Market Roundup
December 10, 2004

Real Virtual

By Jim Balderston

IBM announced this week that it has expanded its partner offerings by deploying more virtualization and grid computing technologies in its Virtual Innovation Center for Hardware as part of its larger PartnerWorld Industry Network initiative. The thrust of the VIC is to allow ISVs the ability to test, deploy, and run their application on IBM technology, including middleware and hardware. IBM has deployed the innovation center using its virtualization and grid computing technologies that allow ISVs to access IBM hardware and software by an access code to get on the innovation center grid. Virtualization enables the needed hardware and software assets to be deployed when and where they are required by ISVs, without the need for specific, dedicated hardware or software for each ISV. The ongoing efforts to bring ISVs into the innovation center include new how-to guides for implementing applications on IBM technology, including development, porting, testing, and deploying. IBM has also unveiled new tools to help ISVs identify the amount of computing power they will need for their applications.

We view this as a "money where their mouth is" by IBM in its ongoing efforts to build out its partner ecosystem. For ISVs and other partners, the ability to access virtual loaners on which they can tune and deploy their applications and solutions in a laboratory setting — as opposed to inside their customers' server rooms or by purchasing unnecessary hardware and software for their own labs — should provide a real boon to those partners. By offering such a program, IBM cuts down on the logistical hassles of getting loaner equipment out to ISVs, allowing them to get to work more quickly and with less hassle. In doing so, IBM gives those partners the ability to get to the market more quickly and economically which will ultimately cause them to sell more IBM gear.

For IBM, not only does it gain more street cred with partners, it gains a much smoother means by which to engage partners and potential partners compared to the days when IBM technology would have to be physically delivered to those partners for porting and testing. IBM also gains the ability to familiarize partners with both virtualization and grid computing capabilities, technologies that we believe will be core elements of future IT deployments. Seeing that both virtualization and grid are still viewed by many as white-coat non-productized technologies at this point, offering a real-world glimpse (or full ogle) at the stuff would seem to be a good way to seed future markets. Present markets are also affected, as IBM allows its partners to fire up their applications on it wide range of hardware offerings, including its new Power products. Finally, we see this effort as a means by which IBM can garner significant market and customer intelligence, as it learns which technologies partners are embracing and which need further work. Add it all up, and it seems that this effort is as real as it gets.

Defining the World from One's Own World View

By Clay Ryder

At the Oracle OpenWorld conference in San Francisco, top Dell executives belittled the vertical scaling approach taken by rivals IBM, Sun, and HP to create large-scale computing solutions. Dell stated that is going to reshape and rebuild how the data center and enterprise are going to be configured in the future. The company indicated

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that it believes mainframes and UNIX systems can be replaced with Intel-based solutions. However, Dell admitted that the biggest hurdle is convincing customers familiar with large systems that clusters are viable alternatives. To bolster its position that clusters are the future of computing, Dell is working with Oracle, Intel, and EMC on MegaGrid, an initiative focused on 128 dual-processor Dell servers running Oracle 10g and other applications. At present, MegaGrid uses Red Hat Linux as its operating system; Dell is developing a new version that uses Novell's SuSE Linux as well as Microsoft Windows. Separately, the Dell executive overseeing the Dell and RedHat partnership stated that Red Hat needs to lower its price for Enterprise Linux 3, or risk losing customers to free versions of open-source Linux.

There are two ways for any company to close the gap between the demand of the marketplace and its current product line. One approach is to pay attention to customer demand and tailor products that meet these needs. The other approach is to convince the customer that the products the company has for sale offer the only valid solution, and that the customer had better change his/her view to match that of the vendor. Typically, vendors will try the first approach (especially if the competition is doing so as well), but if they fail, they will lapse into the second course of action. With Dell, we see this running the course. A few years back Dell was promoting vertically scaled solutions with up to thirty-two CPUs. When that did not set the market on fire, it tried its hand at eight-way solutions, and then downgraded its scope to four-way solutions. Now, the company states that clustered or grid-enabled solutions of two-way servers are the wave of the future. Interestingly, this not only fits with their new architecture vision, but optimizes margin by using systems that can be sold as single units as well.

From the early days of Dell's foray into vertically scaled solutions, many noted that the PC-focused vendor lacked the credentials to play in the rarified air of high-end enterprise computing. Dell's limited success and ultimate abandonment of this space would seem to be testimony to this view. However, does Dell's failure in this segment mean that the market does not want vertically scaled solutions, or does it mean that Dell cannot successfully market these solutions to those who seek them? It is easy to blame others for one's own shortcomings; however, it does not make said shortcomings go away. Dell is attempting to steer the market's calculation of IT solution value based solely on the factors of which Dell is the undisputed leader, e.g., the upfront price. Yet, it is hard to imagine that a cluster of 128 systems requires the same or lesser degree of management as a single vertically scaled server. However, this is not part of the equation as it is inconsistent with the Dell viewpoint. Dell's public disparagement of the cost of Red Hat Linux, a part of the Dell ecosystem, is another illustration that the company wants the value assessment to remain fixated on the initial price of its solutions. While Dell may have the muscle to force this concession, it does nothing to alter the fact that Dell remains a one-trick server pony. Since it has failed to successfully deliver vertically scaled solutions to the marketplace, it will simply berate those who have. This is too bad. From our vantage point, vertically and horizontally scaled solutions each offer unique capabilities that can be easily matched to a given customer's need. In our mind, those who seek to offer the best solution to a customer based upon the customer's needs, as opposed to the vendor's, will be the ones that stand to benefit the most from future IT spending, whether it is for vertically or horizontally scaled solutions.

