



THE HBR INTERVIEW



Leading Change When Business Is Good

An Interview with Samuel J. Palmisano

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NORMAN JEAN ROY

Change *Leading* *When Business* *Is Good*

Interviewed by Paul Hemp and Thomas A. Stewart

IN JULY 2003, International Business Machines Corporation conducted a 72-hour experiment whose outcome was as uncertain as anything going on in its research labs. Six months into a top-to-bottom review of its management organization, IBM held a three-day discussion via the corporate intranet about the company's values. The forum, dubbed ValuesJam, joined thousands of employees in a debate about the very nature of the computer giant and what it stood for.

Over the three days, an estimated 50,000 of IBM's employees—including CEO Sam Palmisano—checked out the discussion, posting nearly 10,000 comments about the proposed values. The jam had clearly struck a chord.

But it was a disturbingly dissonant one. Some comments were merely cynical. One had the subject line: "The only value in IBM today is the stock price." Another read, "Company values (ya right)." Others, though, addressed fundamental management issues. "I feel we talk a lot about trust and taking risks. But at the same time, we have endless audits, mistakes are punished and not seen as a welcome part of learning, and managers (and others)

are consistently checked," wrote one employee. "There appears to be a great reluctance among our junior executive community to challenge the views of our senior execs," said another. "Many times I have heard expressions like, 'Would you tell Sam that his strategy is wrong!!?'" Twenty-four hours into the exercise, at least one senior executive wanted to pull the plug.

But Palmisano wouldn't hear of it. And then the mood began to shift. After a day marked by critics letting off steam, the countercritics began to weigh in. While acknowledging the company's shortcomings, they argued that much of IBM's culture and values was worth preserving. "Shortly after joining IBM 18 years ago," wrote one, "I was asked to serve on a jury. When I approached the bench and answered [the lawyers'] questions, I was surprised when the judge said, 'You guys can pick whoever else you want, but *I want this IBMer* on that jury.' I have never felt so much pride. His statement said it all: integrity, excellence, and quality." Comments like these became more frequent, criticism became more constructive, and the ValuesJam conversation stabilized.

The question of what was worth preserving and what needed to be changed was at the heart of ValuesJam. In 1914 – when the company was making tabulating machines, scales for weighing meat, and cheese slicers – president Thomas Watson, Sr., decreed three corporate principles, called the Basic Beliefs: “respect for the individual,” “the best customer service,” and “the pursuit of excellence.” They would inform IBM’s culture, and help drive its success, for more than half a century.

By 2002, when Palmisano took over as CEO, much had happened to Big Blue. In the early 1990s, the company had suffered the worst reversal in its history and then, under Lou Gerstner, had fought its way back, transformed from a mainframe maker into a robust provider of integrated hardware, networking, and software solutions. Palmisano felt that the Basic Beliefs could still serve the company – but now as the foundation for a new set of corporate values that could energize employees even more than its near-death experience had. Looking for a modern-day equivalent, Palmisano first queried 300 of his senior executives, then quickly opened up the discussion, through a survey of over a thousand employees, to get a sense of how people at all levels, functions, and locations would articulate IBM’s values and their aspirations for the company. Out of this research grew the propositions that were debated in ValuesJam.

After – and even during – the jam, company analysts pored over the postings, mining the million-word text for key themes. Finally, a small team that included Palmisano came up with a revised set of corporate values. The CEO announced the new values to employees in an intranet broadcast in November 2003: “dedication to every client’s success,” “innovation that matters – for our company and for the world,” “trust and personal responsibility in all relationships.” Earthshaking? No, but imbued with legitimacy and packed with meaning and implications for IBM.

To prove that the new values were more than window dressing, Palmisano immediately made some changes. He called on the director of a major business unit – e-business hosting services for the U.S. industrial sector – and charged her with identifying gaps between the values and company practices. He bluntly told his 15 direct reports that they had better follow suit. Another online jam was held in October 2004 (this one informally dubbed a “logjam”) in which employees were asked to identify organizational barriers to innovation and revenue growth.

