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IBM NEWCO: A HIGH-STAKES SPINOFF AMID A BATTLE OF THE TECH TITANS

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Two months after his January 1, 2021, appointment as chief executive officer (CEO) of NewCo, the code name for the soon-to-be spun off managed infrastructures services portion of International Business Machines Corporation (IBM), Martin Schroeter was faced with the daunting prospect of creating a distinct strategy and identity for a huge company in a very short time frame. Announced on October 8, 2020, by IBM's CEO, Arvind Krishna, NewCo was a high-stakes strategic move to "create value through focus" and "increased agility to focus on evolving customer needs and delivery excellence." Once spun off, NewCo would immediately become the world's leading managed infrastructure services provider, with US$19 billion[1] in revenue, 90,000 employees, and 4,600 customers, including more than 75 per cent of the Fortune 100 across 115 countries. With the spinoff expected to be complete by the end of 2021, Schroeter had only a few months to craft a strategy, recruit a leadership team, define a new identity for the company, ensure a "strong strategic relationship" with IBM, and bring thousands of customers and tens of thousands of employees into NewCo. Success required many pieces to come together rapidly and seamlessly. Schroeter was unsure how best to address these challenges. All he knew was that failure was not an option and that time was short.

COMPANY BACKGROUND

Incorporated and headquartered in Armonk, New York, in 1911 and viewed for decades as an iconic leader in computing, IBM provided technology products and services worldwide through five main segments: Cloud & Cognitive Software, Global Business Services, Global Technology Services, Systems, and Global Financing (see Exhibit 1). In 2020, IBM employed 345,900 people worldwide and generated $73.6 billion in revenue and $5.5 billion in net income—down from $79.5 billion and $8.7 billion, respectively, in 2018 (see Exhibit 2).

After eight years of persistent underperformance against the S&P 500 and NASDAQ composite indices, the IBM board of directors voted in January 2020 to replace then-CEO Ginni Rometty with Arvind Krishna, IBM's Cloud & Cognitive Software's senior vice-president, effective April 6, 2020 (see Exhibit 3). While IBM's performance had declined to the point that famed investor Warren Buffett sold all of his IBM shares

[1] All amounts are in US dollars unless stated otherwise.

after an "agonizing seven-year stretch,"[2] Krishna had gained prominence in 2018 by championing IBM's foray into open-source architecture with the $34 billion strategic acquisition of Red Hat, "the world's leading provider of enterprise open source solutions"[3] (see Exhibit 3). As Rometty commented when Krishna was elected CEO, "Through his multiple experiences running businesses in IBM, Arvind has built an outstanding track record of bold transformations and proven business results, and is an authentic, values-driven leader. He is well-positioned to lead IBM and its customers into the cloud and cognitive era."

SPINOFF STRATEGY

In his October 8, 2020, IBM Strategic Update Arvind Krishna, along with chief financial officer, James Kavanaugh, laid out his plans for addressing the $1 trillion opportunity represented by the migration to cloud computing. They estimated that the opportunity segmented into a $300 billion opportunity for cloud transformational services, a $450 billion opportunity for cloud software and platforms, and a $230 billion opportunity for cloud infrastructure. They also argued that IBM had positioned itself for success in these markets by building strength in hybrid cloud and artificial intelligence (AI), accelerated by a strong market adoption of Red Hat. Next, IBM would strengthen its leadership position, accelerate its growth through increased focus and investments, and simplify its operating model.

The focus on the cloud-based market also created both a need and an opportunity for a more focused approach to application and infrastructure services, and IBM announced a "spin-off of the Managed Infrastructure Services business of its Global Technology Services segment (NewCo)." Both companies were expected to be independent and would pursue different segments—hybrid cloud, platform innovation, AI, and digital transformation for IBM, and information technology (IT) infrastructure modernization and service delivery excellence for NewCo. At the same time, each company would leverage the other with a strong strategic relationship (see Exhibit 4.)

The NewCo spinoff was designed to "create value through focus." NewCo would immediately become the "world's leading managed infrastructure services provider, twice the size of the next largest provider [DXC Technology], with increased agility to focus on evolving customer needs and delivery excellence."[4] The spinoff was designed to put the two companies on different growth trajectories. With greater financial flexibility and ability to partner and capture new opportunities, IBM would pursue high growth and at least 20 per cent margins in the cloud business; NewCo would aim for a 6–7 per cent growth rate in a lower-margin segment, fuelled by access to a $60 billion backlog in orders for NewCo's services and a $500 billion market opportunity to modernize and manage customer-owned technology infrastructure. Based on trailing twelve months of revenue through June 30, 2020, IBM was expected to generate $59 billion and NewCo $19 billion by the end of 2021.

If all went as planned, IBM would become the high-growth engine that it was in 2010–2012, and NewCo would have the focus, people, freedom to form new partnerships, and investment needed to grow steadily and become the dominant competitor in the managed infrastructure services space. But the plans all depended on finding a CEO with the ability to deliver such a large spinoff in the hyper-competitive technology services business.