IBM Strategic Announcement: Lenovo Acquires IBM's PC Division

By Rob Kidd

Lenovo has announced that it will acquire IBM's PC division, thus forming the third-largest worldwide PC supplier business, with approximately $12 billion in annual revenues on volume of 11.9 million units. Lenovo is paying IBM $1.75 billion in cash, debt, and stock, and IBM is assuming an 18.9% Lenovo equity position that IBM has agreed to hold for three years. The deal includes a long-term alliance in PC sales, service, and financing worldwide where IBM will be the preferred services and customer-financing provider to Lenovo. After the acquisition, Lenovo will have approximately 19,000 employees, with the IBM PC division and Lenovo contributing approximately equally to the total head count and management to be drawn from both companies. Stephen Ward, IBM's PC division SVP, will become Lenovo's new chief executive. Yuanqing Yang, currently Vice Chairman, President and CEO of Lenovo, will serve as the chairman of Lenovo post-transaction. Lenovo will be headquartered in New York with principal operations in Beijing and Raleigh, North Carolina. The transaction is expected to close by Q2 2005.

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Over the last several years, IBM has been divesting itself of business that is not core to its enterprise market. For some time, IBM's PC business has been low margin, losing money, and not offering the company much leverage in the enterprise space, so its divestiture on one level should be no surprise. Lenovo and IBM consider the move a broad-based strategic alliance, with IBM stating that it is moving its PC portfolio to the company's partner network. This deal may provide IBM the best of several worlds as IBM would be able to concentrate intensely on its enterprise business while not losing its ability to deliver PCs as strategically necessary. By holding an equity position in Lenovo, IBM could also reap gains in the high growth Asian PC markets while having some input into the actions of Lenovo's business through IBM's representation in the post-acquisition management team. Since Lenovo will provide PC products to IBM, its partners and customers may benefit from cost savings achieved by Lenovo's potentially lower manufacturing costs and enhanced economies of scale. Lenovo should benefit as well as the company expands from a $3 billion to a $12 billion enterprise, with an 8% worldwide PC unit market share.

While some would consider this transition an opportunity for Dell and HP to take advantage of FUD in the market, we are not so sure there is cause for great jubilation on their part. Dell, the cutthroat price-cutting giant that manages margins to the fraction, will now face a large competitor with the potential to slice costs and margins perhaps even more than the Texas stalwart. As for HP, perhaps this will provide the opportunity for a reasoned reconsideration of its competing against Dell on Dell's terms approach that has not exactly endowed the company with grand riches. HP could take position as being the only locally owned and operated, high value-add, enterprise-focused PC technology supplier; ironically, the position that used to be associated with IBM. For HP to continue the "volume makes up for margin" approach in this new market would seem suicidal at best. Nevertheless, this deal would increase Lenovo's global presence in the notebook PC marketplace and IBM's 30,000 professional enterprise sales team would provide a robust pipeline of enterprise PC business opportunities well into the future for Lenovo. As the PC market continues to evolve, it is taking on characteristics of the consumer electronics industry, with a tilt towards suppliers with enormous economies of scale, low manufacturing costs, and a singular product. As such, Lenovo, as a PC-only supplier, may be able to find the profits that eluded IBM in delivering PCs not only to the enterprise, but to the consumer markets as well.

Seibel Moves after SMBs

By Jim Balderston

Seibel Systemshas announced that it is launching a new partner program by which it hopes to sell its CRM products to SMBs. The company said its new program will combine direct sales with local and regional channel partners as well as an alliance program to spur the development of applications for the SMB market. The new program, a departure from Siebel's long commitment to direct sales, has already triggered the hiring of more than seventy regional sales territory managers. Those territory managers will help provide sales training and leads to partners who will work in conjunction with Seibel's own internal sales staff. The company also said it would be changing the ways it processes contracts and proposals so that it is more appropriate for the SMB customers it hopes to land. Siebel says its new program is targeted at companies with up to $500 million in annual revenue and that it would be offering the company's hosted CRM OnDemand service as well as the company's CRM Professional Edition on-site application suite.

We suspect this will end up a test case as to how well large enterprise IT vendors can transform themselves into viable SMB players. Seibel Systems has a long history of selling enormous, complex, and expensive CRM products in large enterprises, its product and sales channels have historically been strictly the high end. As Seibel saw its revenue and profits fall, it did notice that companies offering alternative Web-based services — like Salesforce.com — were making significant inroads into their market. Seibel has responded with its own CRM OnDemand service, but apparently believes it must do more to move down market.

Will they succeed? At first glance, it seems that the company is making the right moves initially by building up a partner ecosystem that will allow it to sell to SMBs, who buy most of their IT from trusted channel partners that own both the relationship with the customer and the expertise in the customer's vertical market. Enticing new application development from third parties with both of these attributes could be a successful go-to-market

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strategy. The fact that Seibel's CEO is an ex-IBMer who should have some familiarity with IBM's channel strategy is also a plus. But we are taking a wait-and-see approach to this effort, as Seibel is trying to change long-standing practices within their company that are antithetical to channel partners and anything besides direct sales of costly, complex installations of heavy-duty application suites. While we see this announcement as one moving in the right direction to capture SMB customers, we believe Seibel has a long way to go to prove that it is really serious about selling to SMBs and that it has the ability to defy its existing corporate culture and execute this strategy.

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