Although Palmisano, by his own account, is building on a strategy laid down by Gerstner, the leadership styles of

the two men are very different. Under Gerstner, there was little expansive talk about IBM’s heritage. He was an outsider, a former CEO of RJR Nabisco and an ex-McKinsey consultant, who was faced with the daunting task of righting a sinking ship. In fact, he famously observed, shortly after taking over, that “the last thing IBM needs right now is a vision.” Palmisano, by contrast, is a true-blue IBMer, who started at the company in 1973 as a salesman in Baltimore. Like many of his generation who felt such acute shame when IBM was brought to its knees in the early 1990s, he clearly has a visceral attachment to the firm – and to the hope that it may someday regain its former greatness. At the same time, the erstwhile salesman is, in

We were so successful for so long that we could never see another point of view. And when the market shifted, *we almost went out of business.*

the words of a colleague, “a results-driven, make-it-rain, close-the-deal sort of guy”: not the first person you’d expect to hold forth on a subjective topic like “trust.”

In this edited conversation with HBR senior editor Paul Hemp and HBR’s editor, Thomas A. Stewart, Palmisano talks about the strategic importance of values to IBM. He begins by explaining why – and how – hard financial metrics and soft corporate values can coexist.

Corporate values generally are feel-good statements that have almost no effect on a company’s operations. What made – what makes – you think they can be more than this?

Look at the portrait of Tom Watson, Sr., in our lobby. You’ve never seen such a stern man. The eyes in the painting stare right through you. This was *not* a soft individual. He was a capitalist. He wanted IBM to make money, lots of it. But he was perceptive enough to build the company in a way that would ensure its prosperity long after he left the scene. His three Basic Beliefs successfully steered this company through persistent change and repeated reinvention for more than 50 years.

An organic system, which is what a company is, needs to adapt. And we think values – that’s what we call them today at IBM, but you can call them “beliefs” or “principles” or “precepts” or even “DNA” – are what enable you to do that. They let you change everything, from your products to your strategies to your business model, but remain true to your essence, your basic mission and identity.

Unfortunately, over the decades, Watson’s Basic Beliefs became distorted and took on a life of their own. “Respect for the individual” became entitlement: not fair work for all, not a chance to speak out, but a guaranteed job and culture-dictated promotions. “The pursuit of excellence” became arrogance: We stopped listening to our markets,

Paul Hemp (p hemp@hbsp.harvard.edu) is a senior editor and Thomas A. Stewart is the editor of HBR.

to our customers, to each other. We were so successful for so long that we could never see another point of view. And when the market shifted, we almost went out of business. We had to cut a workforce of more than 400,000 people in half. Over the course of several years, we wiped out the equivalent of a medium-sized northeastern city—say, Providence, Rhode Island.

If you lived through this, as I did, it was easy to see how the company's values had become part of the problem. But I believe values can once again help guide us through major change and meet some of the formidable challenges we face.

For instance, I feel that a strong value system is crucial to bringing together and motivating a workforce as large and diverse as ours has become. We have nearly one-third of a million employees serving clients in 170 countries. Forty percent of those people don't report daily to an IBM site; they work on the client's premises, from home, or they're mobile. And, perhaps most significant, given IBM's tradition of hiring and training young people for a lifetime of work, half of today's employees have been with the company for fewer than five years because of recent acquisitions and our relatively new practice of hiring seasoned professionals. In a modest hiring year, we now add 20,000 to 25,000 people.

In effect, gradually repopulating Providence, Rhode Island!

Exactly. So how do you channel this diverse and constantly changing array of talent and experience into a common purpose? How do you get people to *passionately* pursue that purpose?

You could employ all kinds of traditional, top-down management processes. But they wouldn't work at IBM—or, I would argue, at an increasing number of twenty-first-century companies. You just can't impose command-and-control mechanisms on a large, highly professional workforce. I'm not only talking about our scientists, engineers, and consultants. More than 200,000 of our employees have college degrees. The CEO can't say to them, "Get in line and follow me." Or "I've decided what *your* values are." They're too smart for that. And as you know, smarter people tend to be, well, a little more challenging; you might even say cynical.

But even if our people did accept this kind of traditional, hierarchical management system, our clients wouldn't. As we learned at IBM over the years, a top-down system can create a smothering bureaucracy that doesn't allow for the speed, the flexibility, the innovation that clients expect today.

Continuity and Change

IBM's new values grew out of a long tradition. In 1914, Thomas Watson, Sr., the founder of the modern International Business Machines Corporation, laid out three principles known as the *Basic Beliefs*:

- Respect for the individual
- The best customer service
- The pursuit of excellence

Although these beliefs played a significant role in driving IBM's success over most of the twentieth century, they eventually were subsumed—and, in effect, redefined—by a sense of entitlement and arrogance within the organization. That, according to CEO Sam Palmisano, contributed to the company's failure to respond to market changes in the early 1990s and to its near demise.

