

## Cover Story: How Red is Turning Blue: The effects of \$34B IBM-Red Hat marriage



*Ginni Rometty, chairman, president, and CEO of IBM, at right, and Jim Whitehurst, CEO of Red Hat, left.*

By Lauren K. Ohnesorge – Senior Staff Writer, Triangle Business Journal – Oct. 31, 2018

Red Hat CEO Jim Whitehurst stood in front of hundreds of perplexed faces, telling colleagues – both online and in the folding seats – that the company, long known for its stand-alone culture, was about to go blue.

The day before, on Oct. 28, employees in Raleigh learned that instead of piling into Red Hat Tower on Monday, their presence would be required at Duke Performing Arts Center downtown for an

all-hands meeting to talk about the surprise news most of them hadn't seen coming. Red Hat – the millennial-savvy, jeans-wearing brand that had just celebrated its culture with Red Hat Agile Day 2018 – was being bought by corporate stalwart IBM.

“You're probably in some stage of absolute shock, fear, scared – and I get that,” Whitehurst said. “And there are a lot of emotions associated with this, certainly for me and for I know many, many, many of you.”

Some in the crowd, flecked by the customary red hats the “hatters” received after their hire, nodded in response. “Think about what we continue to talk about at every company meeting, which is we have just such a massive, massive, massive opportunity in front of us,” Whitehurst opined. “And we see that every day.”

His biggest frustration, he told the crowd: “We don't have the resources, we don't have the commercial breadth, we don't have the depth.”



*Red Hat Tower, Raleigh, N.C.*

Enter IBM: A 380,000-employee behemoth that “solves all those problems for us,” he said.

But the \$34 billion price tag comes with risks of its own. The culture Whitehurst, and others before him, built is on the line. Whitehurst, for his part, said it's in safe hands, pointing to IBM's pledge to keep the brand as a stand-alone operation. And how this all plays out will have major implications for the Triangle as two of its major employers, Red Hat and Big Blue, seek to sustain their own identities – and avoid becoming a purple mess.

When asked at the meeting, “Do we have anything beyond good intentions and your word to stand on?” Whitehurst responded, “\$34 billion for an open-source software company is kind of putting your money where your mouth is.”

Analysts say the deal depends on IBM and Red Hat selling that message to employees.

“IBM is really going to need to incubate Red Hat culture,” says Cassandra Mooshian, an analyst with Technology Business Research. “If that flops, then they paid a lot of money for a big mistake.”

### **Major implications for Triangle**

And it’s a mistake that could be felt far outside Red Hat Tower, as Red Hat is integral to Raleigh’s tech-savvy brand.

Red Hat, whose veterans have spurred numerous companies in the region – from Bronto Software to Lulu.com – has become part of the identity of a city that saw it rise and disrupt an industry.

Red Hat, from the beginning, championed the open-source movement – one that pitted it against established players in the technology sphere. It started when a Raleigh technologist known for wearing a red Cornell University lacrosse hat, Marc Ewing, met his co-founder, Bob Young, at a technology conference. Young had been running a catalogue business out of his house. Ewing had been distributing the Linux operating system on CDs. When Young started selling the CDs, Red Hat software was born and brought to Raleigh in 1995.

Red Hat sold Linux as a boxed product on store shelves and tried to explain why open source was a needed alternative to the status quo.

As Young said in 1999: “Would you buy a car with the hood welded shut?”

“You can open the hood of our car and fix it yourself,” he said of Red Hat.

Wall Street bought in that year as the firm went public for \$84 million, raising most of its institutional capital from outside of the Triangle. Less than 20 percent of its 6 million initial shares landed in the hands of individual investors. Triangle Business Journal reported at the time that, despite its local roots, “it appears likely that Triangle investors outside of Red Hat employees and friends received less than one-half of 1 percent of the initial shares.”

Dennis Kekas, associate vice chancellor at N.C. State University, recalls Red Hat’s humble beginnings on just one floor on Varsity Drive at Centennial Campus. Not only did Red Hat soon fill the entire building, they moved into another one across the intersection.

“Then they said, ‘We need to double again,’” he says, recalling how their growth forced them downtown. While at N.C. State, however, Red Hat did its part to make university graduates more competitive, helping to secure federal money for what became the Secure Open Systems Initiative.



*Jim Whitehurst, CEO of Red Hat.*

“It helped us to create a lot of work in the area of security associated with open source as a part of that,” Kekas says. And even after Red Hat left for downtown Raleigh in 2012, the prowess of the brand continued to be leveraged by the university to secure new tenants to Centennial Campus.

“We will frequently mention the relationship we had with Red Hat,” he says. “People say, ‘Gee, you lost them.’ We say, ‘No, look at the community gain.’”

