

Driving Strategy into Action at IBM¹

In the past 15 years, the IBM Company has undergone a remarkable transformation from a struggling seller of hardware to a successful broad range solutions provider. While there are many reasons for this success, at least part of it has been in their ability to both sense and seize opportunities and to reconfigure the company's structure and competencies to address these. In strategic terms, these dynamic capabilities have been made real through an ongoing process of disciplined, fact-based conversations, a common language and problem solving methodology embedded in the IBM Business Leadership Model, and a clear commitment by leaders to compete in mature as well as emerging markets. This language and process is employed throughout the company—from the senior executive levels to first level managers. It is an integrated way to focus on both the formulation of strategy and its implementation.

The IBM case example demonstrates an approach to strategy that permits them to both explore new markets and technologies (e.g., life sciences, pervasive computing) as well as to exploit mature products and markets (e.g., mainframe computers, middleware).

IBM: the turnaround

Through the mid-1980s IBM enjoyed 40 percent of the computer industry's sales and 70 percent of its profit. In 1990 IBM sales were five times their nearest rival, but growth had slowed to less than six percent. Analysts at the time described the company's position as a "dangerous mix of arrogance and complacency."² In the early 1990s, many Wall Street analysts had written off IBM as a company; its stock price was the lowest it had been since 1983. By 1992, more than 60,000 jobs had been lost and, and despite efforts at transformation, the company was failing. When Lou Gerstner took over in 1993, the services unit was 27 percent of revenues and the software unit didn't even exist. In 2001, services and software were \$35 billion and \$13 billion businesses respectively and combined represented 58 percent of total revenues. IBM's market cap had increased from \$30 billion in 1993 to \$173 billion. The share price over that period increased 7X. Since then, with Sam Palmisano as CEO, IBM has continued this remarkable transformation so that today, IBM has revenues of \$91 billion, more than 70% from software and services. During a 20 year period, IBM has gone from success to failure to success; from a technology company to a broad-based solutions provider to, perhaps, an exemplar of the new world of open systems and on-demand capabilities. Unlike other great technical companies such as Xerox, Philips and Polaroid that failed to capture the benefits of their innovation, IBM has been able to leverage their intellectual capital into businesses as diverse as life sciences, automotive and banking—and make healthy profits along the way.

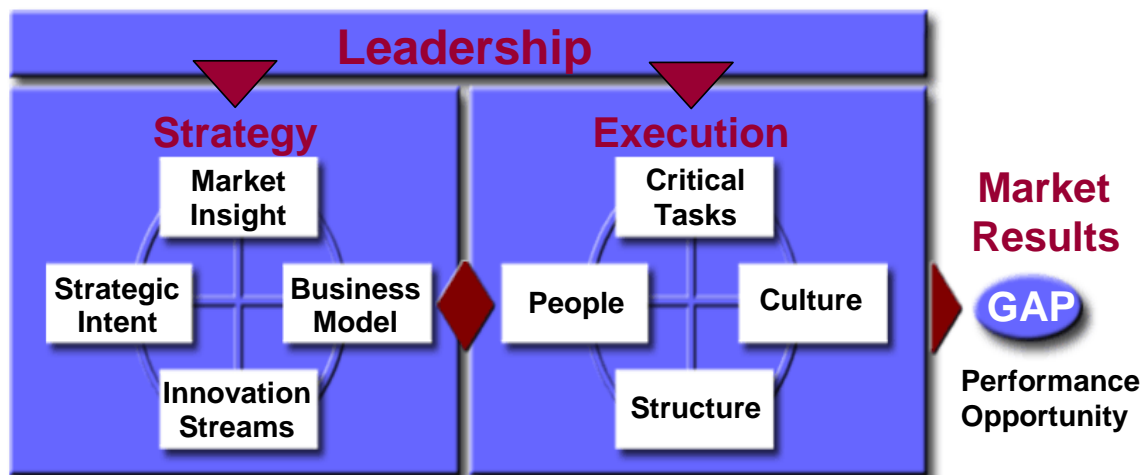
¹ This is a shortened version of an article that appeared in *California Management Review*, September 2007, *Dynamic Capabilities at IBM: Driving Strategy into Action*, J. Bruce Harreld, Senior Vice President, IBM, Professor Charles A. O'Reilly III and Professor Michael L. Tushman

² *Business Week*, June 17, 1991.

