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FINAL REMARKS

INSEAD GLOBAL LEADER SERIES
INSEAD BUSINESS SCHOOL
FONTAINEBLEAU, FRANCE
OCTOBER 3, 2006

"LEADERSHIP, TRUST AND THE GLOBALLY INTEGRATED ENTERPRISE"

I'm here to talk to you about leadership. Of course, we could discuss many issues that will be vital to leaders of companies and institutions in this century. But I believe the seminal development for you - your generation of leaders - is the reality of globalization.

The world finds itself at a historical inflection point, when the very nature of business and business institutions is changing. New forms are emerging, and I think it's important that the leaders of the future understand the enterprises and institutions they will lead in the years ahead.

Globalization is changing the fundamental model, even the idea, of the corporation. I discussed this recently in an essay in the American public policy journal *Foreign Affairs*, where I looked at the evolution of the modern corporation through three distinct models.

The first was the 'international' model of the 19th century. For the international corporation, most operations were centered in the home country, with overseas sales and distribution. This basic structure of import/export - centralized manufacturing and international distribution - applied across almost every industry.

Next was the 'multinational' model of the 20th century - which in many ways was a response to the rise of trade barriers during and following the World Wars. To gain access to local markets, the multinational created smaller versions of the parent company in multiple countries around the world, and it made heavy local investments. American multinationals such as General Motors and Ford, for instance, built auto plants in Europe and Asia, which allowed them to sell to important local markets without incurring tariff penalties.

This is the model I joined when I started at IBM in 1973. IBM was a classic multinational. There were "mini-IBMs" in dozens of countries around the world. IBM Japan, IBM Brazil, IBM UK, IBM Germany, IBM Spain. And it was a very successful model. It allowed us to grow in those markets and understand local customer requirements and customs. The IBM brand became a strong national asset in each of these countries. Very importantly, we grew local talent. We didn't export Americans all over the world. We didn't have to. We hired and developed leaders "in country" and exposed them to various parts of IBM during their careers. IBM France has always been led by a French citizen, I'm happy to say - except for one general manager in the 1990s... and he was a French-speaking Swiss.

And, having worked for three years in IBM Japan, I can tell you firsthand that I was very much the gaijin among my Japanese colleagues.



"...THE WORLD FINDS ITSELF AT A HISTORICAL INFLECTION POINT, WHEN THE VERY NATURE OF BUSINESS AND BUSINESS INSTITUTIONS IS CHANGING."

This was a very efficient way to grow in local markets. IBM today operates in more than 170 countries. However, what once looked like efficiency is now coming to look like redundancy. And this is why all businesses that operate around the world are moving to the next model... what I call the globally integrated enterprise.

Why redundancy? In order to gain access to local markets and to scale our businesses in all of those countries, we had to, in essence, replicate IBM in every country. Every country operation had its own sales force, but also its own supply chain, procurement, finance, HR and other so-called 'back-office' functions. In many cases, the countries had their own manufacturing, development, even research capabilities. This is not only expensive, but it increasingly gets in the way of speed, responsiveness and innovation, of making the most of your collective smarts.

A globally integrated company looks very different. This is an enterprise that shapes its strategy, management and operations in a truly global way. It locates operations and functions anywhere in the world based on the right cost, the right skills, and the right business environment. And it integrates those operations horizontally and globally.

For example, at IBM, where we used to have separate supply chains in different markets, now we have one supply chain - a global one - for the entire company. In our professional services businesses, where we used to think about our human capital - our people - in terms of countries and regions and business units - we now manage and deploy them as one global asset. If you apply that same logic to all the operations of a company... from R&D and finance, to manufacturing and logistics. You begin to see how different this globally integrated model is. IBM and many companies have started down this path.

Why is this new organizational form emerging? Very simply: When everything is connected, work moves... the work of business and the work of technology. Work flows to the places where it will be done best - that is, most efficiently and with the highest quality. It's like water finding its own level. The forces driving it are irresistible.

You know that today, for the first time in human history, everything is connected. There are a billion people and hundreds of millions of businesses on the World Wide Web. And the Web has emerged as much more than a mere connectivity medium. It has become a global platform for work - the work of computers, and the work people do.

At the same time that this global networked infrastructure was being built out, we've seen the advent of free trade agreements, a shift to a services-based economy and the emergence of highly skilled labor forces in places like India and China.

So the institutions and barriers that used to block the flow of work, capital and ideas are weakening - in some cases, disappearing. It's happening on a planetary scale, in ways that wash right over national or organizational boundaries. And we're now beginning to see the real consequence of that for business and for society.



