Investigating the organizational turnaround at ibm

" Who Says Elephants Can't Dance" describes how Louis Gerstner lead the organizational turnaround at IBM when it was at the verge of extinction. Louis Gerstner was the chairman and CEO of IBM from April 1993 to March 2002. Before joining IBM, he had worked on various consulting assignments at McKinsey and led successful organizational changes at American Express and RJR Nabisco.

During the early nineties, IBM was rapidly losing its market share in most of the markets it catered to its competitors. The management was planning to break the organization into individual businesses. Soon after his appointment as CEO, Gerstner identified that the unique competitive advantage of IBM was due to its scale and broad-based capabilities, and therefore advocated that " keeping the company together" will help IBM to utilize this unique advantage by positioning itself as software integrator. Gerstner was instrumental in shifting the mental model of employees from self-centric to customer-centric. He found that most important aspect of organizational change at IBM was its culture – " I came to see, in my time at IBM, that culture isn't just one aspect of the game-it is the game".

In this report, I have analyzed the various levers[1]of organizational change, how Gerstner realigned them at IBM and the extent to which implementation of his strategy at IBM can be considered successful. I have also analyzed the actions taken during this massive organizational turnaround and recommended additional actions which I believe should have been taken.

Organizational re-design at IBM

IBM during early 90's saw itself losing market share to its competitors. The problems were not technical in nature as the company was full of smart, talented people. Gerstner found that the problems were mainly related to " execution" and " culture" of IBM. As a result, he implemented changes and re-aligned various components of organization to bring about a positive turnaround (as mentioned below):

Strategy

Gerstner gave a lot of importance to customer needs and soon after joining IBM, he started conducting meetings with various customers. Based on the feedback from the customer meetings, he decided to offer a price reduction for mainframe computers – one of his early steps towards implementing his customer-centric strategy. This not only helped IBM to gain support from its major customers by establishing credibility[2]but it also helped IBM to move ahead in Technology curve by using superior CMOS technology. Gerstner further launched " Operation Bear Hug" to emphasize his customer focused approach which also became his first step towards IBM's cultural change.

In July 1993, Gerstner indentified (and later implemented) four major strategies for the recovery of IBM-

Keep the company together- This strategy was implemented in order to help IBM to utilize its competitive advantage (resulting from its scale) and offer integration services to clients.

Change the fundamental economic model- This strategy started by comparing expense-to-revenue of IBM with its competitors. Due to higher

expenses at IBM as compared to competitors, a massive program for expense reduction was launched.

Reengineer how business was done- Gerstner saw that the IBM processes were cumbersome, highly expensive as well as redundant. He introduced a re-engineering initiative which drastically reduced the overhead expenses of IBM.

Sell underproductive assets in order to raise cash- Under this strategic objective, IBM sold off unproductive assets to raise cash.

In September 1993, Gerstner articulated the eight principles which will define the priorities of " new" IBM. Later, he formulated a strategic vision for IBM around " Services-Led Model". His vision was to position IBM as technology integrator in this industry. He also made a bet towards " network-centric computing" which later gave rise to " e-business" – the convergence of internet and business. Later, he implemented a strategy to further strengthen the IBM's software business by acquiring middleware firms as well as product firms such as Lotus. In order to keep a strong focus on the existing IBM portfolio, he divested the application software business which opened partnership doors with application software leaders such as Seibel. This also helped IBM to cut its losses in application software business, free up its resources and spend more time in focusing what customers want.

Another important aspect of IBM's strategy was its marketing strategy. Earlier, IBM used to have multiple advertising agencies hired by various product managers. Gerstner hired Abby to analyze the marketing strategy of IBM and she suggested a need to consolidate all of the IBM's advertising

relationships into a single agency. This approach not only saved the unnecessary huge advertising expenses resulting in confusing message for customers but it also gave rise to innovate advertising(" Solutions for a Small Planet") which helped IBM transform its brand image to a global centralized firm with the ability to become world class integrator. Another campaign coined the term " e-business" which helped IBM to establish itself as a leader of the most important trend in the industry.

Structure

The first challenge for Gerstner was to make a decision on whether to break the company or keep the company together. After talking with various stakeholders including customers, he found that the competitive strength of IBM lies in its size which can provide a unique opportunity to the company to position itself as technology integrator in services space. As a result, he decided to keep the company together.