In February 2003, just under a year after taking over as CEO, at a meeting of IBM's top 300 managers, Palmisano raised the idea of reinventing the company's values as a way to manage and reintegrate the sprawling and diverse enterprise. He put forth *four concepts*, three of them drawn from Watson's Basic Beliefs, as possible bases for the new values:

- Respect
- Customer
- Excellence
- Innovation

These were "test marketed" through surveys and focus groups with more than 1,000 IBM employees. The notion of "respect" was thrown out because of its connotations of the past. It was also decided that statements rather than just words would be more compelling.

Out of this process grew the three *proposed values* discussed during the July 2003 online forum, ValuesJam:

- Commitment to the customer
- Excellence through innovation
- Integrity that earns trust

Using a specially tailored "jamalyzer" tool—based on IBM's e-classifier software, but turbocharged with additional capabilities designed to process constantly changing content—IBM analysts crunched the million-plus words posted during the ValuesJam. Some themes emerged. For example, many people said that a silo mentality pitted the business units against one another, to the detriment of IBM as a whole. Several people characterized this as a trust issue. But the proposed value "integrity that earns trust" was criticized as being too vague. Some thought it was just another way of saying "respect for the individual," one of the original Basic Beliefs that many now viewed as outdated. And the notion of trust was seen as being too inwardly focused—management trusting its employees—and not prescriptive enough in terms of how employees should behave with each other or with parties outside the company.

Drawing on this analysis, the results of pre- and post-jam surveys, and a full reading of the raw transcripts, a small team, with input from Palmisano, arrived at a revised set of *new corporate values*:

- **Dedication to every client's success**
- **Innovation that matters – for our company and for the world**
- **Trust and personal responsibility in all relationships**

These were published on the company intranet in November 2003.

Sam Joins the Fray

IBM CEO Sam Palmisano was in China on business during ValuesJam, and he logged on from there. Following are some of his comments (typos included) on a number of topics raised by employees during the online forum:

YES, values matter!!!! (6 reply)

■ [Samuel J. Palmisano 29 Jul 2003 20:00 GMT](#)

Good discussion about the need for values/principles/beliefs, etc. people can be very cynical and sarcastic about this kind of topic, but I appreciate the thoughtful constructive comments I'm seeing. Personally, I believe "values" should embrace a company's broader role in the world –with customers, society, culture, etc. - as well as how its people work together.. I hope this Jam elevates IBM's ambitions about its mission in the 21st century.. WE have a unique opportunity for IBM to set the pace for ALL companies, not just the techs.

doing the right thing for customers... (21 reply)

■ [Samuel J. Palmisano 29 Jul 2003 20:07 GMT](#)

Early in my career when I was in the field in Baltimore, one of our systems failed for a healthcare customer. The customer went to manual processes, but said they would start losing patients within hours if the system couldn't be fixed. The branch mgr called one of our competitors and ordered another system. so two teams of IBMERS worked side by side..one to fix the system, the others to bring up the new one. the mgr never asked Hq what to do.. it was a great lesson in how far this company will go to help a customer in time of need. btw, we fixed the system in time.

integrity/trust in ALL our relationships matter!!!! (44 reply)

■ [Samuel J. Palmisano 29 Jul 2003 20:12 GMT](#)

very interesting discussion... one thing I'm noticing, and it was in the broadcast feedback too: not too many of you are talking about integrity and trust when it comes to our OTHER relationships that are key to IBM's success – customers, communities where we live, owners of the company etc. any thoughts on why that's so? maybe we're too inwardly focused?

a world without IBM???? (35 reply)

■ [Samuel J. Palmisano 29 Jul 2003 20:20 GMT](#)

No IBM? the industry would stop growing because no one would invent anything that ran for more than THREE MINUTES.. no IBM means no grownups... no IBM means no truly global company that brings economic growth, respect progress to societies everywhere... no IBM means no place to work for hundreds of thousands of people who want more than a job, they want to ,MAKE A DIFFERENCE in the world.

suggestion for Sam (9 reply)

■ [Samuel J. Palmisano 29 Jul 2003 20:25 GMT](#)

steve, you make good points about how/when we win... we can blow up more bureaucracy if we all behave like mature adults and take into account ALL OF THE INTERESTS of IBM FIRST.. customers, employees, shareholders, doing what's right for the LONG TERM interests of the company. mgrs have an important role to play in encouraging this kind of behavior... you have my support.

