The 1990s appear to have been a formative decade for a new organizational reality and an intensifying competitive landscape. As companies struggle to meet the growing challenge of survival in the global marketplace, they often experience periods of significant, even radical, organizational change. This is usually accompanied by the commensurate turmoil that change often brings. Although each company is unique, careful study and an insider's view can provide valuable insights into understanding the dynamics of how these organizations cope with both the positive and negative aspects of organizational change.

The spin-off of Electronic Data Systems Corp., a wholly owned subsidiary of GM, on June 7, 1996, was an impressive $27.7 billion transaction (the average spin-off in calendar year 1995 was approximately $1.25 billion). This transaction was more than 11 times the $2.5 billion deal that GM originally struck to acquire EDS just over 11 years earlier in 1984. There are a number of reasons for a parent company to spin-off a subsidiary, ranging from regulatory pressures, or lack of fit between core business processes and management philosophies, to stockholder pressures based on presumption of undervalued assets. In the case of EDS, the spin-off from GM was driven by EDS in an aggressive bid to seek the perceived benefits that independence from an increasingly restraining parent would bring. GM, in turn, extracted extremely favorable contract terms from EDS for the continued operation of their data-processing systems, a rather substantial cash payment, and was able to use the
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proceeds from the spin-off to fund a major deficit in its employee pension fund. Although the transaction was billed as a win-win, it appears that GM was the real beneficiary, and EDS suffered a difficult transition.

We began to study EDS’ “then anticipated” spin-off from GM prior to the 1996 transaction. The express purposes of the study were to gather data that would allow us to develop a better understanding of EDS from a historical perspective and gain insight into the process through which the spin-off from GM was about to occur.

The study of organizations in transition has an active history of several decades. Out of this work has emerged the theory that organizations go through specific, identifiable stages of growth and change, in a similar fashion to living organisms. These stages are (1) the entrepreneurial stage; (2) the collectivity stage; (3) the formalization stage, and (4) the elaboration stage. The life-cycle stages are categorized by a specific critical issue that requires decisive action from management and results in the transition from one stage to the other. This is similar to a traumatic stress event in an individual's life. The manner in which the organization addresses these critical issues can play a key role in the success or failure of the organization. Even when the transition is accompanied by a nonlife-threatening challenge, the organization's ability to weather the transition can be directly affected by how well it identifies and prepares for it. The EDS spin-off would appear to be an example of just such a situation. In this instance, the issue is clearly a need for visible, decisive leadership.

STUDY BACKGROUND

As stated previously, we began to study EDS several months prior to the actual spin-off. The office of the chief financial officer of the company facilitated our work. Following preliminary discussions, the CFO’s office at EDS provided us with extensive archival data regarding EDS, GM, and the spin-off.
We had a series of meetings with the CFO in which the archival data was reviewed, evaluated, questioned and considered, in developing a better understanding of the organization. Through subsequent meetings, a number of questions were explored regarding ongoing activities at EDS concerning the spin-off, as well as the future direction of the company post spin-off. During this time, it was determined that a series of interviews with a cross-section of upper-management team members would provide valuable input.

An interview protocol was developed that would enable us to focus on four primary areas of interest: technology, organization, finance, and human resources. The protocol was structured, but did not unnecessarily limit or influence the candid responses of the interviewees. The selection of interview subjects was structured to provide both a vertical and horizontal slice of several layers of the organization. The interviews were completed between October and December 1996. In all, 15 interviews were completed during more than 25 hours. The subjects ranged from very senior executives to department heads, and also included one nonemployee, an industry analyst at a major stock brokerage. The length of service as an employee for EDS ranged from less than 1 year to more than 30. The background and experience of the subjects was diverse, and well represented the different functional areas of the company.

HISTORICAL DEVELOPMENT OF EDS

Although the split from GM was a noteworthy event, it was just one step in the evolution of this company that has spawned an industry. EDS currently finds itself poised at the cross-roads of a future that simultaneously holds promise, opportunity, danger and complexity. The actions the company took in the period immediately following the spin-off have been critically important to its level of success. To understand a
company’s present situation, it is often helpful to understand its history. As an organization, EDS appears to have progressed through three distinct stages or “eras” in its corporate life. These are the Perot era, the GM era, and finally the Renewed Independence era (see Table 1). These stages relate to the previously discussed life cycle stages of entrepreneurial, collectivity, and formalization, respectively.