The next challenge for Gerstner was to modify the existing organizational structure. Over the years, the structure of IBM has evolved in two directions – as powerful geographic units and as powerful product divisions. Geographical units attempted to own everything in their region and the product divisions built what they wanted to build. There was no focus on customer needs. Also, there was lot of redundancy in operation of various business units and each unit had its own financial system – " In Europe alone we had 142 different financial systems". All the business units competed with each other with no coordination between their activities. As a result, there was an urgent need to " break up the Fiefdoms". Gerstner decided to

organize the company around global industry teams and broke out the IBM's customer base into twelve groups: eleven industries and a final category covering small and medium-size business. The company was then aligned around these groups covering various industries. This was a good decision since it not only helped the company to align with its customers but also removed redundant operations leading to cost synergies.

People/HRM

Thomas J. Watson, Sr. has instilled three basic beliefs in IBM :

Excellence in everything we do.

Superior customer service.

Respect for the individual.

The interpretation of these beliefs changed from what it meant in 1962. " Excellence in everything we do" became the bottleneck of product development. This is due to a slowed decision making process which resulted from this obsession to perfection. " Superior customer service" now meant " servicing our machines on the customers' premises" rather than paying attention to their changing business needs. " Respect for the individual" resulted in a culture of entitlement in the minds of employees. Another important aspect which Gerstner saw at IBM was the formal dress code. He ended this dress code since he saw a change in customer profile in 1990s as compared to 1960-70s.

In order to transform employees' beliefs with changing times, Gerstner developed following eight basic principles which defined the priorities of new IBM:

The marketplace is the driving force behind everything we do.

At our core, we are a technology company with an overriding commitment to quality.

Our primary measures of success are customer satisfaction and shareholder value.

We operate as an entrepreneurial organization with a minimum of bureaucracy and a never-ending focus on productivity

We never lose sight of our strategic vision.

We think and act with a sense of urgency.

Outstanding, dedicated people make it all happen, particularly when they work together as a team.

We are sensitive to the needs of employees and to the communities in which we operate.

In order to focus the attention of employees towards the topics of leadership and change, Gerstner formed Senior Leadership Group (SLG) in 1995. He also gave high priority to promote and reward those executives who accepted the new culture at IBM. This helped in sending out a signal to all the executives that the path to success has changed.

Another important aspect of people management by Gerstner was the use of PROFS for internal communication with employees. This helped him to get closer with the employees at IBM and also share their concerns.

Rewards

The existing compensation system at IBM consisted primarily of salary with a little amount paid in bonus. Also, the existing system offers a little differentiation in salaries of employees based on their performance. This actually reduced the incentive for an employee to compete with his/her peers. The existing compensation system offered huge paternalistic benefits to IBM employees in line with the philosophy of Watson, Sr. Gerstner found that this incentive structure was not in accordance with current business world. He introduced " pay by performance" incentive structure and offered a portion of salary as variable. The bonus of an employee depended on the performance of his/her unit as well as the business. For the highest level executives at IBM, the bonuses were based entirely on company's overall performance. On the other hand, the executives at the next level down were paid 60% based on IBM results and 40% based on business unit results.

Gerstner used external benchmarks rather than internal benchmarks for performance evaluation. He offered stock options to IBM employees and made it the highest component of executives' pay. He also ensured the executives have their " skin in the game" by creating a guideline which ensured that executives have invested their own money into the direct ownership of company's stock. Overall, all these changes not only helped in

aligning the incentives of employees with that of company but also made them more productive.

Information & Decision Support

Gerstner saw a need to make changes in some of the existing processes in IBM. One such process was the slow decision making and information flow among various business units (and headquarters) due to clashes between geographic units as well as product teams. In order to resolve this problem, Gerstner introduced a new organizational structure to improve the decision making process and enhanced the information flow[3]within IBM. Another bottleneck in the IBM process was the management committee which comprises of six powerful IBM employees. Gerstner ended the concept of management committee since he found that IBM people have learned how to exploit the system to promote their own agendas. As a result, the purpose of the management committee was no more than a rubberstamp formality for a proposal. Overall, the changes which Gerstner introduced in the organizational processes were vital in improving the speed of organizational processes.