IBM's new approach to strategy

Although theories of strategy can be elegant in their formulation, they are often less helpful in practice. What passes for strategy in many organizations too often consists of three-ring binders, power point slides, and annual meetings as carefully scripted as a *Kabuki* drama—and, just as in the Japanese version, those who fail to play their roles often suffer an organizational fate much like the villains in the play. Worse, many strategists typically don't want to get their hands dirty with the myriad of details necessary for successful execution. As a result, in many organizations a barrier exists between strategists and operational executives.

Until 1999, IBM followed this familiar pattern – with an annual document that purported to describe a unit's marketplace (e.g., competitor moves, technology changes) and what the financial implications were for the business. Irritated with what they saw as a 'staff driven' process, Lou Gerstner and Bruce Harreld, SVP of Strategy, set about remaking the company's approach. What emerged was the "IBM Business Leadership Model" that encompasses a process of *strategic insight* (strategic intent, marketplace insight, innovation focus, and business design) designed to systematically identify opportunities and *strategic execution* (alignment of people, structure, culture, and process) designed to seize opportunities by ensuring that every strategic initiative also had an associated plan for execution. From this perspective, strategy doesn't matter unless it changes what the company does in the marketplace. Otherwise it's "chartware".



Source: Adapted from *Winning Through Innovation*, Tushman & O'Reilly, 1997, in our work with IBM

In the IBM model, strategy is stimulated by leaders' dissatisfaction, described as a performance gap (a shortfall between expected and actual results), or aspirations, described as an opportunity gap (a discrepancy between current business results and those achievable with a new business design). General Managers define their gaps in terms of a clear business owner, financial metrics that quantify the gap, and a specific time frame for addressing it (Figure 2 provides several examples). Closing the gap requires both strategic insight to assess the opportunities and threats and strategic execution to build the capabilities to deliver market results.

Strategic Insight emphasizes four interrelated disciplines:

- *Strategic Intent* sets the overall direction and goal for the organization.
- *Market Insight* involves a focus on understanding customer needs, competitor moves, technology developments, and market economics.
- *Innovation Streams* challenges general managers to actively experiment and challenge their thinking in the design and implementation of strategy,
- *Business Design* specifies how the business will go to market, its customers, value proposition and the sustainability of its competitive positioning.

Strategic Execution is based on an honest appraisal of current four key organizational capabilities:

- *Critical Tasks* are the key activities necessary to deliver on the business design.
- *Structure* is the explicit formal organization, metrics, and rewards required to direct, control, and motivate individuals and groups to perform the unit's critical tasks.
- *People and Skills* is the requisite human resource characteristics, capabilities, and competencies needed to execute the critical tasks.
- *Culture is the* expectations about how people need to behave to support the accomplishment of the critical tasks.

The successful execution of strategy critically depends on the alignment of these 4 elements with the strategy. What is sometimes overlooked, however, is that whenever a strategy is changed, it is almost always the case that the existing organizational alignment will also need to be changed. Unless management actively realigns their business to reflect the new strategy, execution will suffer.

IBM's Dynamic Capabilities

Gerstner's vision of IBM's future was built around a new strategy: "Our bet was this: Over the next decade, customers would increasingly value companies that could provide solutions—solutions that integrated technology from various suppliers and, more importantly, integrated technology into the processes of the enterprise."³ The core competence required to execute this strategy was the ability to integrate—open middleware (the software that permits applications to be used across a variety of platforms) and services were key to this. Commenting on whether IBM, a traditional hardware company, could make this transition, Gerstner said, "Services is entirely different. In services, you don't make a product and sell it. You sell a capability...this is the kind of capability you cannot acquire."⁴

Competencies are embedded in organizational processes or routines around coordination, learning and transformation. For IBM, this meant it would need to take its existing competencies in technology and quality and add to them the capability to learn better how to serve the customer, integrate the organization around the customer's needs, and to transform themselves from a great product company to one that solved customer's problems. To ensure that the strategy process provides the insight necessary to sense

³ Gerstner, 2002, op cit, P. 123.

⁴ Op cit., P. 133

opportunities and the execution required to seize them, a set of complementary mechanisms have evolved.