THE PEROT ERA
(ENTREPRENEURIAL STAGE)

The entrepreneurial stage is characterized by the creation of a product or service and then nurturing and sustaining the organization as it begins to grow. In 1962, Perot founded EDS at a time when American companies were still trying to understand what computer technology was, let alone have a need to outsource it to a company such as EDS. Perot had worked for IBM Corp. prior to starting the company, and was unable to convince his superiors of the wisdom of his vision—that companies would someday wish to take advantage of the power of technology without having to manage it, or even truly understand how it worked. Perot wanted to create a company that would be ready to answer this need to outsource the management of data-processing functions. After a rocky few years, EDS began to flourish and grow. Perot was very deliberate in creating EDS. He insisted on hiring armed forces veterans and ran the company in a virtually militaristic fashion. Dress was conservative and formal—white shirt, dark suit, highly polished, lace-up shoes. This conservatism is still present in the company; a fact made evident in early 1997 when the company finally made a formal dress code change to allow women employees to wear trousers—provided, of course, that they were part of a conservative pants suit. This formality and conservatism permeates the company in a number of ways and has played a significant part in establishing and maintaining an extremely strong work ethic that exists to this day.

In 1968, Perot took the company public, although he maintained controlling interest. In 1976, the first offshore contract was

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| Perot (1962–1984)         | - Entrepreneurial start-up  
                          | - Autocratic leadership  
                          | - Ex-military employees  
                          | - Outsourcing gains acceptance  
                          | - Conservative  
                          | - Strong, aggressive work ethic  
                          | - Rapid growth to 10,000 employees and $850 million in sales  |
| GM (1984–1996)            | - GM business adds significantly to size of EDS  
                          | - Perot departs: establishment of leadership council  
                          | - Establishment of SBUs  
                          | - EDS profitable despite GM decline  
                          | - Sales grow to $3 billion  
                          | - Employees exceed 50,000  |
| Renewed independence (1996 and onwards) | - Establishment of outside board  
                          | - Leadership council divides into executive and global operations councils  
                          | - Outsourcing evolves into commodity  
                          | - Increased competition  
                          | - Declining margins  
                          | - Market pressures  |
signed with the Saudi Arabian government, followed rapidly by Iran. By the early 1980s, EDS had grown to a company of almost 10,000 employees and was approaching $1 billion in sales. As the company rapidly expanded, Perot’s tight, authoritarian style of management was beginning to infringe on its continued growth potential. As is typical for the critical challenge of the entrepreneurial stage, the need for leadership that would allow the company to continue to grow soon became a crisis situation.

THE GM ERA (COLLECTIVITY STAGE)

The collectivity stage is characterized by the beginnings of a more structured organization, where employees begin to more formally divide responsibility to increase efficiency. The employees identify very closely with the organization and begin to see themselves as a collective. In 1984, Perot sold the company to GM for $2.5 billion in cash and GM stock, simultaneously securing a seat on the GM board. The $3 billion contract that GM subsequently awarded EDS to handle its information technology business skyrocketed the company into the big leagues, and the 9,000 GM employees that EDS picked up as a result nearly doubled the company’s employee base.

The acquisition by GM was good for both EDS and GM in a number of ways. GM was able to virtually fix its costs in the technology arena for the next decade. In addition, EDS continued to grow and profit. In 1992, when GM as a whole lost nearly $5 billion, EDS contributed a healthy $636 million to the bottom line. For EDS, the GM years allowed a period of rapid growth and entry into a number of markets, such as manufacturing and retail, that it had not previously been able to crack.

Although traumatic to the company and its employees at the time, the highly publicized dispute between Perot and Roger Smith, then chief executive officer (CEO) of GM, also benefited EDS. This is because it ultimately resulted in the inevitable transition in leadership from the entrepreneurial founder management of Perot, to the professional management of Lester Alberthal Jr., who was appointed CEO of EDS in 1986. Perot left to later form the more appropriately named Perot Systems, a direct competitor for EDS that has yet to provide any real threat. Alberthal quickly moved to offset any negative aspects of the “Perot years” by pushing authority down the line through the establishment of 30 strategic business units (SBUs) and the creation of a leadership council of top executives that controlled the company through a team approach.

