POST-MERGER INTEGRATION:

How I.B.M. and Lotus Work Together

To create a successful merger requires respecting each partner’s differences. It also requires procedures for settling disputes and integrating workforces strategically.

BY GLENN RIFKIN

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At 8:25 A.M. on Monday, June 5, 1995, Jim Manzi, chief executive of the Lotus Development Corporation, received an unexpected phone call from Louis V. Gerstner Jr., the chairman and chief executive of the International Business Machines Corporation.

I.B.M., Mr. Gerstner said, had just tendered an all-cash offer of $64 a share for Lotus, a storied software maker in Cambridge, Mass., and he hoped Mr. Manzi would come willingly to the deal. Shocked and surprised, the combative Mr. Manzi initially refused, spent two days seeking a white knight to keep Lotus independent and then grudgingly accepted the $3.5 billion buyout, the largest by far in software industry history.

This is the story — pieced together through interviews with many of the principal players — of what happened in the aftermath of that agreement. An anatomy of a corporate marriage that started out as the idea of only one of the parties, the story is a case study of the consummation and management of a high-profile merger, offering lessons that have resonance for C.E.O.’s in any industry, not just those in high tech.

Many of the events that followed the announcement of the deal were expected. These included an avalanche of media coverage; the departure of many top Lotus executives, including, eventually, Mr. Manzi; fear and uncertainty among Lotus’s 4,500 employees; and speculation by industry pundits that Mr. Gerstner’s bold and aggressive move was doomed to failure.

Now, three years later, it is clear that something unexpected also occurred: by any reasonable measure, the I.B.M.-Lotus deal has succeeded, meeting and exceeding nearly all strategic and financial projections, thus flying in the face of industry history.

High-tech mergers and acquisitions have left a spotty record over the last two decades. Many of the largest, most visible deals have failed outright or produced a dubious payoff for their participants. Great expectations have often been dashed by a woeful lack of vision along with the difficulties of merging disparate product lines, operations and cultures in an unforgiving and rapidly shifting marketplace.

With all that, the appetite for deals has gotten only bigger. Merger and acquisition activity in the global high-technology marketplace has soared in the past two years, with the number of transactions rising from 2,700 in 1995 to more than 4,000 in 1997 and their dollar value jumping from $130 billion to nearly $250 billion, according to Broadview Associates, a technology mergers and acquisitions investment banker in Fort Lee, N.J.

Pressed by shortening product and technology life cycles, an increased need for scale in both manufacturing and distribution, the proliferation of the Internet and the consolidation of certain industry segments, high-tech companies are turning more than ever to mergers and acquisitions as a preferred path to growth, Broadview pointed out.

In the continuing search for a formula for success, C.E.O.’s with voracious appetites might do well to turn to the I.B.M. acquisition of Lotus for a blueprint of best practices in the art of M&A. Though high-tech mergers have certain characteristics unique to that industry, the tenets for success cross industry boundaries and can be applied to most marketplaces. Indeed, while Mr. Gerstner made few acquisitions — none hostile — before joining I.B.M. in 1993, what he knew of deal-making he learned during his long career in such brand-based businesses as RJR Nabisco and American Express.

Against what seemed to be insurmountable odds, the I.B.M.-Lotus marriage has reaped great benefits for both companies. I.B.M. now has a leadership position in a key market segment in which it would otherwise have been a struggling also-ran. For Lotus, the arrival of I.B.M. provided the resources to jump-start the sales of its flagship product, Notes, without sacrificing its corporate mission or culture. But the merger meant even more than that: in a marketplace increasingly dominated by the Microsoft Corporation, Lotus was in imminent danger of

becoming irrelevant when I.B.M. threw out its $3.5 billion lifeline.

That was hardly the anticipated outcome when word spread of I.B.M.’s proposal that June morning. Lotus, critics warned, would be smothered by the bureaucratic morass of I.B.M., its unique and innovative culture lost in a Big Blue quagmire. Conversely, the top software developers at Lotus would undoubtedly rush to the exits, the outsiders said, and I.B.M. would be left holding a $3.5 billion bag. No one, the pundits snickered, had told Mr. Gerstner that you simply don’t do hostile takeovers of software companies.

