

## **Lenovo-IBM: Bridging Cultures, Languages, and Time Zones Becoming a Global Player (C)**

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## **Lenovo-IBM: Bridging Cultures, Languages, and Time Zones**

Becoming a Global Player (C)

Reference Number 0006/2012

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Case Series

“Our fiscal year ended impressively with a strong momentum,” asserted Lenovo’s CEO Yang Yuanqing on March 23, 2012, noting the firm’s 2011 fiscal year performance<sup>i</sup>. In support of this claim, he could point to several pieces of evidence: By October 2011, Lenovo had become the world’s second largest personal computer (PC) company in terms of worldwide shipments, outpacing Dell, the Acer Group, and Asus. Its market share growth reached 43.7% compared with the first quarter of 2011. In contrast, the market leader Hewlett-Packard (HP) achieved only moderate growth of 3.2%; Dell and Acer even lost market shares<sup>ii</sup>. Furthermore, Lenovo’s revenues increased at the same time, by 54% compared with the year before.

These stellar numbers did not tell the whole story though. Lenovo had struggled through a rough patch, especially in the aftermath of its merger with IBM. The integration pains were acute, including the departure of two chief executives. Similar to most PC makers, it was hard hit by the global financial crisis and the consequent recession, which prompted structural changes and a strategic reorientation.

### The Merger’s Aftermath: Ongoing Integration Issues



Lenovo CEO Yang Yuanqing making strategic moves | Photo by Chad Ingraham

The IBM–Lenovo merger induced massive change in the world of Lenovo. Its headquarters were moved to the United States. Steve Ward, a former IBM executive, was appointed as the new CEO of Lenovo in 2005—a symbol of Lenovo’s commitment to the merger as a *marriage of equals*. In April 2005, shortly after the merger, Lenovo’s founder Liu Chuanzhi explained the appointment in an interview with *BusinessWeek*<sup>iii</sup>:

It was not a difficult decision for us. All of us agreed when we were choosing our CEO that we would choose the best one possible, no matter what nationality he or she might be.... We want to establish a global company, so it is very natural to find a global CEO for our company. The situation was quite similar in choosing the location of our headquarters. We originally considered having two headquarters, but we realized we need to send a strong, clear message to our investors. So we chose a global location for our headquarters.

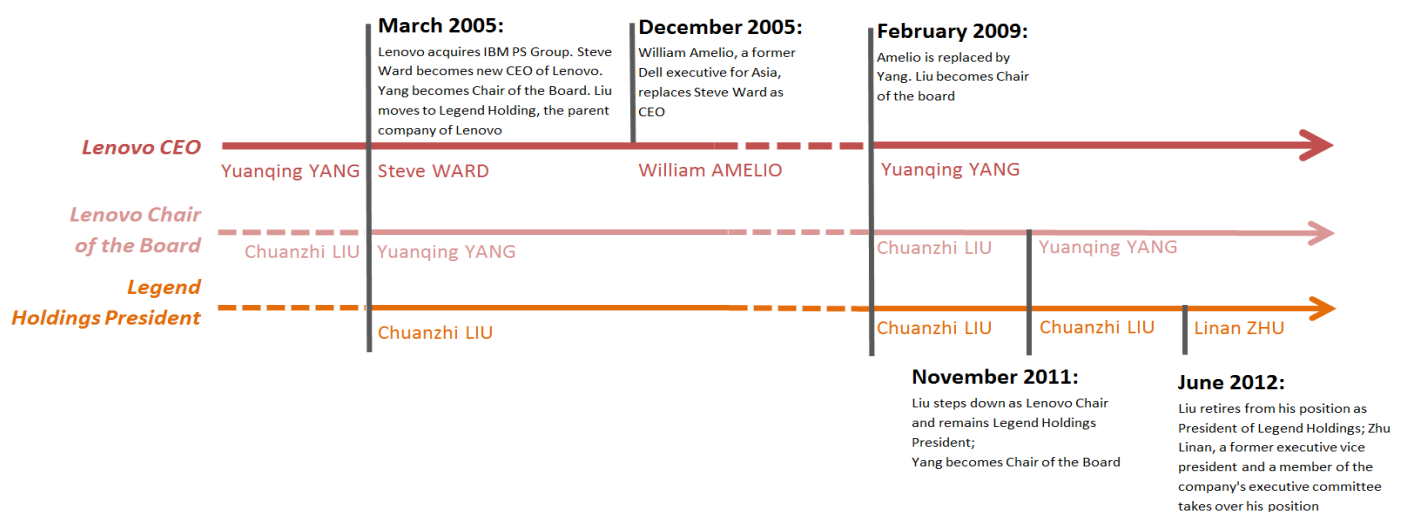
The integration was ambitious by any measure. It aimed to combine the best aspects of two very different companies that operated across 12 time zones. One of them was very local; the other was an international player. Yet the initial transition went remarkably well. Employees expressed excitement about the new development, and Lenovo appreciatively noted: “The deal has enhanced our technology and innovative capabilities by at least 5 years. More importantly, we have the world-class managerial team from IBM, and that is invaluable”<sup>iv</sup>.