Evaluation of organizational change at IBM

In order to evaluate the extent to which the implementation of strategy at IBM was successful, I looked at changes implemented by Gerstner in various organizational components (as shown above) and found them successful. I also saw an alignment in his organizational change decisions across various components, evident from following analysis: – Gerstner advocated a customer-centric strategy at IBM and in order to implement this strategy, he

changed the organizational structure of IBM towards customer-based structure. Further, he aligned the processes (Information & Decision Making) with the customer-centric strategy by improving the speed. Also, the incentives of the employees were not properly aligned with the demands of a new customer-focused IBM. As a result, he introduced performance based reward system and also implemented further changes in executives' salary structure. He also articulated his eight basic principles in order to align the employee's belief with his vision. As a result, I found all these decisions taken by Gerstner well aligned with each other.

On a broader analysis, I looked at various aspects of the execution and compared the various steps employed by Gerstner with the Golden's four stage organizational change model. The first step in the four stage model is to determine the desired end state. Based on the Gerstner's approach in the book, I found that there was some sense of direction but not a lot of clarity. The second stage is to assess readiness for change. Since there was a sense of urgency and support from top management on this change, so I feel that readiness for change was present. The third stage comprises of organizational re-design and broadening support. Gerstner was successful in communicating a need for change to the employees and was quite successful in re-design process (discussed previously). The fourth stage is sustaining change which was not evident in Gerstner's book since it does not capture any current account on monitoring and re-evaluation of change. Further, based on recipe of change (Ambrose, 1987), I saw that Gerstner's change effort had a vision, skill, incentive, resources as well as an action

plan. Overall, based on my analysis, I see that Gerstner's implementation of this change strategy was completely successful

Critique on actions taken and recommendations

Gerstner took a number of actions during his stint at IBM. The previous section of this report describes the evaluation of the actions taken by Gerstner during the organizational re-design at IBM. I found all those actions had a positive impact on the overall organizational culture and were very helpful in turn-around of IBM. In particular, " Operation Bear Hug" was one of the more important actions since it showed the importance of customers to IBM employees who have been ignoring them in past. I also found his decisions to move to service industry and e-business as excellent decisions. On the other hand, there were a few actions Gerstner took which I could not find satisfactory. One such action was the IBM's entry in DRAM business. Here, I found the Gerstner was more focused on a short-term objective and that he had taken un-necessary risk since he knew that market was cyclic. Later, he decided to remain in this business despite of losses just to show customers that IBM is serious about the component business. Despite of all this, he finally exited from this business. I saw a lack of clarity in his long term vision of components business. Another thing was the decision to remain in the PC business. Even though Gerstner was not satisfied by the PC business – " Still, it's a spotty record at best, and I am not terribly proud of it", still he decided to keep this business based on the assumption that PC drove company's image in the industry which seems illogical to me since IBM was trying to move to services business from product business.

In terms of the actions which were not taken, I found the first action was utilizing the power of open-source Unix Operating system. IBM should have established a partnership with UNIX for its servers which could have hampered windows OS penetration in server market. Another important action was related to the compensation structure. I think that Gerstner should have made more changes in reward component by aligning a part of employee's compensation with the his/her sense of cooperation – an approach introduced by Jack Welch – highlighted during the class discussion of GE's case.

Conclusion

Gerstner brought a complete turnaround for IBM. He showed how important is execution for the success of a company. Another important aspect of his leadership was the detailed insight he had regarding the execution of a strategy as well as the interplay between human behavior and the execution process. This is evident from Gerstner comment- " People Respect What You Inspect" and also from- " I believe effective execution is built on three attributes of an institution: world-class processes, strategic clarity, and a high-performance culture".

In case of IBM, I also saw that the decision between centralization vs. decentralization played an important role in the restructuring process. While analyzing the actions taken by Gerstner, I found most of them had a very positive impact on the culture of IBM except few actions which were very short-sighted. Gerstner did an excellent job in launching " Operation Bear

Hug". He was also instrumental in making a new board for IBM which comprised of all the external directors except Gerstner.

Another positive aspect of Gerstner's action was the immediate realization that competition in PC will lead IBM to " nowhere". As a result, he started focusing on middleware applications and distributed application since he saw that the middleware application fills the gap in the services industry. One of the most important decisions for Gerstner was to move away from OS/2 and focus towards services industry.

Gerstner not only articulated excellent principles (8 steps) to his fellow employees but also implemented them at IBM. He also helped IBM to adapt to the changing business environment unlike many other firms who failed to do the same. Overall, I think that Gerstner was almost completely successful in implementing his strategies for a turnaround at IBM.

Final Page

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