The early returns seemed to support the doomsayers. Within months of initiating the buyout, I.B.M. was facing what appeared to be a crippling blow to the future of the Lotus deal. Notes, the popular “groupware” communications program that was the main enticement for I.B.M., was under siege. Groupware is a type of software that connects many users, allowing them to share information or work together on a project.

Notes was suddenly being challenged by technology on the Internet and the World Wide Web, in particular, that appeared, at first blush, to provide similar groupware capabilities but was cheaper and easier to install and use. The “intranets,” or private corporate networks, made possible in large part by such technology were beginning to proliferate, and industry analysts began to spread the message that Notes was dead. A front-page article in The Wall Street Journal in November 1995 cast doubt on the I.B.M.-Lotus deal, speculating that I.B.M. might never recoup the high price it paid.

Thus the table was set for Mr. Gerstner and John M. Thompson, I.B.M.’s senior vice president for software. Not only did they face the unenviable task of incorporating Lotus into the I.B.M. universe, but they would also have to labor under harsh market conditions. If any merger or acquisition looked primed for failure, it was this one.

What the analysts underestimated, however, was Mr. Gerstner’s resolve. They also didn’t appreciate just how deftly Mr. Gerstner and Mr. Thompson had been handling the deal from the outset.

THE PLAN

Mr. Gerstner has a well-earned reputation as a corporate turnaround artist, winning high marks as chief executive at both RJR Nabisco and American Express prior to joining I.B.M., where he inherited a foundering giant badly in need of an overhaul. He has led I.B.M. through a thorough re-engineering process: the company has shed 200,000 workers and become leaner and more focused than at any time since the days of Tom Watson Jr.

Under Mr. Gerstner, I.B.M. turned an $8 billion loss in 1993 into steadily growing profits, earning $6 billion last year on sales of nearly $80 billion. I.B.M.’s market valuation has grown by more than $75 billion since 1993 and is now nearly $100 billion. Last year, the stock hit an all-time high, and split for the first time since 1979.

Like a veteran military leader, Mr. Gerstner is a tenacious tactician who understands markets and pays close attention to details. Mr. Thompson does his homework, too. When he suggested the Lotus acquisition to Mr. Gerstner in February 1995, he had left little to chance.

Mr. Thompson had initiated extensive analysis of the marketplace and of Lotus’s prospects. He made sure, for example, that the deal would be a good fit, both strategically and operationally. Lotus not only would fill a key product gap but it would be a central pillar in Mr. Thompson’s six-pronged strategy for turning I.B.M. into a software powerhouse. The acquisition would also reflect a new dynamism at I.B.M., showing that Big Blue was not a stodgy dinosaur but instead was willing to take a risk and pay serious money to back it up. The planning was detailed and thorough. Though serendipity always plays a role in successful deals, this acquisition worked because of a well-conceived game plan.

David Marshak, a vice president of the Patricia Seybold Group, a Boston consulting firm, has tracked Lotus for more than a decade. What led to the deal’s success, he said, was the right mix of personalities and industry conditions. “In many acquisitions, there is a loss of focus on what the company is about and the competitive situation,” Mr. Marshak said. “With I.B.M. and Lotus, Microsoft gave them a common enemy to position against.”

Most important, he added, Lotus customers were not “victims” of the merger. “Overall, they have felt better taken care of since the merger than...
before it happened,” Mr. Marshak said. What follows are some of the key tenets that I.B.M. followed.

**Don’t drag your heels and don’t look for bargains.** I.B.M.’s game plan was clear, simple and perfectly executed. When Mr. Gerstner called Mr. Manzi that Monday morning, the offer of $64 a share, a premium price, was both non-negotiable and impossible to spurn.

Some analysts said that I.B.M. had vastly overpaid. But the idea was to move quickly and without hindrance. Mr. Thompson knew that

“From an investment banking standpoint, the execution was flawless,” said Michael Zisman, a Lotus vice president at the time. Mr. Gerstner, he said, is a tremendous stickler for details and his diligence pays off. “By 10 o’clock the first morning, we were just observers,” Mr. Zisman said. “It was done.”

Mr. Thompson gets credit for the planning and execution of the deal. As a software veteran at I.B.M., he feared the hostile takeover route more than Mr. Gerstner did. But he built a team inside I.B.M. of 15 key people to sort through every detail of the plan — financially, legally, operationally — so that I.B.M. could move quickly.