Unfortunately, positive attitudes and appreciation rarely are enough. The integration yielded some unexpected difficulties as Lenovo struggled to complete the integration of operations, and cultural issues became more apparent. This situation harmed the company's competitive position. As one PC analyst at IDC stated in 2009: "While HP and Acer had been pushing ahead, [Lenovo] spent all this time integrating their operations and developing their brand name. The competition was out there grabbing opportunities in the market, but they still had internal challenges distracting them."<sup>vi</sup> In a more recent interview<sup>vi</sup>, Liu Chuanzhi confirmed that the most pressing of these internal challenges were problems at the top management level—especially when Ward resigned as CEO after only a few months. The reasons for his rapid departure were uncertain. Some guessed a personality clash with Yang Yuanqing—a man 10 years his junior who embraced a completely different style. Others speculated that Ward had been too accustomed to the "IBM way" and could not adapt to the new culture.

Cultural issues within the management team also triggered frequent changes to the board and restructuring efforts. In December 2005, former Dell executive Bill Amelio replaced Steve Ward, with a mandate to facilitate the integration and speed up Lenovo's drive to become the market leader in the PC industry. But Amelio also was unable to bridge the cultural gap between China and the United States. In those difficult years, morale among the workforce plunged. Amelio departed when his contract expired in February 2009. Yang stepped in as CEO, and Liu once again became chairman while still maintaining a position at another firm.

In November 2011, the founder stepped down and handed over the responsibilities to CEO Yang. The frequent changes at the top management level had remained a major distraction, contributing to Lenovo's problems in the years after the merger. Asked explicitly about cultural issues, and especially conflicts within the management team, Liu admitted, "I have to say that it was difficult to some extent. Most of the problems lay in senior management"<sup>vii</sup>.

