

Big Blue Gets A Red Hat:

An analysis of the alliance between IBM and Red Hat



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Introduction

The traditional model of software sales (often called closed source) is based on the producer of the software having tight control over the software; effectively they have a monopoly on every aspect of the software. Users do buy not the software but, rather, a license to use the software. Typically, an End User License Agreement (EULA) prohibits the user from making copies of the software except for backup purposes. Additionally, the EULA usually restricts users from modifying the software.

With open source software such as the Linux OS, users are not prohibited from copying the software and many open source licenses include clauses whereby the source code *must* be included with any distribution of the software to protect the user's freedom to use and modify the software.

If users can freely copy and distribute the software, the traditional business model of selling software becomes untenable. The most popular business model being pursued by companies which produce and distribute open source software is that of selling convenience and services such as installation, support, training and custom modifications.

If you are a closed source software producer, anyone who wants a copy of your program must purchase it from you and any changes a user may desire must be made by you. Users of open source software are not beholden to any producer or distributor; in the open source environment, reputation, reach and customer loyalty become much more important than in the closed source environment. And there is no better way for a fledgling company to gain these attributes than to associate themselves with a large and respected industry leader such as the alliance Red Hat has forged with IBM.

Big Blue

At one time IBM controlled and set the pace for the computer industry. No longer in the dominating role they once occupied, IBM is still the largest technology-focused corporation in the world¹.

Recognizing they no longer have the power to dictate to the industry, IBM has adopted a strategy of embracing nearly any and all technologies available. This allows them to adopt (or reject) technologies as they see fit, unlike several other large companies whose business models are based on controlling markets or segments thereof².

Seeing the value of open source software and how it would prevent a company from influencing what IBM did with the software, IBM has joined the movement with open arms.

Using a strategy of being “above the fray”, IBM has developed alliances with four of the leading Linux distributors. However, from press releases and research, it appears that Red Hat is the favored distribution³.

Red Hat

Begun as part of a class project of founder Marc Ewing in 1992, Red Hat has grown and matured to become the leading Linux distribution in North America and is the largest Linux-focused company in the world.

Recognizing early on that they needed more support from the industry⁴, Red Hat developed a series of relationships with major companies ranging from vague marketing agreements to actual investments in Red Hat by these companies. None of these relationships has been more important to Red Hat than the one with IBM for building credibility with investors, potential clients and providing a mentoring relationship for Red Hat as a whole.

When discussions of an IPO began in early 1999, COO Matthew Szulik⁵ understood Red Hat needed more of an advantage over other distributors of *nix⁶ systems than loyalty and reputation if they were to grow beyond the small technically astute user base they

had developed and move into the corporate server room. They needed wide exposure and alliances with the companies who installed and serviced the computers in businesses. The beginning of these alliances was for Red Hat to secure \$7 million in their final round of funding from several technology “heavy hitters” including IBM.

Benefits

Mentoring

Connections between Red Hat and IBM run deep. Red Hat founder Marc Ewing spent summer internships at IBM⁷, held a contract job at IBM⁸ for a short time period after he graduated from college, Ewing’s father worked for IBM⁹ and IBM invested in Red Hat in early 1999. In December 2000 Dr. James Neiser moved from IBM to Red Hat bringing many years of experience to the role of Chief Marketing Officer. With all of these connections, there is bound to have been a large transfer of corporate values and business acumen from IBM to Red Hat.

Financial

The amount of money IBM invested in Red Hat¹⁰ is not a significant amount given the size of IBM or Red Hat but the value of this vote of confidence to Red Hat in market exposure and customer association far exceeds this investment.

Marketing

From 1998 to the present, one advantage Red Hat has gained over other Linux distributors is their association with many industry “heavy hitters.” Given that the Linux operating system can be freely copied and modified, the switching costs from one distribution to another are very low and qualities such as brand name gain increased importance. In part through cross-marketing, licensing agreements and co-branding services with IBM and others¹¹ Red Hat has cultivated their brand name to become the best known and largest Linux distribution in North America.

Reach

Red Hat gains advantage from IBM through IBM’s global reach. Following petroleum and other companies to the far reaches of the globe, by carrying Red Hat’s products, IBM is giving them much more and much larger exposure than Red Hat could afford¹².

Potential Liabilities

Dependence

Diversity in customers as well as suppliers is important for the long term health of any organization. If Red Hat derives too much of their revenue from IBM-related sources, this could be a potential liability to Red Hat if their relationship with IBM should sour or if IBM does not support Red Hat as much in the future. Red Hat should continue to make efforts to build a successful business independent of IBM.

Independence

Financial investments, personal relationships, even employee “exchange” has occurred between IBM and Red Hat. All of these connections make it difficult for Red Hat to pursue an independent course of action which may be at odds with what is best for Red Hat.

Conclusion

Red Hat, one of the first commercial Linux distributors, has grown to become the largest and most recognizable distributor in no small part due to the active interest IBM has shown. Red Hat has derived great benefit from this mentoring relationship and it is in their interest to continue this relationship into the foreseeable future. There are, however, potential problems which could arise including a lack of diversity in customers and a lack of operational independence. Red Hat should strive to grow their non-IBM customer base as well as grow their organizational capabilities to wean themselves from the heavy dependence they currently have on IBM.

Notes

- ¹ IBM is the world's largest information technology company, as well as the world's largest hardware company (\$33B); IT Services (\$35B) and IT rental and financing (\$3.4B) company. (Jan.'02)." See <http://www-916.ibm.com/press/prnews.nsf/html/fyi.html#corporate>
- ² Two companies which come to mind are Microsoft which, for all intensive purposes, controls the desktop market and is notorious for "improving" their OSES to maintain their market dominance and, Sun Microsystems whose market share is rapidly being eroded by cheaper alternatives (see the Netcraft survey for Feb 02 at <http://www.netcraft.com/survey/> for a graph which shows the rapid demise of Solaris on webservers).
- ³ With the compatibility found between all Linux distributions, it would be very easy for IBM to switch their primary alliance to any other Linux distribution.
- ⁴ "[CEO] Szulik felt Red Hat had to have more support from industry... if it was going to have a shot at convincing the capital markets that the company was more than just a hacker's commune..." See http://www.linux-mag.com/1999-11/redhatipo_01.html
- ⁵ Matthew Szulik joined Red Hat in December 1998 as COO. See "Inside the Red Hat IPO" by Wendy Goldman Rohm at <http://www.linux-mag.com/cgi-bin/printer.pl?issue=1999-11&article=redhatipo>
- ⁶ *nix is often used to represent the many OSES of Unix descent including OSES such as Minix, Linux, FreeBSD, Solaris, etc.
- ⁷ See http://www.salon.com/tech/view/1999/10/04/marc_ewing/ for history of the beginnings of the Red Hat Linux distribution.
- ⁸ Alan MacCormack & Kerry Herman, "Red Hat and the Linux Revolution" (Harvard Business School case 9-600-009), page 6.
- ⁹ See http://www.linux-mag.com/who/lmwho_all.html
- ¹⁰ The exact amount is unknown but it is known that IBM, Compaq, Dell Novell and Oracle together provided \$7 million in Red Hat's third and final round of funding before their IPO. See http://www.linux-mag.com/1999-11/redhatipo_01.html
- ¹¹ These agreements range from the red Hat logo being put on Dell servers and listed as a "partner" on their website to the tight integration between the IBM and Red Hat developer teams.
- ¹² Red Hat currently has offices in 18 countries. Source: <http://www.redhat.com/about/corporate/wwoffices/>