Lotus could not survive as an independent entity in the current market and he feared that either the Oracle Corporation or AT&T would make a bid. He had tried to negotiate a deal with Mr. Manzi on several occasions but had been rebuffed. I.B.M. had to act fast and with precision, even if it meant a hostile bid. There would be no protracted talks and negotiations to drag the deal out for weeks or months, as often happens with hostile offers. Most important, the high price would scare off potential rivals and competing bids.

“You can’t do it tentatively,” Mr. Thompson noted. “You have to have a game plan that is thought through really well, especially in a hostile takeover.” And what Mr. Thompson’s team concluded from carefully studying Lotus and the marketplace was that a contingent of people at the company would view the takeover as positive, as a way for Lotus to continue its fight to make Notes an industry standard platform. Contrary to conventional wisdom, the team said, a hostile takeover would not set off a massive brain drain. Some people would leave, but Ray Ozzie, the creator of Notes and the single indispensable figure in the deal, would stay.

(See accompanying story, next page.)

In fact, as with most successful mergers, timing was everything. At the time of the offer, Lotus was a company on the ropes, with revenues from its former flagship product line — its desktop suite of applications like Lotus 1-2-3 — in steep decline and revenue growth and profitability from Notes still just a pipe dream.

Had I.B.M. waited, Lotus’s fortunes would likely have dipped even further, along with its share price, and I.B.M. might have closed the deal at a far lower price. But Mr. Gerstner un-
In the acquisition of a software company, the main asset is the people and their intellectual capital.

In deciding to acquire the Lotus Development Corporation, Louis V. Gerstner Jr. and his team at I.B.M. had done their due diligence and drawn up a list of the people at Lotus who were indispensable. A week after the initial offer for Lotus in June 1995 and within a day of the decision by Jim Manzi, the C.E.O., to accept the deal, Mr. Gerstner and John M. Thompson, I.B.M.’s software division vice president, flew to Boston to meet Lotus employees and then the press.

Mr. Gerstner, I.B.M.’s chairman and chief executive, made all the right comments to employees — that I.B.M. valued the Lotus culture and staff and that he intended to make sure they stayed intact — but the initial shock and fear of widespread layoffs remained. I.B.M. had also posted news of the merger and its plans for Lotus on the Internet so that word would spread quickly in the high-tech community and among Lotus customers. In addition, I.B.M. launched an extensive public relations campaign to reassure employees, customers and business partners that it intended to keep Lotus’s popular product, Notes, on track.

Mr. Gerstner and his people felt that they had to do even more — and quickly. The I.B.M. deal doubled the value of stock options held by many Lotus employees, and the sudden liquidity of those options was already stirring thoughts of departure in many minds. The loss of some valuable people was unavoidable in such a situation, but a stampede for the exits would be disastrous.

Leaving the downtown Boston theater where he had met with Lotus employees, Mr. Gerstner, accompanied by Mr. Thompson and by Mr. Manzi and other Lotus executives, jumped into a limo, drove to Logan Airport and boarded a company helicopter for perhaps the most crucial stop of the day.

The helicopter made the short trip from Boston to Westford, a suburb northwest of the city and the home of Iris Associates, a newly acquired subsidiary of Lotus. The unusual detour was critically important. Mr. Gerstner wanted to meet Ray Ozzie, the head of Iris and the creator of Notes. It was no secret that Notes was the linchpin for the deal, the killer product that I.B.M. had built the merger around. If there was one person the company could not afford to lose, it was the 40-year-old Mr. Ozzie.

In the nondescript Iris offices, the company’s 60 employees waited with Mr. Ozzie for Mr. Gerstner and Mr. Thompson, the architect of the deal, to arrive and pay them homage. The Iris employees, still getting used to their acquisition by Lotus a year earlier, were cynical and apprehensive.

Mr. Gerstner eased the tension. He glanced around at the small group and the austere surroundings and quipped, “I paid $3 billion for this?” Everyone laughed and listened while the I.B.M. executives stated their case. There were no canned speeches, Mr. Ozzie recalled. “My people are engineers — they are candid
derstood the risk: a cheaper price might have brought him a lesser asset or even cost him the prize by attracting another suitor. I.B.M., with $10.5 billion in cash in its coffers, could afford the higher cost. Mr. Gerstner decided not to wait.

And when things happened, they happened quickly. Rather than allow the seeds of fear, uncertainty and doubt to be sown in the sudden upheaval at Lotus, I.B.M. moved fast with a raft of critical decisions.