**“...WHEN EVERYTHING IS
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CONSIDER:

- The dramatic growth of Indian companies in information technology, accounting and healthcare services.
- The way Google has, in the space of a couple of years, built a market value of \$120 billion.
- The startling fact that more than 70 percent of the computer chips being produced today do not go into "computers."

The Indian services firms and Google are, in different ways, building business models based on the notion that work, activity and collaboration can and will flow from anywhere to anywhere in a flat world. The fact that much of the world's computing is being done, not in traditional computers, but in cars, airplanes, phones, high-definition TVs, game consoles and a proliferating array of devices illustrates that the work of technology also flows anywhere to anywhere in an interconnected world.

In the case of Google, the computing model is totally different from a traditional technology company - say, a Microsoft. Ask yourself: When you "google" some word or some person, where is the data you search through? Where is the software? Where does the processing take place? A tiny fraction of this work is done by your PC. The software is delivered as a service, over the Net. And the processing happens in massive "google-plexes" located in various parts of the world.

For that matter, consider IBM itself. We are the largest computing company in the world, and more than half of our business is services. Increasingly, we will be delivering the benefits of computing over the network, because it's the most efficient and cost-effective solution for many of our clients.

So we have this dynamic flow of work across the global platform. But what determines how and where the work flows? As I see it, it's driven by a couple of forces - you can think of them as Laws of Global Integration. There are three: economics, expertise and openness.

First, economics. You can't fight the laws of economics. A key determiner of where and how work will move is cost and profit potential. There's no question that low cost has been the initial reason why so much work has moved to places like India, China and Latin America... Indian and Chinese labor costs, for instance, are one tenth those in America and much of Western Europe. By one estimate, between 2000 and 2003 alone, foreign firms built 60,000 manufacturing plants in China.

But costs aren't the only factor. If they were, we'd see everything commoditizing and all work flowing in one direction. And that's not what's happening. Why are European biotech and pharmaceutical companies like Roche and Eppendorf building manufacturing and R&D centers in the U.S.? Take Bharti, an Indian telecommunications company. Why is it outsourcing its IT to an American firm... IBM? Why does IBM's annual survey of foreign direct investment trends in manufacturing, services and R&D indicate that Europe regained its position as number one in 2005 - attracting 39 percent of all projects, vs. Asia's 31 percent?

In all these cases, companies are not moving solely or primarily to low-cost environments. What they're doing is obeying the second law of global integration - expertise. In a world where the means of production and distribution are increasingly available to anyone, the only way to differentiate yourself is to have better skills, to have a better idea, to come up with a more innovative solution, to know more than the next guy, and to apply it more effectively.

Of course, a lot of people still hold outdated views on this - including many of the experts who follow IBM. Many believe that globalization is only about low cost: "a race to the bottom." In some ways, I don't blame them. You can't really appreciate what's happening unless you experience it directly.

Frankly, that's the reason we took the unusual step of holding our annual meeting with securities analysts this year in India. Could we have made the same intellectual points about global integration in New York? Sure. But I thought it was important to force these Wall St. analysts to see for themselves what is happening in Asia, so they'd realize that places like India do not simply mean "cheap labor." It was quite an eye-opening experience for those who went to India for the first time.

Finally, you can't defeat open systems and open approaches. You may be able to interrupt the spread of openness or temporarily delay it, but I don't think there's much doubt that open approaches will win out in the end. They provide a level playing field, which stimulates competition, innovation, and the free flow of goods and ideas. Importantly, systems that are open nurture collaboration - the co-creation of value, such as the Linux operating system, which is developed by countless programmers collaborating on the Internet.

So these three forces - economics, expertise and openness - are my candidates for the Laws of Global Integration. Maybe there is a fourth, or a fifth. I'll be interested to hear your thoughts on that.

If you accept the principle that when everything is connected, work moves... then the burning question for companies, for nations, and for individuals is: What will cause work to move to me? On what basis will I differentiate and compete? Economics? Expertise? Openness?

This is a big question, and I can't tell you how many CEOs, heads of state and academic leaders are grappling with it. After a good deal of soul-searching at my own company, we've decided. We've decided to compete on the basis of expertise and openness, and we are moving from a multinational to a globally integrated model just as fast as we can.

This is not easy to do. I can tell you that people develop an emotional attachment to businesses - and ways of doing business - that have been very successful and profitable in the past. But if you want to differentiate yourself and compete in this globally integrated environment, you have to be willing to change, to re-invent yourself, to innovate. And you have to be willing to tolerate the naysayers, at least for a while.

Now, as with any change of this magnitude, there are myriad challenges for leaders. We have to think seriously about issues in a global, not just a multinational context - the rules governing the ownership and use of intellectual property... the new skills we'll need to develop... and the new kinds of organizational culture that will be required.