Exhibit 1: The Changing Leadership of Lenovo

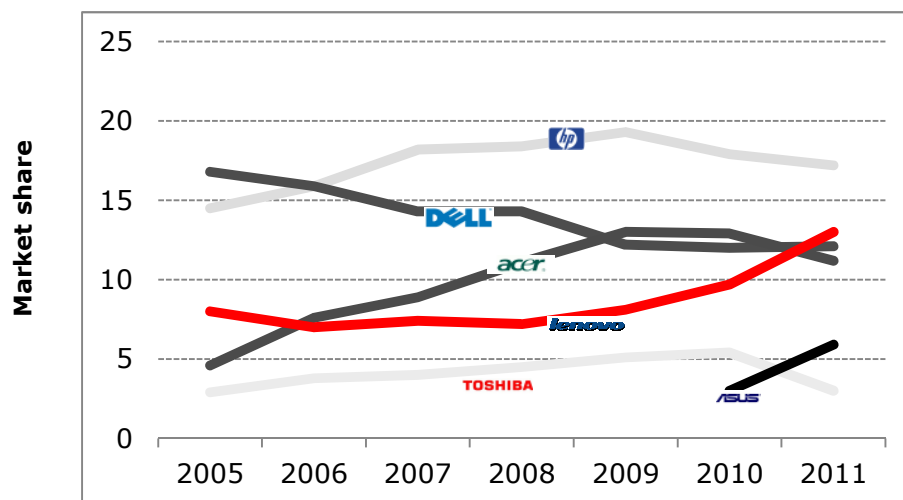


As Exhibit 1 shows, Yang and Liu took over when Lenovo experienced its roughest times, during the financial crisis. In the following years, Lenovo underwent a series of cost-cutting programs and restructuring efforts, peaking in a massive layoff—the largest of its history—of 11% of its workforce in 2009. In addition, the number of senior executives fell from 24 to 9. Even with these cuts, Liu and Yang worked at retaining a fair balance between Chinese and Western executives, reflecting their drive to make Lenovo into a global firm.

## Overhauling the Strategy

Before taking over IBM, Lenovo’s ambitious goal had been to become the world’s leading computer manufacturer. With the acquisition, it became the third largest computer vendor, with an 8% market share in 2005. However, it slipped to fourth place in following years (Exhibit 2).

Exhibit 2: Market Shares in the Global PC Market by PC Shipment Units<sup>viii</sup>



The financial crisis of 2007–2008 strongly affected the global computer market; negative industry growth reached more than 5% year-on-year in terms of market value. Sales of Lenovo PCs declined by 8.9%, more than the industry average, and Lenovo thus reported losses of US\$226 million for the fiscal year 2009. At the same time, new industry trends became more visible. Notebooks started to outsell desktop computers while their prices continued to decline by –21.9% on average from 2005 through 2008. Shrinking margins in the hardware industry were a persistent trend. Moreover, cheaper netbooks became very popular (Exhibit 3). Yet Lenovo remained so focused on its internal challenges that it missed these fundamental shifts in the market. Competitors, and particularly Acer and Asus, grasped the potential of netbooks a lot earlier and thus were able to defend their market position and even grow in economically weak times.

Exhibit 3: Global Netbook Market Size (millions of units shipped), 2008–2012

	2008	2009	2010	2011	2012
<b>Netbooks shipment</b>	6	10	20	29	48
<b>Growth (%)</b>		55.7	114.7	39.7	66.7

The U.S. market presented a particularly tough challenge. Although it already was very strong in the consumer PC market in China, after the IBM–Lenovo merger, Lenovo became far more dependent on corporate sales, especially in the United States. This dependence on the corporate market made Lenovo vulnerable to the external effects influencing the corporate segment. To counteract its vulnerability, Yang tried to convince Amelio, the CEO at the time, to accelerate Lenovo’s internationalization in the consumer segment. The proposed strategic reorientation met resistance though, as the founder of Lenovo recalls: “[Amelio] was focused on short-term performance; he cared about what investors say every three months”<sup>xix</sup>. Instead, the global financial crisis was prompting many corporate buyers to cut their PC expenditures significantly. Weak brand recognition in the consumer market thus deteriorated Lenovo’s U.S. position even further.

By the end of the crisis, soon after Lenovo sold its mobile phone segment for US\$100 million to focus on its core strengths, the market saw a new trend: the increasing popularity of tablets and handheld devices (e.g., smartphones). The smart gadget era had arrived, and once again, Lenovo had missed the first boat when it came to responding to these trends in the consumer space.<sup>x</sup> Competitors like Apple, Samsung, and Sony already understood the importance of convergence among hardware, applications, and services.