So you're saying that values are about how employees behave when management isn't there, which it can't be – which it shouldn't be – given IBM's size and the need for people to make decisions quickly. You're basically talking about using values to manage.

Yes. A values-based management system. Let me cast the issue in a slightly different light. When you think about it, there's no optimal way to organize IBM. We traditionally were viewed as a large, successful, "well-managed" company. That was a compliment. But in today's fast-changing environment, it's a problem. You can easily end up with a bureaucracy of people overanalyzing problems and slowing down the decision-making process.

Think of our organizational matrix. Remember, we operate in 170 countries. To keep it simple, let's say we have 60 or 70 major product lines. We have more than a dozen customer segments. Well, if you mapped out the entire 3-D matrix, you'd get more than 100,000 cells – cells in which you have to close out P&Ls every day, make decisions, allocate resources, make trade-offs. You'll drive people crazy trying to centrally manage every one of those intersections.

So if there's no way to optimize IBM through organizational structure or by management dictate, you have to empower people while ensuring that they're making the right calls the right way. And by "right," I'm not talk-

ing about ethics and legal compliance alone; those are table stakes. I'm talking about decisions that support and give life to IBM's strategy and brand, decisions that shape a culture. That's why values, for us, aren't soft. They're the basis of what we do, our mission as a company. They're a touchstone for decentralized decision making. It used to be a rule of thumb that "people don't do what you expect; they do what you inspect." My point is that it's just not possible to inspect everyone anymore. But you also can't just let go of the reins and let people do what they want without guidance or context. You've got to create a management system that empowers people and provides a basis for decision making that is consistent with who we are at IBM.

How do the new values help further IBM's strategy?

In two main ways. Back some 12 years ago, three-fifths of our business was in computer hardware and roughly two-fifths was in software and services. Today, those numbers are more than reversed. Well, if three-fifths of your business is manufacturing, management is basically supervisory: "You do this. You do that." But that no longer works when your business is primarily based on knowledge. And your business model also changes dramatically.

For one thing, people – rather than products – become your brand. Just as our products have had to be consistent with the IBM brand promise, now more than ever, so do our people. One way to ensure that is to inform their behavior with a globally consistent set of values.

Second, the IT industry has continued to shift toward reintegration. We all know the story of how the industry fragmented in the 1980s and 1990s, with separate companies selling the processors, the storage devices, and the

Companies usually face the issue of workforce integration after a huge merger. We needed to integrate our existing workforce as a strategic response to the reintegration of the industry. It won't surprise you that I didn't think the answer lay in a new organizational structure or in more management oversight. What you need to foster this sort of cooperation is a common set of guidelines about how we make decisions, day in and day out. In other words, values.

And what happens when the strategy changes?

Ah, that's why the right set of values is so important. There's always going to be another strategy on the horizon as the market changes, as technologies come and go. So we wanted values that would foster an organization able to quickly execute a new strategy. At the same time, we wanted values that, like Watson's Basic Beliefs, would be enduring, that would guide the company through economic cycles and geopolitical shifts, that would transcend changes in products, technologies, employees, and leaders.

How did IBM distill new values from its past traditions and current employee feedback?

The last time IBM examined its values was nearly a century ago. Watson was an entrepreneur, leading what was, in today's lingo, a start-up. So in 1914, he simply said, "Here are our beliefs. Learn them. Live them." That was appropriate for his day, and there's no question it worked. But 90 years later, we couldn't have someone in headquarters sitting up in bed in the middle of the night and saying, "Here are our new values!" We couldn't be casual about tinkering with the DNA of a company like IBM. We had to come up with a way to get the employees to create the

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software that make up a computer system – almost killing IBM, the original vertically integrated computer company. Now customers are demanding a package of computer products and services from a single company, a company that can offer them an integrated solution to their business problems. This is a big opportunity for IBM. We probably have a wider array of computer products and services and know-how than anyone. But it's also a challenge. How can we get our people in far-flung business units with different financial targets and incentives working together in teams that can offer at a single price a comprehensive and customized solution – one that doesn't show the organizational seams?

value system, to determine the company's principles. Watson's Basic Beliefs, however distorted they might have become over the years, had to be the starting point.