Get the right people to run the show. Perhaps the most important lesson of the deal has to do with the way that I.B.M. responded to Mr. Manzi’s decision to resign, which came 99 days after the acquisition was announced. Mr. Manzi initially surprised I.B.M. and industry watchers by saying he would stay on after the merger. His personal stake, after the deal, was $78 million, and the volatile, sharp-tongued chief executive seemed an unlikely candidate to be satisfied running a subsidiary.

Mr. Manzi insisted on reporting directly to Mr. Gerstner, and Mr. Thompson, a people-savvy veteran and team player, stepped aside and patiently watched events unfold. Mr. Manzi decided not to hold up I.B.M. for more money, was a powerful message both to his own people and to I.B.M.

When Mr. Manzi abruptly quit later that year, the press again speculated that Mr. Ozzie would soon follow him out the door. Mr. Manzi had championed Notes for many years, even rejecting a sale of the nascent technology early in its development.

But Mr. Thompson said he was not worried that Mr. Ozzie would leave anytime soon.

“I understood what Ray wanted to accomplish by then,” Mr. Thompson said. “I didn’t think he would leave because Jim left. His loyalty was to Notes.”

And he didn’t leave until the fall of 1997, when it was clear that Notes was well on its way.
Neither Mr. Zisman nor Mr. Papows wanted the C.E.O. job — Mr. Thompson sensed they were afraid it would undermine their strong relationship. So he suggested a dual leadership of Lotus, through an Office of the President, with Mr. Zisman as chief executive and Mr. Papows as C.O.O.

Gerstner his intentions, Mr. Thompson placed a call to Mr. Zisman and to another Lotus vice president, Jeffrey P. Papows, who were both at a managers’ meeting on Cape Cod. He told them about Mr. Manzi’s decision to leave and asked them to meet him that afternoon in Boston at the Four Seasons Hotel. As they drove back from the Cape, the two Lotus executives could only speculate about what Mr. Thompson had in mind. Would he bring in an I.B.M. manager? Would he look outside?

Within 15 minutes, Mr. Thompson laid out his plan. The right thing, he said, was to have a Lotus executive run the show. Putting in someone from Big Blue would be disastrous, a blow to the integrity of the deal, and an outside search would take months and likely not yield the best candidate. And that, too, would send the wrong message.

Mr. Thompson said, “You guys are insiders, you’re in the right place. How do you want to do this?” The two were startled but pleased by the decision. Mr. Papows (pronounced Pap-pas), a 44-year-old former jet fighter pilot with the Marines, joined Lotus in 1993 after serving as president and C.O.O. of a small software company. Mr. Zisman, 49, an entrepreneur, sold his company, Soft-Switch, to Lotus in 1994 and stayed on as a senior executive. The pair had been successfully running Lotus’s communications business unit together and Mr. Thompson had noticed them well before Mr. Manzi decided to leave.

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It was a bold stroke and the two men agreed. Mr. Gerstner approved it immediately. News releases announcing the move were out within 24 hours of the disclosure of Mr. Manzi’s resignation in order to squelch hallway rumor, gossip and angst at Lotus and around the industry.

The new arrangement served to reinforce the autonomy that Lotus was being granted by I.B.M. To be sure, a few industry watchers suggested that the pair were “yes” men that I.B.M. wanted in place of Mr. Manzi and that their installation was actually the first step toward the loss of Lotus’s identity. But over the next two years it became clear that I.B.M. had, in fact, found the right leaders for a ticklish merger situation: smart, assertive consensus builders who could sublimate their own need for the spotlight to make the marriage work. Mr. Thompson laughs at the suggestion that either man was a sycophant, pointing to the opinionated, outspoken nature of both as well as their willingness to lock horns with I.B.M. managers on a host of issues.

In choosing the two, I.B.M. got a pair of complementary veterans: Mr. Zisman had worked closely with I.B.M. over the past 15 years and Mr. Papows knew Lotus and Notes intimately. Mr. Papows was also well-connected in the industry and had strong ties to such key business partners as Sun Microsystems, Oracle, Intel and even Microsoft.

More importantly, both men were
able to check their egos at the door. They had no hidden personal agendas or designs on power. The challenge for them was making the merger work and building the success of Notes.