Lenovo’s response to the turmoil in 2008 included a major restructuring of the organization and another reshuffling of top management in February 2009. The management changes foresaw the return of Liu, the founder of Lenovo, as chairman. This was announced at the same time as Lenovo revealed its massive pre-tax loss of US\$268 million for the third quarter of 2008<sup>xi</sup>. In turn, Yang replaced Amelio as CEO in an attempt to turn the company around before it was too late. He introduced his *resource redeployment plan* to lay off 11% of Lenovo’s global workforce and cut back the salaries and bonuses of managers by 30%–50%<sup>xii</sup>. Liu announced that the new leadership would increase its focus on the Chinese and other emerging markets. He further explained that Lenovo’s strong ties to the corporate PC segment, which was a result of its merger with IBM, had left the organization vulnerable during the global financial crisis. Some analysts interpreted this comment as criticism directed at Amelio for failing to push into the consumer market. Thus, though Lenovo’s new strategy aimed at regaining strength in its domestic market and other emerging markets, a simultaneous push into the consumer segment took strategic priority.

In addition to these strategic changes, Lenovo’s production was streamlined and moved to inland China, with the reorganization was structured around three new geographical business units: (1) China, (2) Emerging Markets, and (3) Mature Markets. Furthermore, the company’s headquarters would span three regional headquarters: Raleigh (North Carolina), Beijing, and Singapore, in support of the new strategic focus. Yang also streamlined the managerial organization, such that by 2009, he had reduced the senior management team to just nine people in an effort to speed up decision making and alignment. By the end of 2009, Yang launched his *Protect and Attack* strategy<sup>xiii</sup>, which emphasized speed as the key driver of success. With this new strategy, he intended to *protect* and further strengthen Lenovo’s core markets: China and the corporate segment. After getting back on track in those markets, Lenovo wanted to *attack* new markets, such as emerging economies, and push harder into the customer segment in all geographic regions.

Only a year after its sale, Lenovo bought back its mobile division for US\$200 million (twice the amount it had sold it for) to ensure it could profit from the rapid growth in the mobile segment. As a late mover, Lenovo eventually entered the netbook market and introduced its first smart gadgets, the *Lephone* and *Lepad*.

By the nominal end of the financial crisis, it seemed that Lenovo had found the right track, though its ability to close the gaps and become a global industry leader remained to be seen. Sales increased rapidly; Lenovo gained market shares in all regions. This quick growth nearly immediately required another organizational change to serve its different markets better. Therefore, Yang restructured Lenovo's divisions again in 2011, with an even stronger geographical focus, differentiated into the following units: (1) China, (2) North America, (3) Europe-Middle East-Africa, and (4) Asia-Pacific-Latin America. Its reinvestment in mobile technology also seemed to be showing the first signs of success. Even though Lenovo trailed behind the market leader Samsung and its local competitors Huawei and Coolpad in China, a positive market analysis suggested that Lenovo was gaining traction with the latest generation of its Android products<sup>xiv</sup>. Global net profits recovered from the 2009 loss to reach US\$273.2 million in 2011. In October of that year, Lenovo finally overtook Dell in terms of computers sold and became the second-ranked contender in the global PC market. Also in 2011, Lenovo's Chinese market and corporate global market—that is, the targets of the *protect* part of Yang's strategy—generated approximately 70% of Lenovo's US\$21 billion revenue. With this *protect-and-attack* strategy, Yang devoted approximately US\$273 million of Lenovo's profits from 2010 to the *attack* side to invest into emerging markets, new product categories (tablets, smart TVs, phones) and the U.S. market.

### **A Persistent Challenge: The Elusive U.S. Market**

Lenovo's North American market share in the PC market would not seem to budge though. The decision to focus on its domestic market and other emerging markets resulted in a loss of U.S. market share. By 2012 Lenovo ranked fifth in terms of market share, leading some observers to note that Lenovo's goal to establish global brand recognition through the IBM acquisition had failed.