After getting input from IBM's top 300 executives and conducting focus groups with more than a thousand employees – a statistically representative cross-section – we came up with three perfectly sound values. [For a detailed description of how IBM got from the Basic Beliefs to its new set of values, see the sidebar "Continuity and Change."] But I knew we'd eventually throw out the statements to everyone in the company to debate. That's where Values-Jam came in – this live, companywide conversation on our intranet.

What was your own experience during the jam? Did you have the feeling you'd opened Pandora's box?

I logged in from China. I was pretty jet-lagged and couldn't sleep, so I jumped in with postings on a lot of stuff, particularly around client issues. [For a selection of Palmisano's postings during the ValuesJam, see the sidebar "Sam Joins the Fray."] And yes, the electronic argument was hot and contentious and messy. But you had to get comfortable with that. Understand, we had done three or four big online jams before this, so we had some idea of how lively they can be. Even so, none of those could have prepared us for the emotions unleashed by this topic.

You had to put your ego aside—not easy for a CEO to do—and realize that this was the best thing that could have happened. You could say, "Oh my God, I've unleashed this incredible negative energy." Or you could say, "Oh my God, I now have this incredible mandate to drive even more change in the company."

When Lou Gerstner came here in 1993, there was clearly a burning platform. In fact, the whole place was in flames. There was even talk of breaking up the company. And he responded brilliantly. Here's this outsider who managed to marshal the collective urgency of tens of thousands of people like me to save this company and turn it around:

On Monday morning, I walked into our executive committee meeting and said, "You guys ought to read every one of these comments, because if you think we've got this place plumbed correctly, *think again.*"

without a doubt one of the greatest saves in business history. But the trick then wasn't creating a sense of urgency—we had that. Maybe you needed to shake people out of being shell-shocked. But most IBMers were willing to do whatever it took to save the company, not to mention their own jobs. And there was a lot of pride at stake. Lou's task was mostly to convince people that he was making the right changes.

Once things got better, though, there was another kind of danger: that we would slip back into complacency. As our financial results improved dramatically and we began outperforming our competitors, people—already weary from nearly a decade of change—would say, "Well, why do I have to do things differently now? The leadership may be different, but the strategy is fundamentally sound. Why do I have to change?" This is, by the way, a problem that everyone running a successful company wrestles with.

So the challenge shifted. Instead of galvanizing people through fear of failure, you have to galvanize them through hope and aspiration. You lay out the opportunity

to become a great company again—the greatest in the world, which is what IBM used to be. And you hope people feel the same need, the urgency you do, to get there. Well, I think IBMers today do feel that urgency. Maybe the jam's greatest contribution was to make that fact unambiguously clear to all of us, very visibly, in public.

What were the chief points of debate—or contention?

There was actually remarkable agreement on *what* we all value. The debate, as it turned out, wasn't over the values themselves so much. The debate was about whether IBM today is willing and able to live them.

For instance, people seemed to understand the need to reintegrate the company, but there were complaints—legitimate complaints—about things that are getting in the way. People would describe extremely frustrating situations. They'd say something like: "I'm in Tokyo, prototyping software for a client, and I need a software engineer based in Austin *right now* to help in a blade server configuration. But I can't just say, 'Please come to Tokyo and help.' I need to get a charge code first so I can pay his department for his time!"

There's a collective impatience that we've been tapping into to drive the change needed to make IBM everything

that all of us aspire for it to be. I'm convinced that we wouldn't have gotten to this point if we hadn't found a way to engage the entire IBM population in a genuine, candid conversation.

By the way, having a global, universally accessible intranet like ours certainly helps, but the technology isn't the point. I think we would've found a way to have this companywide dialogue if the Web didn't exist. [For an explanation of how the jam worked, see the sidebar "Managing ValuesJam."]

What happened after the jam?

Well, we got a mountain of employee comments. The team analyzed all of it, and it was clear that the proposed value statements needed to change to reflect some of the nuances and emotion people expressed. So, drawing on this analysis, along with other employee feedback, a small team settled on IBM's new corporate values.