I want to close my remarks by highlighting two challenges of overriding importance: the need for a new model of leadership and the vital issue of trust.

For the reasons I've described, a globally integrated company is radically different from the multinational corporation it will replace - and it will have to be led by a new generation of leaders, with different skills, experiences and acumen.

Think back to how we at IBM historically developed leaders all over the world. That model worked well if you put most of your global mission in the 'home country' - in our case, the U.S. - and installed strong local leaders heading up your local country organizations. In other words, management was still largely defined by national boundaries. But that approach does not necessarily prepare people to lead global missions headquartered in any part of the world.

Already we have moved our global procurement mission to China, global services delivery to India, and many of the services that support our external and internal Web sites to places like Brazil and Ireland. These people are not leading teams focused on China or India or Brazil or Ireland. They are leading integrated global operations.

I am spending a lot of time on this leadership challenge at IBM. So are many of my fellow CEOs who lead global companies. How do we identify and develop leaders to be effective in these roles? How do we prepare them to lead truly global operations from anywhere in the world? Where will this next generation of leaders come from? I hope some of them will come from leadership business schools like INSEAD. I hope some of them are sitting in this room! If you are, I'd encourage you to think about the important issues and dilemmas you will be grappling with.

And that brings me to the final thought I want to leave with you... the issue of trust. Of all the challenges raised by globalization perhaps the most fundamental is trust. This isn't just about issues like ethics and legal compliance - though obviously those are essential for any business. What I'm talking about goes far beyond that. How do you sustain trust in enterprises that are based on increasingly distributed models? How do you ensure trust when your company's operations, customer and employee relationships and brand may be shaped - or even managed - by companies that are part of your 'virtual' enterprise?

You may choose to leverage the expertise and scale of partners. There are compelling reasons to do that. But I would submit that you cannot outsource trust and responsibility. And I think we all realize that we cannot effectively manage a 21st century company through tops-down hierarchy or organizational structure or by the rule book.

Businesses have to find other ways to operate, and to build trust. At IBM, we've set off down the path of empowering and enabling our people to make decisions and to act. We have been working to "lower the center of gravity" of the company, as I put it - that is, to trust IBMers and push decision-making authority out and down.

We've done this in many ways. We've eliminated layers of management, starting here in Europe, and moved more resources closer to clients in markets. We've innovated in our policies - such as establishing blogging guidelines, which encourage IBMers to get out and engage with the blogosphere, but to do so in a responsible and transparent way. We've undertaken trust-enhancing policy initiatives that extend beyond IBM - such as our recently announced move to improve the quality of patents. This was developed in an open way using a wiki, in collaboration with more than 50 global experts from law, academia, economics, government and technology.

We've also innovated in our management practices, such as our global online 'jams,' where the entire IBM workforce comes together as equals to shape everything from new business ideas, to our business processes and operations - all the way to our core values. In our most recent jam, which just finished a few days ago, more than 140,000 people - including some of our clients and even our own family members - in 77 countries participated.

I can assure you that being much more open and collaborative is, at times, messy and, by definition, uncontrollable. You have to accept a measure of that. But we've found that treating our people as grown-ups - and having confidence that they will behave in a manner consistent with our values - is itself a demonstration of trust. It's how we are building a values-based culture and a values-based management system.

As one final example of this view of a trust-based, globally integrated enterprise, let me mention a new senior management position we've just created - Chief Trust and Compliance Officer. Many companies have senior-level compliance officers, whose roles are typically to ensure enforcement of existing rules and laws. But, as I've said, the issue of trust goes far beyond compliance. The most important job of our Chief Trust and Compliance Officer will be to unleash the ideas and dedication of the only people who ultimately can make trust a pervasive quality within IBM - IBMers themselves.

Now, I won't claim that these new approaches - or any approach - can be foolproof. No matter what controls you put in place, what values you instill or how open and transparent you are, people will make mistakes and do things that aren't right. When that happens, that's when leadership becomes so crucial. It is the responsibility of leaders to act. If you're a CEO, it's not something you delegate. It's your job.

The newness of all this is genuinely interesting - and genuinely challenging. Real innovation always is. But my guess is that you wouldn't be at a place like INSEAD if you didn't know that already. I suspect you came here today understanding that we're at a profound crossroads in business history - and I bet your impulse is to seize upon that and lead it, rather than to resist it or hide from it.

Which is why I'm so happy to be here today, and to have a chance to hear your ideas. Because your leadership is exactly what the world of business - and the world -- will need in the decades ahead.

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