Its weak brand recognition, especially in the United States, might have resulted from its decision to drop the IBM brand name sooner than required. The agreement between IBM and Lenovo would have allowed the Chinese acquirer to carry the IBM name until 2010, but former CEO Amelio decided to drop the name completely in 2007. To some observers, that move smacked of hubris and overconfidence. David Reibstein, a renowned marketing professor at Wharton Business School said: "What Lenovo is trying to do is get itself established with credibility in this market, but it feels like a premature transition. Lenovo may be strong in China, but it is a non-name in the West"<sup>xv</sup>. By then, Lenovo had recognized the problem too. And yet, profitability was slowly increasing. Experiencing such a boom, despite its low brand recognition in the United States, implied that "the business is ahead of the brand"<sup>xvi</sup>.

In a December 2011 interview, Yang acknowledged these weaknesses and announced his plans to spend millions to promote the brand: "Advertising the brand is crucial to success. We not only have to drive growth, but we also have to drive our margins and profits. We will invest more in branding." Advertising expenditures in the United States alone exceeded US\$100 million and included televised spots, Internet and social media presence, public relations, and sponsorship. With high global growth rates, Lenovo needed to choose the right strategy to advance its brand recognition if it hoped to become a serious competitor in the consumer segment.

## The New Lenovo Culture

By August 2012, Lenovo was “close to surpassing Hewlett-Packard as the world’s leading manufacturer of personal computers following a strong quarterly rise in sales”<sup>xvii</sup>. Hewlett-Packard was only 0.6% ahead of Lenovo in terms of global market share.

But Yang was not satisfied with initiating strategic and structural changes; he also identified a need to strengthen the corporate culture to become a more values-driven company. Both Yang and Liu had identified the “old” Lenovo culture as a major contributor to the problems that had plagued Lenovo in the years after the IBM deal. When the company reported its losses in 2009, the cultural gap widened further. Liu Chuanzhi reflected on the corporate culture at the time of the financial crisis:

In its previous status—after the acquisition and right up to the crisis—the company didn't care about the principle of delivering on your commitment. The top management had a budget year to year, but every quarter when they couldn't deliver, they revised down their expectations. The board witnessed a lot of cases of the management failing to deliver. It was a similar situation with subordinates and managers. When it came to drafting targets, the subordinate would sometimes come up with targets that were too high, or too boastful. But the manager didn't say anything for fear of alienating the employee. Or on the other hand, sometimes a manager would come up with unrealistic targets for the subordinate, but the subordinate wouldn't speak up so as not to criticize his or her boss<sup>xviii</sup>.

As a result, Yang and Liu decided that all divisions, no matter in which time zone they were located or which nationality they represented, should share the same set of values:

Our values serve as the foundation of our company and define who we are and how we work. Principal among them are:

- Serving Customers
- Trust and Integrity
- Teamwork Across Cultures
- Innovation and Entrepreneurial Spirit<sup>xix</sup>

Lenovo had always claimed these as their corporate values, but after the financial crisis, trust and integrity were “upgraded” to become core values, and Lenovo made a greater attempt to instill its values throughout the organization.

Our culture defines us ... it's our DNA. We call it the Lenovo Way and it's the values we share and the business practices we deploy. It's how we address our day-to-day commitments. The Lenovo Way is embodied in the statement: We do what we say and we own what we do...<sup>xx</sup>

Lenovo also made great strides to become a more employee-focused organization: “The key or essential part of our core values is to put people first. We need to make sure our employees love this company. And when we are successful, we need to give back to our employees with incentives and rewards. We need to take care of our employees to make sure they have a good life”<sup>xxi</sup>.

## Toward Global Leadership in the PC Industry

“Our goal is to be No.1 in global PC market. It’s the first time we’ve ever been so close to the top”, Yang announced in April 2012<sup>xxii</sup>. A few months later, Yang promised that he



would donate US\$3 million of his bonus to his staff after seeing them reach a 73% rise in net profits compared with the year before. According to a Lenovo spokesperson, Yang made his donation because he felt it was the right thing to do, "to redirect the money to the employees as a real tangible gesture for what they've done."<sup>xxiii</sup>

Lenovo's financial performance and the changes in culture and mind-set brought about by the merger indicate that the IBM acquisition greatly facilitated Lenovo's transition from a Chinese firm to becoming a global player.



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