Sensing New Opportunities -- Strategic Insight

- The ***Technology Team*** assesses the market readiness and potential of emerging technologies, drawing on the deep expertise of IBM Fellows and Distinguished Engineers.
- The ***Strategy Team*** examines the market results of existing unit strategies as well as to explore new growth areas. It blends the expertise of general managers, strategy executives, and other key functional leaders.
- The ***Integration & Values Team*** is a group of 300 key leaders, selected annually by the CEO and senior executives who lead corporate-wide strategic efforts known as ***Winning Plays***
- A ***Deep Dive*** is a structured process, typically requested by a general manager confronting a performance or opportunity gap and staffed jointly by the operating unit and the strategy group. This is an intensive, analytical, focused process where a topic (e.g., a new technology or change in competition) is scrutinized in great detail.

Seizing New Opportunities -- Strategic Execution

In addition IBM has a set of mechanisms to help seize these by reallocating resources and, when needed, recombining and reconfiguring assets and structures as markets and technologies change.

- ***Emerging Business Opportunities (EBOs)*** are an integrated set of processes, incentives and structures designed explicitly to enable IBM to address new business opportunities. The EBO process begins with the recognition that mature, well-established businesses need to operate differently from new, exploratory ones. To succeed, emerging businesses have different key success factors and require a different style of leadership and different alignments of people, formal organizations and culture. IBM recognized that the current management system rewarded short-term execution aimed at current markets. Trying to operate new business within a mature one can be exceedingly difficult, with the result that the new business is often killed. Further, the company lacked the disciplines for selecting, experimenting, funding, and terminating new businesses. This led to the development of a process to identify new growth opportunities and to establish separate new organizations with their own leadership, alignment, and funding—all with senior management oversight to ensure that the new businesses got the resources needed to explore the opportunity. Between 2000-2005, 22 EBOs were established and of these 14 graduated to become part of the core business, while the rest failed and were withdrawn. By 2006, EBO initiatives have contributed over \$14B in revenue—far superior to acquisition – driven growth. There are now 180 EBOs across IBM.
- The ***Strategic Leadership Forums (SLFs)*** are 3 ½ day team-based workshops built around specific performance or opportunity gaps that bring extended teams together for intensive work on problems or opportunities. These workshops begin with work on refining the gap statement, challenging the strategy, a deep root cause analysis of the specific underlying causes of the performance or opportunity gap, and the development of an action plan. Built around the research and tools of Professor Tushman & Professor O’Reilly, this process helps line managers to have a

structured, candid conversation with a common language—and to explicitly link strategic insight to execution in a disciplined way. Over a 3 ½ year period, there were 23 Strategic Leadership Forums that hosted 113 teams and more than 1700 executives. These forums were used to address significant strategic initiatives such as accelerating the development of Emerging Business Opportunities like Life Sciences, as well as addressing performance gaps within mature businesses. The SLF is not simply education but a mechanism to solve major strategic problems. It provides a powerful common methodology and language which is used throughout IBM and facilitates a common systematic approach to strategic initiatives.

- The ***Corporate Investment Fund*** was developed as a way of providing funding for new initiatives identified by the I&VT or EBOs. This \$500M fund was taken from existing units and specifically designed to provide the resources to start new initiatives. It is not the conventional internal venture fund found in many companies. Rather, it is designed with the recognition that the annual budgeting process may not be sufficiently responsive to fund new initiatives as they emerge during the year—especially those that cut across business units and may not be attractive enough for any specific business to fund by itself.

Taken together, these processes emphasize strategic insight and execution and general management leadership responsibility. While many organizations have several of these elements as a part of their strategy process, what is different about the IBM approach is that they have an integrated set of mechanisms to both sense and seize opportunities. This allows the firm to consider trends in markets and technology and identify issues that are relevant to customers, examine them in detail, and to reconfigure assets to address these. Once these decisions are made, this allows the new initiatives to be embedded into the disciplined machine that characterizes IBM's more mature businesses.

Learning from the IBM approach

The IBM Business Leadership Model explicitly makes three important points. First, leadership by general managers requires both strategic insight and execution. Second, this is anchored on either a performance or opportunity gap as manifest in hard performance outcomes such as market share gain, margins, growth, or profit. Third, this process highlights the importance of alignment or complementarities among the components. For example, strategic execution occurs not from attention to people or incentives or culture but from the alignment of all of these with the critical tasks necessary to execute the chosen strategy. Effective strategy is not simply the articulation of a strategic intent but the linking of this to innovation, solid marketplace insight, and an appropriate business design. The overarching challenge is to ensure general management involvement and ownership in this process—and not to let it become a staff function. As useful as the IBM Leadership Model is in framing the strategic challenge, the risk is that it becomes “chartware”—and lower level managers become cynical about it.

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