“I’ve had C.E.O. next to my name for a long time,” Mr. Zisman said. “I’m doing this for a different reason and it’s not for the money. To me, the really interesting challenge is how you make a merger of this magnitude work.” Mr. Zisman sees himself as someone who can drive decisions by getting disparate factions to work together.

Not long after the arrangement was instituted, however, Mr. Zisman’s wife became gravely ill. He took a five-month leave to care for her and their three young children and when she died, Mr. Zisman permanently downsized his role. He remains a key partner and adviser to Mr. Papows, who has become Lotus’s chief executive, and a conduit between I.B.M. and Lotus for strategic technical matters.

As is usual in any acquisition, the Lotus deal was marked by an exodus of senior executives that began before Mr. Manzi left and continued afterward. At least 10 top managers took their lucrative payouts and left. But Mr. Gerstner and Mr. Thompson expected some departures as inevitable and never panicked. In most successful takeovers, when senior people leave, a new layer of talented managers emerges and, given the opportunity, performs admirably under pressure. It was no different at Lotus, where a group of young managers was ready to step in and take over. Armed with a grant of autonomy from I.B.M., the new leaders helped make the transition a smooth one.

Insure autonomy, avoid layoffs and feared layoffs, employment steadily rose. In under three years, the head count has swelled to close to 9,000, nearly double what it was at the time of the acquisition. And the annual attrition rate, which was 11 percent before the merger, has since dropped to 6 percent.

Mr. Thompson understood the focus on cultural issues and the fear that I.B.M., with its remaining army of more than 200,000 employees, would simply smother the creative Lotus environment with a bureaucratic blanket. Lotus employees realized that I.B.M. sold more in a week than Lotus did in a year.

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both worlds,” he said. “I’ve seen too many deals where the acquirer thinks the way they do things is the right way and they impose their values and management systems on the acquired company without any regard to what worked well there. If you do that, you can destroy their system and end up buying nothing.”

By contrast, Mr. Thompson was quite prepared to celebrate the Lotus culture and to have it rub off on I.B.M. “Frankly, I wanted some of our employees to behave more like Lotus employees,” he said. Thus, he kept all Lotus systems — such as benefits, compensation plans, stock options — in place. “I really didn’t care about that stuff,” he said. “It was not instrumental to making Notes more successful.”

To insure that Lotus’s culture would be protected, Mr. Thompson assigned a person in his office to be the full-time gatekeeper of all communications between the two companies for the first year. In this regard, he avoided having a thousand well-meaning I.B.M.ers descend on Lotus with suggestions and rules about how things got done.

During the first six months, only one I.B.M. employee transferred into Lotus. J. Philip Dellasega, a 30-year sales and finance veteran, came to Lotus in October after the chief financial officer resigned. Mr. Dellasega took over the post and spent the first six months quelling the paranoia that he was sent in to initiate layoffs.

Mr. Dellasega said the fear gave way to a period of “peaceful coexistence” as it became clear that I.B.M. fully intended to allow Lotus to remain autonomous. In many acquisitions, the new parent proclaims at the outset that it wants input from the acquired company only to turn its back on the promise as soon as the ink is dry. Instead, layoffs commence, bean counters arrive, cost-cutting measures begin and turf battles break out. But Mr. Gerstner had no intention of going that route. He and Mr. Thompson honestly believed that I.B.M. needed to create a viable presence in the networked personal computer software market and that Lotus would show them the way.

I.B.M. was actually humble enough to admit that its track record in mergers and acquisitions was terrible. Showing up like a barbarian at the gate was not likely to be effective at a company with a culture like Lotus’s. And despite its mammoth size, I.B.M. understood its limitations. “We were not sure we could bring as much value to Lotus as they could bring to us,” Mr. Dellasega said.

Lotus had pioneered the desktop software market with the groundbreaking 1-2-3 package in 1982 and Notes would become the 4-5-6. Despite its stumbling in a market increasingly dominated by Microsoft, Lotus understood the game, the rules and the players. What I.B.M. acquired was not only leadership in what is known as the distributed middleware market, but a presence as a forward-looking, hip player in the hottest part of the software business. With Lotus as a spearhead, I.B.M. would shed its stodgy mainframe image and become the New Blue.

