of developing of what the business units wanted. Changing the corporate compensation culture from a focus on benefits - no matter how the unit performed - to performance aspects constituted another paradigm shift in IBMs corporate culture. Executives' salaries were from this moment on also characterized by a stock-based compensation.

Regarding the market orientation, IBMs product focus was changed to middleware, networked applications and web hosting for software products. For the hardware domain, IBM set its focus on selling integrated product solutions, which included hardware and software from various providers instead of producing all components by its own. Gerstner's strategy also embraced to move to open standards. The selling proposition was aligned to offering integrated products coupled with services. In accordance to this focus, IBM started to licensing its products to third parties and selling components to other computer companies. The success was obvious with a resulting income of $500 million in 1994. IBM furthermore built up numerous partnerships with software manufacturers, pursuing their new strategy as integrator of software and hardware. The distribution channels were also down-sized. IBM stopped for instance selling products through retail stores and moved to digital distribution channels.

The term 'e-business' described the strategy of connecting businesses via networks as upcoming technology. IBM therefore moved to open standards, enabling businesses to send messages and data even outside their own networks. This also enabled the growth of the internet how it's known today (2013). This strategy also supported IBMs strategy as integrator.

A fundamental, defining decision was to keep IBM together as one single company instead of splitting it into pieces. Otherwise IBM would probably not exist in the form of a global enterprise as it does currently in the year 2013.

3. SUCCESSFUL TRANSFORMATION

From 1994 onwards, IBM returned making profits, which could incrementally be increased in the following years. After implementing the radical changes, the company reached the phase of conservation in terms of the adaptive cycle of change, consolidating the new strategy and strengthening its new product strategy in the market.

The transformation to a new equilibrium situation took IBM several years, as for that size of company the implementation and complete reorganization takes time. The reinvention of IBM was enabled by moving from a product based company to a customer oriented service-based company. The decision of hiring an external manager was crucial for enabling the organization to change radically. Gerstner changed the corporate culture and his decisions, as for example keeping IBM as one company, were crucial to the survival and success of IBM afterwards to the crisis.

It is hard to state when exactly the company returned to a new equilibrium as IBM went through numerous small cycles of change, in addition to the three major cycles as described in the introduction. IBM survived the crisis, radically transformed and became a globally successful company with a strong focus on customer demands. As companies return to business as usual in the stage of equilibrium, it is hard to predict whether IBM will be able to radically transform again in future. Nonetheless, it is likely that IBM will be able to change again as the company is already familiar with radical transformations.

REFERENCES

[1] Jetter Martin, Satzger Gerhard, Neus Andreas, "Technological Innovation and Its Impact on Business Model, Organization and Corporate Culture – IBM's Transformation into a Globally Integrated, Service-Oriented Enterprise", Business & Information Systems Engineering, February 2009, Volume 1, Issue 1, pp 37-45, 2009.

[2] A.W. Abcouwer and B.G. Parson, "SUSTAINABLE ASSERTIVENESS – THE ADAPTIVE CYCLE OF RESILIENCE: CAN CURIOSITY BE ORGANIZED?", 2011.

[3] Mairi Macintyre, Glenn Parry, Jannis Angelis, "Service Design and Delivery", Springer, 2011, XXII, 170 p., pp 31-40, 2011.

[4] Dittrich, K., Duysters, G., & de Man, A. P., "Strategic repositioning by means of alliance networks: The case of IBM", Research Policy, 36(10), 1496-1511, 2007.