For the NewCo CEO job, Krishna and the board tapped Schroeter, a seasoned IBM executive whose last position was senior vice-president for the firm's Global Markets segment. In this position, Schroeter had

[2] Matthew J. Belvedere, "This Decade Saw Warren Buffett Finally Turn His Back on IBM and Jump Big Time into Apple," CNBC, December 31, 2019, https://www.cnbc.com/2019/12/31/this-decade-saw-warren-buffett-finally-exit-ibm-jump-big-into-apple.html;, accessed May 28, 2021.
[3] Red Hat Corporation, "Cloud Constraints? Challenge Accepted," accessed on July 25, 2023, https://www.redhat.com/en.
[4] IBM Corporation, "IBM Strategic Update 2020."

been responsible for IBM's revenue, profit, business development, and customer satisfaction worldwide, and had honed the necessary mindset to excel in a global leadership position. A graduate of Temple University's Fox School of Business and Carnegie Mellon University's Tepper School of Business, Schroeter had also been responsible for IBM's Global Financing business, the world's largest captive IT financier, as well as IBM's marketing and communications functions, which were responsible for building the company's brand and reputation globally and was the firm's corporate controller. In short, Schroeter had learned a tremendous amount about IBM, its people and capabilities, and about the markets and industries in which it competed—all of which prepared him well to guide NewCo.

MARKET CHALLENGES

IBM was rated one of the leaders in the "Data Center Outsourcing and Hybrid Infrastructure Managed Services" quadrant and a "major player" in the "Data Processing & Hosting Services in the US" industry.[5] According to Gartner, the worldwide IT services market was expected to reach $1.3 trillion in 2024 and was dominated by data centre and infrastructure services.[6] Within this, the managed services market was very competitive, including rapidly expanding challengers such as DXC Technology (DXC), numerous established lower-margin competitors such as Wipro, HCLTech, and Tata Consultancy Services (TCS), and brand names such as Accenture plc and Dell Inc. (see Exhibit 5).

Of these, perhaps DXC was the most formidable. It was formed by the merger of Computer Sciences Corporation and The Hewlett-Packard Company's enterprise business (which included Ross Perot's Electronic Data Systems) and had a long history of providing IT services and solutions to a range of industries in the private and public sectors. DXC focused on IT modernization, including on premises and in the cloud, data-driven operations, and workplace processes; its services included analytics, business process, consulting, enterprise and cloud apps, the creation and management of modern workplace, and security.[7]

The competition between firms was not just about market share; they also competed fiercely worldwide for staff. The global IT labour shortage was expected to grow to 4.3 million workers by 2030, resulting in close to $450 billion in unrealized output.[8] The IT job market, fuelled by the pandemic, was fluid, workforce mobility was high, and although it was easier to recruit, it was equally easy to lose staff, who were comfortable with changing locations and working at any time and from any place.[9] NewCo would enter the market with a strong group of skilled employees used to the IBM way—not necessarily the rough-and-tumble of the cutthroat managed services market or meeting customers where they were. One of the challenges for Schroeter was retaining key, highly skilled workers while attracting new ones to upskill the existing mix of staff.

Although it would start in a strong position in the marketplace, NewCo was going to have to work hard to transition IBM customers and to maintain its leadership position in the managed infrastructure services sector. Soon after his appointment, Schroeter began a listening tour, spending at least 40 per cent of his

[5] Mark Ray, Daniel Barros, Stephanie Stoudt-Hansen, Andrew Miljanovski, and Leah Ciavardini, "Magic Quadrant for Data Center Outsourcing and Hybrid Infrastructure Managed Services, North America," Gartner, June 9, 2020, https://www.gartner.com/en/documents/3986143; Jeremy Moses, "Data Processing & Hosting Services in the US. Industry Trends (2017–2022)," IBISWorld, Industry Report 51821, https://www.ibisworld.com/united-states/market-research-reports/data-processing-hosting-services-industry/.
[6] Ray et al., "Magic Quadrant for Data Center Outsourcing."
[7] "DXC Technology Co DXC.N—Profile," Reuters, accessed May 14, 2021, https://www.reuters.com/companies/DXC.N/profile.
[8] Korn Ferry, "Future of Work: The Global Talent Crunch," 2018, accessed on July 25, 2023, https://www.kornferry.com/content/dam/kornferry/docs/article-migration/FOWTalentCrunchFinal_Spring2018.pdf.
[9] Munir Mandviwalla, Dinesh Desai, Linda Descano, Larry Dignan, Chris Kearns, and Raghu Sankaran, "Guest Editorial: An Industry Perspective on Major Post-pandemic Issues," *MIS Quarterly Executive* 20, no. 1, Article 2 (2021), https://aisel.aisnet.org/misqe/vol20/iss1/2.