The first value is "dedication to every client's success." At one level, that's pretty straightforward: Bring together



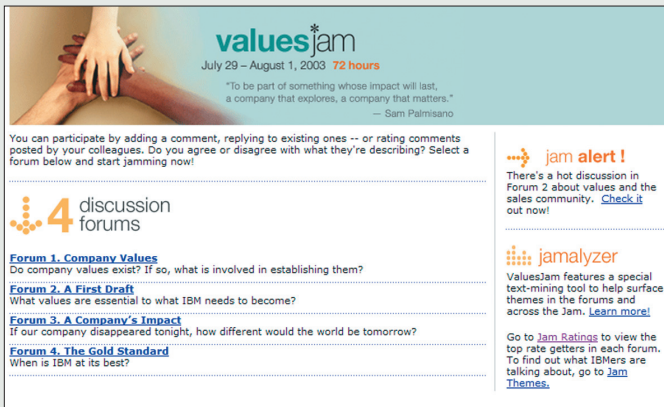
all of IBM's capability – in the laboratory, in the field, in the back office, wherever – to help solve difficult problems clients can't solve themselves. But this is also a lot more than the familiar claim of unstinting customer service. "Client success" isn't just "the customer is always right." It means maintaining a long-term relationship where what happens after the deal is more important than what happens before it's signed. It means a persistent focus on outcomes. It means having skin in the game

of your client's success, up to and including how your contracts are structured and what triggers your getting paid.

The second is "innovation that matters – for our company and for the world." When employees talked about IBM making a difference in the world, they included more than our work of inventing and building great products. They talked about how their work touches people and society, how we can help save lives – say, through our cutting-edge work with the Mayo Clinic or by helping governments

Managing ValuesJam

IBM had experimented before with jam sessions—relatively unstructured employee discussions around broad topics—both on the corporate intranet and in face-to-face off-site brainstorming sessions. But the 72-hour ValuesJam, held in July 2003, was the most ambitious, focusing as it did on the very nature and future of IBM.



One thing was clear: You wouldn't be able to orchestrate a forum like this, the verbal equivalent of an improvisational jam session among jazz musicians. In the words of CEO Sam Palmisano, "It just took off." But, much like a musical jam, the dialogue was informed by a number of themes:

Forum 1. *Company Values*

Do company values exist? If so, what is involved in establishing them? Most companies today have values statements. But what would a company look and act like that truly lived its beliefs? Is it important for IBM to agree on a set of lasting values that drive everything it does?

Forum 2. *A First Draft*

What values are essential to what IBM needs to become? Consider this list: 1. Commitment to the customer. 2. Excellence through innovation. 3. Integrity that earns trust. How might these values change the way we act or the decisions we make? Is there some important aspect or nuance that is missing?

Forum 3. *A Company's Impact*

If our company disappeared tonight, how different would the world be tomorrow? Is there something about our company that makes a unique contribution to the world?

Forum 4. *The Gold Standard*

When is IBM at its best? When have you been proudest to be an IBMer? What happened, and what was uniquely meaningful about it? And what do we need to do—or change—to be the gold standard going forward?

fight terrorism with our data technology. This kind of innovation is a major reason we are able to attract great scientists. They can do cool stuff and maybe make more money in Silicon Valley – for a while, anyway—but they can do work that actually changes business and society at IBM. And it's also about what I mentioned before: a continually experimental attitude toward IBM itself. Over most of our 90 years, with the exception of that one period when we became arrogant and complacent, this company never stopped questioning assumptions, trying out different models, testing the limits—whether in technology or business or in progressive workforce policies. Employees reminded us that those things are innovations that matter at least as much as new products.

The third value is “trust and personal responsibility in all relationships.” There's a lot in that statement, too. Interestingly, the feedback from employees on this value has focused on relationships among people at IBM. But we're also talking about the company's relationships with suppliers, with investors, with governments, with communities.

We published the values in their final form—along with some elaboration on them and some direct employee postings from the jam—in November 2003. Over the next ten days, more than 200,000 people downloaded the online document. The responses just flooded in, both in the form of postings on the intranet and in more than a thousand e-mails sent directly to me, telling us in often sharp language just where IBM's operations fell short of, or clashed with, these ideals. Some of the comments were painful to read. But, again, they exhibited something every leader should welcome: People here aren't complacent about the company's future. And the comments were, by and large, extremely thoughtful.

What did you do with this feedback?

We collected and collated it. Then I printed all of it out—the stack of paper was about three feet high—and took it home to read over one weekend. On Monday morning, I walked into our executive committee meeting and threw it on the table. I said, “You guys ought to read every one of these comments, because if you think we've got this place plumbed correctly, think again.”