Kekas is hardly alone in leveraging the company’s brand to lure technology jobs to the region.

Red Hat is an oft-worn talking point for economic development recruiters. In touting Raleigh’s technology talent pool, economic developers always mention the open-source software giant in its information packets. Whitehurst would even take it a step further, as he did with the state’s successful pitch for Infosys’ 2,000-job Raleigh tech hub in 2017. Ravi Kumar, president and deputy

chief operating officer of Infosys, said at the time that a personal appeal by Whitehurst served as “the emotional quotient needed to close this deal faster.”

But now, will Red Hat have the same recruitment oomph?

Brent Lane, a Kenan Institute Fellow of economic strategy at the UNC-Chapel Hill Kenan-Flagler Business School, says that, even if the brand remains, “the corporate entity, the leadership will certainly be secondary to IBM and that, to me, is a loss.”

“Just as it’s prominent on the skyline, it’s prominent on external perceptions and internal perceptions of the new Raleigh,” he says, equating the deal to “a big death in the family.”

“Red Hat, in many ways, is the new Raleigh. ... IBM was the old corporate, Research Triangle Park tenant. ... I think they embody different generations of Raleigh and now one has eaten the other,” Lane says.

But John Boyd, a site selection consultant with The Boyd Company in New Jersey, disagrees.

“There’s this idea of the branding quotient, of losing a headquarters,” he says. “But executives will not interpret this move in that light because everybody knows about IBM’s long history in Raleigh and the RTP.”

Boyd says there are numerous examples of acquired companies who – so far – have kept their branding power, such as Whole Foods, whose headquarters remained in Austin, Texas, even after the Amazon acquisition.

“This really makes IBM now the No. 1 cloud-computing company in the nation, bigger than Amazon, bigger than Google and Apple, so this will be a new engine, a new driver of IT jobs in low-cost, pro-business, skill set-rich Raleigh,” he says. “There’s even some additional nuances here that speak to Raleigh’s emergence as a major player, a major IT market in North America.”

### **Can the cultures co-exist?**

But the potential strength of the deal depends on whether two companies with dramatically different cultures can connect.

Red Hat, even as it built a reputation as a disruptor, was also crafting a cultural brand – one outlined in Whitehurst’s own book, “The Open Organization.”

“Red Hat is an experiment in applying the principles of open source for how you run an organization ... an organization that engages participative communities inside and out,” Whitehurst wrote in 2015.

IBM, once known for a conservative approach marked by its suits and white shirts, has worked hard over the years to shift its own brand toward the collaborative, opening up “agile workspace” at its massive RTP campus as it transitions toward emerging technologies such as cloud and cybersecurity.

But the opaque white walls that framed its development teams haven’t entirely come down. While Red Hat is an urban company, where jeans are encouraged and walks to downtown Raleigh sandwich shops are routine, IBM remains on its expansive campus at the largely unchanged RTP. IBM has seen multiple layoff rounds and is defending itself against federal lawsuits accusing it of age discrimination. And while Red Hat’s earnings calls talk about growth expectations, IBM’s calls continue to talk up traction in an ongoing transition.

IBM, for its part, has said the Red Hat brand and management team will remain untouched, for cultural and business reasons. To remain neutral, a “Switzerland” in the software landscape, executives say it’s important that Red Hat remain a separate entity.

With nearly a year to go before deal closure, the companies will need to sell that message to employees, analysts say. As it’s an open-source company, the real value is in its people and their expertise – and that is set to diminish if Red Hatters jump ship, Mooshian says.

Diane Adams, chief culture and talent officer at Sprinklr, agrees. Adams, whose tenure includes executive positions at Cisco and Allscripts, says Red Hat’s culture is effective because the company has engaged its staff to “rally around the mission.” The key to keeping the culture will be in keeping that mission, she says. In her tenure at Cisco, she saw more than 100 acquisitions, and the ones that worked there were “where they were allowed to continue to thrive relative to their culture,” Adams says.

In Red Hat’s case, Whitehurst’s commitment to stay on as part of IBM’s executive team, reporting directly to IBM CEO Ginni Rometty, works in its favor, as he’ll likely be a strong advocate for the culture he helped build, Adams says. And keeping employees through the close of the deal requires something Red Hat is already good at, she adds: communication.

“They’re going to have to acknowledge the uncertainty ... talk about how they’re going to keep the culture ... and have open, two-way communication,” she says.



*Virginia "Ginni" Rometty, CEO of IBM.*

## **Huge bet for IBM**

While IBM has conducted several acquisitions, analyst Mooshian says this is “IBM’s first go at bringing in a company and saying right from the get-go, this is going to be operated as a stand-alone unit.”

