

# Red Hat Within The 7-S Model:

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An Analysis



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## Introduction

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An analysis of Red Hat's responses to the rapidly shifting market and the slump in the technology sector provide much insight into the internal workings of the largest commercial Linux vendor in the world<sup>1</sup>.

As the largest company in a nascent segment of a troubled industry, Red Hat has shown their mettle in nimbly dealing with numerous challenges which have broken many other Linux-focused companies.

Red Hat's structural form is best described as "functional". Research into their corporate structure shows a formal delineation of responsibilities with five top managers and 12 vice presidents of varying responsibility and seniority<sup>2</sup>. This paper provides an analysis of their structure within the 7S model.

## Analysis

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### Strategy

Red Hat's strategy as of June 1999 was to be "a leading provider of open source software and services"<sup>3</sup>. With the overwhelming success of their IPO, Red Hat had the resources to invest in other companies (buying some outright, partnering with or, financing others) as well as attempting to develop their own e-commerce website. Three major factors in their strategy which, in hindsight prevented them from the fate that has visited many other startups were their continued focus on Linux, their comparative restraint in spending and the collective business expertise they gained through management turnover.

Red Hat began with and has stayed focused on Linux throughout it's life. Their IPO engendered experimentation in the form of expansion, acquisition, increased R&D and the development of numerous new products. Many of these experiments proved unprofitable and have been shelved.

Perhaps due to their distance from Silicon Valley, Red Hat did not succumb to as many of the excesses of the technology boom as other new ventures did<sup>4</sup>. Also, unlike many other new ventures, Red Hat had a tangible product and a known reputation as one of the premier Linux distributors prior to their IPO.

Unable to compete on price for their flagship product (Red Hat Linux) due to the GPL, Red Hat early on focused on reputation, offering high service levels and market awareness/penetration as well as research and development.

## **Structure**

Research indicates that Red Hat follows a functional delineation of responsibilities with much cross-fertilization. Red Hat's top management is divided into 2 groups of upper management (5) and the vice presidents (12). The vice presidents assume very specific responsibilities including research (Vice President, Engineering), product development (Senior Vice President, Technical Workstation & Vice President Engineering Services, etc.) and several functional and regional sales areas. The sales functions do overlap between geography and function (i.e. embedded sales and north Asia) but, in practice, this causes little conflict because the geographic sales regions tend to be in the smaller non-north American markets<sup>5</sup> where a single regional manager makes sense.

With the end of the technology boom, Red Hat is facing their first life-threatening challenge. They have taken a beating in their stock price<sup>6</sup> and have been forced to lay off employees<sup>7</sup> in search of cost savings but have fared much better than many of their IPO peers who have been bought out or gone out of business.

## **Systems**

The public face of Red Hat is one of a close knit team working smoothly to achieve their goals. As a high profile player in the Linux market, one could reasonably assume this to be correct due to a lack of recriminations and gossip<sup>8</sup>. However, according to SEC filings, many of the current executives have golden handcuffs which hold on for four years. Many of the vice presidents have not been working for Red Hat for quite four years, having replaced other executives or been recruited after the 1999 IPO. It will be interesting to see if there are any defections over the next two to three years as the golden handcuffs are released.

Not top heavy for a 600 person company, the corporate team is well experienced running technology companies and is composed of almost equal parts long term employees, executives from the acquisition of Cygnus in late 1999 and three who have joined since

1999<sup>9</sup>. Of the top five executives, one is a founder and the other three were brought on board beginning around 1999.

Being tied to the Linux community and industry leaders<sup>10</sup> through the GPL, Red Hat receives almost instantaneous feedback on research and product development. As a lead funder of Linux R&D, they also influence the development of Linux itself<sup>11</sup>. As a service provider they must be very attuned to their customers needs; a service provider's mark of quality is their reputation.

### **Style & Shared Values**

The public culture of Red Hat is that of a cheeky, competent medium sized business with designs to grow dramatically. They have used the media much to their advantage to tweak Microsoft and other competitor's noses<sup>12</sup>. As the lead Linux distributor, many pundits assume they will be the next Microsoft if/when Linux takes over the desktop.

An analysis of the public statements of Red Hat managers show they are very aware of this assumption but are careful to hedge their bets and continually repeat the mantra of their focus – corporate servers and embedded systems. Yet their actions speak of a broader dream; to be the Linux desktop of choice to replace Windows.

### **Skills**

Red Hat is a leader in providing comprehensive solutions based around Linux. They focus on corporate back office solutions, the embedded market and more recently, partnering with larger solutions providers.