Don't get me wrong. The passion in these e-mails was positive as well as negative. People would say, literally, “I'm weeping. These values describe the company I joined, the company I believe in. We can truly make this place great again. But we've got all these things in our way...” The raw emotion of some of the e-mails was really something.

Now, if you've unleashed all this frustration and energy, if you've invited people to feel hope about

something they really care about, you'd better be prepared to do something in response. So, in the months since we finalized the values, we've announced some initiatives that begin to close the gaps.

One I have dubbed our "\$100 million bet on trust." We kept hearing about situations like our colleague in Tokyo who needed help from the engineer in Austin, cases in which employees were unable to respond quickly to client needs because of financial control processes that required several levels of management approval. The money would usually be approved, but too late. So we allocated managers up to \$5,000 annually they could spend, no questions asked, to respond to extraordinary situations that would help generate business or develop client relationships or to respond to an IBMer's emergency need. We ran a pilot for a few months with our 700 client-facing teams, and they spent the money intelligently. There were lots of examples of teams winning deals and delighting clients with a small amount of "walk around money" to spend at their discretion. So, based on the success of that pilot, we expanded the program to all 22,000 IBM first-line managers.

You can do the math: \$5,000 times 22,000 managers is a big number. I'm sure there were people in the company who said, "We need to get this under control." But they're not the CEO. Yes, you need financial controls. Yes, not every dollar spent from this Managers' Value Fund will yield some tangible return. But I'm confident that allowing line managers to take some reasonable risks, and trusting them with those decisions, will pay off over time. The program also makes a point: that we live by our values.

The value of "trust and personal responsibility in all relationships" – including those with IBM's shareholders – led to another initiative: a change in the way we grant top executive stock options. After getting a lot of outside experts to study this (and concluding that the complicated algorithms they recommended were wonderful, if you wanted to hire the outsiders as permanent consultants, but terrible if you wanted a simple formula that aligned executive behavior with shareholder interests), we settled on a straightforward idea. Senior executives will benefit from their options only after shareholders have realized at least 10% growth in their investments – that is, the strike price is 10% higher than the market price on the day the options are issued. Look at it this way: IBM's market value would have to increase by \$17 billion from that date before any of the execs realize a penny of benefit. We think we are the first large company to take such a radical step – and it grew out of our values.

Let me give you one more example. It may not sound like a big deal, but for us, it was radical. We overhauled the way we set prices. We heard time and again from employ-

ees about how difficult it was to put together a client-friendly, cross-IBM solution, one involving a variety of products and services at a single, all-inclusive price. We couldn't do it. Every brand unit had its own P&L, and all the people who determine prices had been organized by brand. Remember those 100,000 cells in our 3-D matrix? Our people were pulling their cross-IBM bids apart, running them through our financial-accounting system as separate bids for individual products and services. This was nuts, because it's our ability to offer everything – hardware, software, services, and financing – that gives us a real advantage. When we bid on each of the parts separately, we go head-to-head against rivals by product: EMC in storage, say, or Accenture in services. This was tearing out the very heart of our strategy of integration, not to mention our unique kind of business-plus-technology innovation.

People on the senior team who lived through IBM's near-death experience will *do anything not to go back to that.*

Let me give you a humorous (if somewhat discouraging) illustration. Every senior executive has responsibility for at least one major client – we call them "partnership accounts." Our former CFO John Joyce, who now heads IBM's services business, put together a deal for his account that involved some hardware, some software, and some services. He was told he couldn't price it as an integrated solution. And he's the CFO! So we figured out a way to set a single price for each integrated offering.

This sounds like a great business move. But what does it have to do with values? Wouldn't you ultimately have decided you had to do that in any case?

To be honest, we'd been debating the pricing issue at the executive level for a long time. But we hadn't done anything about it. The values initiative forced us to confront the issue, and it gave us the impetus to make the change. You know, there are always ingrained operations and habits of mind in any organization – I don't care whether it's a business or a university or a government. Well, the values and the jam were great inertia-busting vehicles. A small business in this place is \$15 billion, and a big one is \$40 billion. So you have senior vice presidents running *Fortune* 500-sized companies who aren't necessarily looking for bright ideas from the CEO or some task force every day. But when you hear from so many of our people on the front lines, you can't just ignore it. They're crying out: "We say we value 'client success,' and we want to grow our business. This one thing is getting in the way of both!" You've got to pay attention – if not to me, then to them.