Perhaps nothing demonstrated I.B.M.’s faith in Lotus more than the way the company reacted in late 1995 to a proposal from Mr. Zisman and Mr. Papows. Clearly dispelling any doubt about their chutzpah, the two suggested that the price of Notes be chopped in half, to under $70, from $155. In response to the burgeoning competitive threat of the Internet and Web-based intranets, Lotus needed to greatly accelerate its market share growth, and a sharp price cut would potentially fuel such growth. There
was no hard proof, however, that the move would succeed. Some companies, having just paid a premium price for an acquisition, would have thought such a request outlandish.

But when Mr. Zisman and Mr. Papows presented the idea to I.B.M. executives, they got a quick and unconditional go-ahead. Both Mr. Gerstner and Mr. Thompson understood the move was speculative. “We’re betting on people at this point,” Mr. Gerstner said. “Let’s go for it and hope you’re right.”

Lotus announced the price cut in December 1995 along with a revamped Notes strategy, including a new add-on product called Domino that would complement the Web and make Notes more effective for Internet users. The hope was that Domino would weaken the argument that the Web would render Notes irrelevant. I.B.M. sent 600 people to join Lotus’s sales force and sales began to grow immediately. Mr. Thompson later created software account manager slots, some filled by Lotus people and some by I.B.M.ers, so that the cross-pollination of the sales force would move quickly.

Sales accelerated even more when Lotus, with I.B.M.’s approval, launched a $200 million international marketing and advertising campaign in 1996 for Notes and Domino. Yet another demonstration of I.B.M.’s faith in Lotus was its willingness to pay for the offbeat marketing campaign, which featured television and radio ads with the quirky comedian Denis Leary. Had another I.B.M. division suggested using the irreverent, wisecracking Mr. Leary to pitch a product, the answer would have been “no way,” according to Mr. Dellasega. But for Lotus, I.B.M. gave its approval. Mr. Thompson even sent I.B.M.’s advertising agency, Ogilvy & Mather, to help out. Because of the campaign, Domino has become the crown jewel in I.B.M.’s Internet strategy and one of the most recognized Web brands.

Understand the real cultures, not the outside perceptions. Whatever the cultural differences between the two companies, the gap was not nearly as wide as the press made it out to be. Both companies had moved far from the stereotypes that might have held true a decade earlier.

Lotus’s founder, Mitchell Kapor, who had taught Transcendental Meditation and favored Hawaiian shirts at the office, had left in 1986. Though Lotus retained its reputation for an open, creative environment with progressive benefits plans, it was not the undisciplined counterculture that some made it out to be. With $1 billion in revenues, Lotus was a serious business venture, replete with a strict set of operational guidelines and all the internal politicking of a real company.

Conversely, I.B.M., under Mr. Gerstner, had shed much of its straight-arrow image along with its infamous dress code of blue suits, white shirts and black wingtip shoes. Having undergone a massive and painful restructuring in the early 1990’s, I.B.M. emerged with a new attitude. Casual dress and a refocused view of the computer world brought I.B.M. and
Lotus much closer together than outsiders could know.

“The reality is the cultures really weren’t that different — it’s 250,000 of the most anal-retentive, type-A personalities on the face of the earth,” Mr. Papows said in an interview with The Boston Globe.

One of the first questions Mr. Gerstner got from a Lotus employee when the merger was announced, for example, was what impact the deal would have on Lotus’s benefits policy for spousal equivalents of gay employees. I.B.M. not only did nothing to subvert that plan, or any other part of Lotus’s benefits, but actually adopted spousal equivalents coverage for I.B.M. equivalents as well.

Don’t damage the acquired company’s credibility with customers and business partners. From the outset, Mr. Gerstner and Mr. Thompson did more than toss bouquets and issue rallying cries. They took decisive steps to show they were solidly behind the acquisition.

Within three months of the merger, for example, Mr. Thompson terminated all internal software development for programs that might compete with Lotus products. He also shut down I.B.M.’s antiquated internal electronic mail system and installed more than 200,000 copies of Notes, making I.B.M. a showcase for the product. In so doing, he greatly reduced the potential for inter-organizational squabbling, which often sinks mergers. The territorial battles would never get under way. By keeping the focus on the market rather than on themselves, the two companies avoided the interminable meetings that paralyze most acquisitions.