More generally, as young as they are, they are building a reputation for uncompromising quality. In the services industry, reputation is everything; if they do not maintain/continue to build it, they are sunk.

## **Staffing**

Like any technology company, Red Hat's most valuable asset is their human capital. Recruiting and retaining the best programmers is a very high priority. Attracting them to their main campus can be difficult given its geographic location in North Carolina however they also have R&D offices in Sunnyvale and Oakland, California.

Founded by Marc Ewing and Bob Young in 1994, Red Hat's management has seen much change since their pre-IPO days. Matthew Szulik was recommended as president by major funders in 1998 and, with his arrival Red Hat began the transition from a startup company to a well organized, focused organization. Major changes ensued in 1999 with the acquisition of Cygnus and growth from their IPO. Since 1999 the management team has stabilized as they focus on consolidation and weathering the current slump in the market.

## **Conclusion**

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Red Hat has matured from a small one man operation to the premier Linux distributor with 600 employees in only 8 years. The largest challenge Red Hat has faced is the loss of customers and capital due to the bursting of the tech bubble. Through the maturity and experience of their management, Red Hat resisted many of the excesses found at other tech companies during the bubble. They wove themselves into a complex web of high-powered funding<sup>13</sup> and marketing and R&D agreements. It is this network, their refocusing on core competencies and their fiscal discipline which has, so far, carried them through these tough times. With the strong momentum that Linux is gaining, if Red Hat is able to continue to adapt to the shifting market and survive these lean times, they will be poised to take advantage of the many developments occurring in the Linux market.

## Notes

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<sup>1</sup> Red hat is the largest company focused purely on Linux as measured by size of company. With the freely downloadable and freely copied nature of all Linux distributions, any statistics given as to market share have quite a bit of error. See <http://counter.li.org/reports/machines.html> for more statistics.

<sup>2</sup> See <http://www.redhat.com/about/corporate/team/>

<sup>3</sup> From the 4June99 S-1 SEC filing for Red Hat, inc. which may be found at: [http://10kwizard.ccbn.com/fil\\_list.asp?TK=RHAT](http://10kwizard.ccbn.com/fil_list.asp?TK=RHAT).

<sup>4</sup> Though top management still had to send out company-wide emails chastising employees for rollerblading everywhere, showing that they were not immune to the relaxed atmosphere of the time.

<sup>5</sup> Showing a dramatic increase to 33% of revenue but still, 2/3 of their revenue comes from the North American market. See <http://www.linuxgram.com/article.pl?sid=01/09/27/1637215&section=185>.

<sup>6</sup> Opening at \$14 a share, Red Hat's stock quickly soared up to \$286/share before descending to a low of \$2.40/share. Recently the stock has stabilized and even grown slowly.

<sup>7</sup> On September 27, 2001 Red Hat quietly laid off 17% of their workforce, bringing the company headcount back down to about 600, the same level as seen in early 2001. Those laid off were primarily "from non-revenue-producing activities such as marketing along with some folks from two acquisitions that Red Hat recently closed that the company decided not to keep." (see <http://www.linuxgram.com/article.pl?sid=01/09/27/1637215&section=185>) This move can be interpreted as an effort by Red Hat to increase their efficiency and eliminate non-core (or low revenue generating) areas.

<sup>8</sup> Through extensive research, only one single derogatory comment from an anonymous "former executive" was found regarding Red Hat's management structure and systems.

<sup>9</sup> Long term employee is defined here as an executive who has been with Red Hat since before their IPO, Cygnus, a small but profitable company was acquired in late 1999 to gain their compilers and embedded expertise.

<sup>10</sup> Through funding and marketing arrangements, Red Hat is tied to many industry leaders including IBM, Dell, Hewlett Packard and others.

<sup>11</sup> Red Hat's influence on Linux development is inclusive, not exclusionary. They can not deter others from working on any particular aspect but can encourage (through funding and research) development on specific aspects and by keeping high-profile developers such as Alan Cox (a kernel maintainer) on their payroll. Alternatively, we live in a world of limited resources and Linux development has very dispersed but limited resources. Any development Red Hat influences is development effort which could have gone elsewhere.

<sup>12</sup> Red hat has issued "challenges" to debate Microsoft in the past and, more recently, offered to provide a free copy of Red Hat for every computer which Microsoft was going to donate to schools as part of a proposed (rejected) settlement in the DOJ case. See <http://www.eweek.com/article/0,3658,a%253D18847,00.asp>

<sup>13</sup> from the likes of Intel and IBM among others