So we took the pricers—the people who set the prices for client bids—and we said to them, “You work for IBM. When there’s a cross-IBM bid with multiple products, you price it on the IBM income statement, not on the income statements of each product.” Needless to say, this involved a series of very difficult meetings with senior executives. There was a huge debate among the finance people about all the reasons why we couldn’t do it: “It will be too much work to reallocate all the costs and revenue of a project back to individual profit centers.” And they’re right: It isn’t easy, especially when we now have to certify everything. But the CFO was with me on this: After all, he’d seen the problem firsthand! And we made the change, so that now when we make a truly cross-IBM bid, we can optimize it for the client and for us.

This brings us back to the tension between soft values and hard financial metrics. In the long run, they shouldn’t conflict. But along the way, they’re going to be jabbing at each other. After all, people still have to make their numbers.

Certainly, there’s no getting around that in a commercial enterprise. But I think values inject balance in the company’s culture and management system: balance between the short-term transaction and the long-term relationship, balance between the interests of shareholders, employees, and clients. In every case, you have to make a call. Values help you make those decisions, not on an ad hoc basis, but in a way that is consistent with your culture and brand, with who you are as a company.

Look at how we compensate our managing directors, who are responsible for our largest client relationships. We decided to take half their comp and calculate it not on an annual basis but on a rolling three-year basis. We ask clients to score the managing director’s performance at the end of a project or engagement, which might last longer than a single year, and that plays a big part in his bonus. So a big piece of his compensation is based on a combination of the project’s profitability—whether the manager made his annual numbers—and on the client’s satisfaction over a longer-term horizon. The managing director can’t trade off one for the other.

So we’ve tried to keep balance in the system, to make sure that things aren’t completely oriented toward short-term financials. But you’re absolutely right: There are times when people will argue, “Well, jeez, you guys are pushing us in both directions.” It’s a valid debate. I think, though, that the best place to have that debate is at the lowest level of your organization, because that’s where these decisions are being made and having an impact. Thousands of these interactions go on every day that none of us at the top will ever, or should ever, know about. But you hope that the values are providing a counterweight to the drive for short-term profitability in all those interactions. In the long term, I think, whether or not you have a values-driven culture is what makes you a winner or a loser.

You’ve had the new values in place for just about a year now. They’ve already created strong emotions and high expectations. What’s the prognosis?


We’re just starting down the road on what is probably a ten- to 15-year process. I was back in Asia not long ago, and I did one of these town hall-style meetings with IBM employees and talked about the values. Probably two-thirds of the people clearly knew about them, had read about them. But a third of the people—you could look at their faces and see it—hadn’t even heard of the values. Or at least the values hadn’t resonated with them yet. So we have work to do. Not just in getting everyone to memorize three pithy statements. We need to do a heck of a lot to close the gaps between our stated values and the reality of IBM today. That’s the point of it all.

I know that not everyone on my executive team is as enthusiastic about the values initiative as I am—though they’d never admit it! But people on the senior team who lived through IBM’s near-death experience will do anything not to go back to that. The blow to everyone’s pride when IBM became the laughingstock of the business world was almost too much to bear. I have zero resistance from the senior team to initiatives that can save us from a return to that. And our values work is one of the most important of those initiatives.

Then look at the employee response to ValuesJam. There is an unmistakable yearning for this to be a great company. I mean, why have people joined IBM over the years? There are a lot of places to make money, if that’s what drives you. Why come here?

I believe it’s because they want to be part of a progressive company that makes a difference in the world. They want to be in the kind of company that supports research that wins Nobel Prizes, that changes the way people think about business itself, that is willing to take firm positions on unpopular issues based on principle.

You know, back in the 1950s, Watson, Jr., wrote the governors of southern states that IBM would not adhere to separate-but-equal laws, and then the company codified an equal-opportunity policy years before it was mandated by law. I’ve got to believe that a company that conceives of itself that way, and that seriously manages itself accordingly, has strong appeal to a lot of people. We can’t offer them the promise of instant wealth, which they may get at a start-up, or a job for life, as in the old days. But we can offer them something worth believing in and working toward.

If we get most people in this company excited about that, they’re going to pull the rest of the company with them. If they become dedicated to these values and what we’re trying to accomplish, I can go to sleep at night confident of our future. 

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