Having the C.E.O. stay visibly committed to the deal was crucial. Mr. Gerstner immediately began meeting with key Lotus customers. Within the first two quarters, I.B.M. and Lotus salespeople were doubling up on accounts, giving Lotus unprecedented visibility. And Mr. Gerstner didn’t just talk the talk — he has continued to be Lotus’s highest-profile salesman, actively promoting Notes to all I.B.M. and Lotus customers. I.B.M. has opened doors to a slew of new Notes accounts, including US West, Chrysler, Coca-Cola, Mobil and Prudential.

There were other crucial calls that impressed Lotus employees. For example, I.B.M. could have used Notes to try to prolong the life of OS/2, an operating system the company had unsuccessfully marketed to compete with Microsoft Windows. Toward that end, I.B.M. could have insisted that Lotus developers create a Notes version for OS/2, which would have caused costly delays in the design of newer versions of Notes that customers were waiting for. Instead, I.B.M. agreed to delay the OS/2 version until other platforms had been accommodated.

As soon as the takeover was announced, in fact, both Mr. Gerstner and Mr. Thompson placed personal phone calls to a list of high-profile C.E.O.’s — Scott McNealy at Sun Mi-
crosystems, Lew Platt at Hewlett-Packard, Larry Ellison at Oracle and Andrew Grove at Intel, among others—to assure them that I.B.M. was committed to a cross-platform Notes and would not create disadvantages for their products in order to gain advantages for I.B.M.’s computers.

Though competitors scoffed, I.B.M. backed up the promise. It allowed Lotus to delay implementation of Notes for I.B.M. mid-range and mainframe computers, not only because a decision to the contrary undoubtedly would have sent Lotus engineers rushing for the doors, but that changes were well considered and happening gradually.

Nothing demonstrates the payoff more than the numbers. Fewer than 3 million copies of Notes were sold before the merger. By the end of 1998, sales will reach 30 million. Notes is now a $1 billion business by itself, with Lotus’s total sales well above that mark, according to I.B.M., which does not break out separate figures. At the time of the deal, Mr. Thompson estimated that for every dollar that a Notes sale generated, the company would reap $2 more in service, support, consulting and hardware revenues. In fact, I.B.M. is gaining $5 for every $1 of Notes sold.

Go beyond peaceful coexistence to successful cross-pollination. The best mergers maintain a balance of independence and integration between the two companies. If I.B.M. erred at all, it was in not pushing Lotus harder and earlier to take advantage of I.B.M.’s rich trove of resources. John Landry, Lotus’s chief technology officer at the time of the deal and now a consultant to both companies, met with Mr. Gerstner early on. “You could have made a better investment, like a Treasury bond, if you’re just going to leave Lotus alone,” he remembers telling Mr. Gerstner. But the I.B.M. chief felt the synergy would come over time.

Mr. Papows said that Lotus missed opportunities to leverage I.B.M.’s influence in the corporate computing market by erring on the side of caution. “We didn’t want to send the wrong signals to our people and risk accelerating the exodus,” he said. But because of I.B.M.’s huge presence, Lotus could have fashioned more deals, for example, getting personal computer makers to bundle in its Smart Suite applications package.

Nonetheless, I.B.M. opened its research and development doors wide for Lotus engineers. Ray Ozzie, the creator of Notes, who eventually did leave the company to begin research on his next big idea, said that the technology transfer between the two organizations has been impressive. He recalled that at the outset, Mr. Thompson promised that I.B.M. would not overwhelm engineers at Lotus or at Iris Associates, a company headed by Mr. Ozzie that Lotus had itself recently acquired. “Our people

Both Mr. Gerstner and Mr. Thompson displayed great patience at every crucial juncture, acceding to the wishes of the acquired company rather than forcing their will during a volatile period when connections were being made and relationships formed.

also because the company needed to gain credibility within the industry if it had any hope of making Notes a widely accepted standard.

Both Mr. Gerstner and Mr. Thompson displayed great patience at every crucial juncture, acceding to the wishes of the acquired company rather than forcing their will during a volatile period when connections were being made and relationships formed. The perception of Lotus customers was
rolled their eyes,” Mr. Ozzie recalled.

But true to its word, I.B.M. allowed
the engineers to schedule meetings at
which I.B.M. researchers would
demonstrate various I.B.M. technolo-
gies. “You can pick what is interesting,”
Mr. Thompson told them. This kind of
unqualified access to a multibillion-dol-
lar research resource was unprece-
dented in the software business and
Lotus has integrated several key I.B.M.-
spawned features, such as voice recog-
nition, into new versions of Notes.