And IBM needs to execute the deal “perfectly,” she says. Otherwise the price tag – which already means debt for IBM – will sink Big Blue even further, she adds. And IBM has banked its strategy – not just its billions – on the deal.

“This is a way for IBM to get access to the mid-market,” Mooshian says. “It’s not something they’re necessarily great at executing, whereas Red Hat is very pervasive there. ... And if they have access to IBM’s global scale and IBM’s global enterprise base, that could really help scale Red Hat’s own portfolio reach.”

But even with the business case for the deal, overlap exists that could make its way into Red Hat Tower.

The deal brings Red Hat under IBM’s technology services and cloud platform group, “which has a ton of services people of its own, some of which are trained in Red Hat,” she says. “Are they going to keep Red Hat people and do more layoffs at IBM or vice versa?”

Mooshian predicts IBM as the only suitor able to offer Red Hat a buyout at that price – particularly as Microsoft recently made its own major open-source move in acquiring GitHub.

Mooshian says there could be an ulterior motive behind the acquisition, noting that Rometty could be nearing retirement. "IBM tends to hold on to their CEOs until they turn 60 and Ginni Rometty is now 61," she says. "Could they be trying to prime Red Hat's CEO to take over IBM?"

Even if that's the case, Mooshian says she can't "begin" to predict what that might mean for the Triangle, where Whitehurst and his wife, entrepreneur Lauren, have built their home and family.

The deal makes IBM's presence in the region even more massive.

Already, IBM owns more than 900 acres and 3.2 million square feet of office space in RTP, a campus that has anchored the sprawling office park since the 1960s. And it has a small office footprint at Centennial Campus. Red Hat occupies its entire building in downtown Raleigh, with subleases running through 2035. And, through its 2015 Ansible acquisition, it also leases space above the Durham Bulls Athletic Park. It's a combined footprint that far exceeds the 450-acre IBM World Headquarters in Armonk, New York.

When asked if IBM and Red Hat might utilize each other's real estate, Steve Robinson, IBM's RTP-based general manager of cloud platform services, said, "We're not even close to being able to speculate on that."

On a media call, however, Arvind Krishna, senior vice president of hybrid cloud and director of IBM Research, opened the door to that possibility, joking that he might someday "move offices into [Red Hat's] Boston location."

"It's literally nicer than where I am right now," he said.

### **Quiet concerns at Red Hat**

It's a statement that unknowingly sums up some of the Red Hatters' fears, expressed online in the days following the deal announcement, even as executives continued to try to quell concerns through a series of conference calls, memos and that all-hands meeting in Raleigh.

On Reddit, anonymous users opined about what they feared would be "the death of Red Hat." They swapped stories about colleagues already purportedly leaving for competitors such as Google.

But executives insist the fears are unsubstantiated.

"Red Hat as a brand is going to keep going for as long as I can foresee. ... There is no time limit on that," Krishna told reporters.

"They're spending \$34 billion on an open-source technology company," added Paul Cormier, executive vice president at Red Hat. "That means they're not buying IP, they're not buying



technology. They're buying people. I think that's a testament to that level of investment to help maintain the culture that's made Red Hat the value it is today."

Still – industry watchers say that, no matter what, something bigger is changing – bigger than a stock ticker.

"They get a really great premium ... but at the same time, the Triangle loses another headquarters," says Joe Colopy, a Red Hat alum who went on to found Bronto Software. "Even though Red Hat will be run independently ... it's not the same, and over time, things will change. It might take a while. It might be slow. But they will change."



*Paul Cormier, Red Hat executive vice president and president of products and technologies.*

"It's definitely the end of an era," agrees Todd Olson, whose growing downtown Raleigh tech firm Pendo is one of several companies in line to be the next homegrown brand. "It's kind of sad."

But both see opportunities rising from whatever is left, however – no matter what happens in the coming decades. For Olson, it could mean recruitment opportunities, as his firm, now at 150 employees, continues to compete for talent.

"Red Hat culture is probably very different from IBM culture and ... while it will take a while for the dust to settle ... you'll start seeing an opportunity to recruit from there," he says.

Colopy sees new companies emerging, should "seasoned" executives embark on their own. "Now we need to build the next Red Hat, right? So 20 years from now we can have another billion-dollar exit," he says.

And Young says the \$190 per Red Hat share IBM is paying will create major liquidity.

He uses himself as an example. When he sold off shares in the company years ago, he invested the money into new ventures, such as Raleigh drone developer PrecisionHawk and his own publishing startup, Lulu.

“Think of all the investment money now freed up,” Young says. “A whole bunch of investors now have capital to invest in the next big thing. ... They have just empowered a huge investment in the open-source community.”