At the same time, engineers from
both companies began to migrate
back and forth and further the inte-
gration of the product lines, gearing
up for the inevitable onslaught from
Microsoft in the communications soft-
ware battle that is already under way.

Engineers, Mr. Zisman said, don’t care
whether they are in Cambridge or Ar-
monk, N.Y., where I.B.M. is based, or
what company badge they wear as
long as they are working on the next
great idea. Together, for example, Lo-
tus and I.B.M. engineers created a Ja-
va-based suite of productivity appli-
cations called eSuite that extends the
company’s presence in network-
based computing.

In turn, I.B.M. reaped its own re-
wards, particularly in the change in
perceptions about the company as a
player in networked desktop comput-
ing, electronic commerce and the In-
ternet. Analysts now mention I.B.M. in
the same breath as Microsoft, Oracle,
SAP, Sun, Compaq, Dell and Hewlett-
Packard. This was a big leap forward
for a company that had traditionally
been tied to the corporate data center
and glass-housed mainframes.

“Having a presence in the cus-
tomer’s face is very different than be-
ing buried in the backroom,” Mr.
Landry said. “This showed I.B.M. to be
bold, with a dynamism that hadn’t
been there before.”

Indeed, the Lotus deal was a key
strategic piece of the remaking of I.B.M. under Mr. Gerstner. The com-
pany’s 1997 annual report embodies
this remarkable makeover, with an at-
ttractive young woman, an I.B.M. Java
developer clad in tight black jeans,
gracing the cover. With the flair of a
Gap ad, the report is titled “The New
Blue.” I.B.M. has repositioned itself
back into relevancy, analysts say, and
Lotus has played no small part in that
transformation.

The good experience with Lotus
also helped persuade I.B.M. to acquire
another independent software com-
pany, Tivoli Systems Inc., in March
1996. Emboldened by the Lotus deal,
I.B.M. folded its systems management
group into Tivoli and allowed Tivoli
management to run the show. A $50
million company at the time of the
deal, the Tivoli division has surpassed
$1 billion in sales and is still growing at
a rate of more than 100 percent a year.

As the Lotus deal has progressed,
the market reaction to I.B.M. has shift-
ed enormously. In just three years,
I.B.M.’s stock went from being a “boat
anchor,” as Mr. Papows said at the
time of the deal, to a high flyer. Not on-
ly have Lotus employees reaped new
and lucrative rewards with I.B.M.-sup-
ported bonus plans — as evidenced
by a fleet of Porsches in the company
garage — but the very image of I.B.M.
has changed completely.

“I.B.M. is now a cooler place to be
associated with than when we started,” Mr. Papows said. Lotus, for example, sent 75 people to Nagano, Japan, for the Winter Olympics to run I.B.M.’s Web site. The site received half a trillion “hits” during the Games, which gave Lotus engineers a test lab for high-volume Internet traffic that they could not have created in any other way.

Hold the champagne. If the two companies have learned anything, though, it is that success is a hard thing to hold on to, especially in the high-tech sector. Microsoft has Notes squarely in its gun sights and plans to use its ubiquitous operating system to bundle in its own Notes-like product, Exchange. Industry analysts believe that Lotus has a two-year technology lead, but Microsoft salespeople are already telling customers “we’ll make Lotus irrelevant.”

For Lotus, the buyout has freed it from the constraints and pressures of quarterly earnings reports and the scrutiny, at least directly, of the public market. But Lotus employees, especially the longtime veterans, understand the risks involved in staying dependent on a single successful product for too long, as happened with Lotus 1-2-3. Even with the protective cloak of I.B.M., there is an urgency to find the next big idea.

“There will come a day when Notes will be subsumed by something else,” Mr. Dellasega said, “and we have a huge portion of our eggs in this basket. We need to know which is the next market we want to lead.”

With I.B.M.’s deep pockets and global presence, Lotus now has its best shot at finding that next prize. Still, with the acquisition just marking its third anniversary, the laurels are not solid enough to rest upon. The short-term success of the deal can pave the way for greater cooperation and synergy, but all that can be lost quickly if the respective leaders lose touch with the core of the relationship. At the very least, the key players are acutely aware of that possibility.

“You can accomplish anything when there is mutual respect,” Mr. Zisman said. “You can’t do anything when there isn’t.”