By 1994, as EDS continued to grow, Alberthal and his team grew to believe that further advancement for the company was being stifled by the GM connection and the “auto-maker mentality” that GM was perceived to impose on EDS. An attempt to merge with communications giant Sprint in 1994, which would have created a data-communications powerhouse, went sour largely because Sprint wasn’t happy with the GM/EDS financial arrangement. In addition, there was the troubling limitation of not being able to market to most of GM’s competitors in the highly lucrative automotive and finance industries. Finally, there was the perception that it was simply time to disassociate from GM. EDS operates in an environment of rapid change and blinding technical advancement, requiring the ability to make rapid-fire decisions with an organic, flexible management approach. The GM bureaucracy, which may contribute to its own current industry problems, was not the ideal model that EDS senior executives wanted to emulate in this competitive environment.

The challenge of the collectivity stage is that the organization has now grown to the point where it is more difficult for top management to adequately control the organization in a hands-on manner. There is a need to develop rules, procedures and mechanisms that ensure the proper actions are performed by the employees in reaching the organization’s goals.
THE RENEWED 
INDEPENDENCE ERA 
(FORMALIZATION STAGE)

In the formalization stage, a more bureaucratic organizational structure is adopted. On June 7, 1996, EDS was separated from GM and its stock was distributed to GM shareholders. Now that the spin-off was complete and EDS could concentrate on its future, it faced some substantial challenges. Outsourcing has become a commonly accepted means of doing business for many companies. Indeed, it appears from the level of sophistication that most businesses now possess, combined with the number of players that are competing for outsourcing contracts, that outsourcing has become a commodity. EDS had historically enjoyed little competition and the subsequent high margin business that comes with such a situation. The increased competition has placed substantial pressure on the margins that EDS historically enjoyed. Names like IBM, AT&T Corp., and Arthur Andersen are now commonplace when requests for proposals (RFPs) are initiated. In fact for the first time in its history, EDS is no longer the biggest player, having been eclipsed by IBM's Global Services unit in late 1996. IBM signed up twice as much new business as EDS in 1996.

To counter these trends, Alberthal and company attempted to take some definitive steps. In September 1995, EDS had acquired management consulting firm A. T. Kearney with the intent of providing full-service business solutions to companies through problem analysis and the creation of technology-based solutions. In conjunction with A. T. Kearney, EDS developed a concept called co-sourcing. Co-sourcing is a means of risk sharing in which EDS and the customer can share both the costs of developing business process improvements and the benefits derived from them. EDS could no longer be simply a computer systems operator for its clients. Rather, it must provide a value-added service that cements the relationship between them and the client while allowing them the opportunity to expand into new areas of growth. Co-sourcing was touted as one means to do this.

The top management team was not concerned about market size. Modest estimates in 1996 put the world-wide market for technology-related services at over $2.5 trillion. EDS' challenge was, and may still be, figuring out what piece of that market it was going to go for. In late 1996, the company had achieved its independence (and the supposed concurrent increase in flexibility), was facing a booming demand for its services, while simultaneously facing the threat of increased competition. Rather than galloping into action, the company often seemed to be struggling to find its way. New orders, particularly large billion dollar plus deals, did not materialized as hoped. In 1996, EDS did not sign a contract in excess of $1 billion. During this time, rival Computer Sciences Corp. secured three deals valued at over $1 billion and IBM Global Services secured another two. EDS' profits continued to sag due to decreased margins and labor pressures.

A PERIOD OF CHALLENGE

Normally a divestiture requires a significant investment of time from the top executives of the parent firm. Although GM obviously was significantly involved in this case, the driving effort came from the top management team at EDS. During the year prior to the spin-off, the CEO and many of the senior officers at EDS spent as much as 80% of their time working on the details of the spin-off. Although the effort was successful, the diversion of these critical players away from their core business activities and the rapid advances made by their competition, had a significant impact on the performance of the company, particularly with regard to its overall direction and guidance towards the corporate mission.

EDS faced a number of internal challenges as well. The executive "team management" concept was now expanded and included both an executive council, which
oversaw the long-term direction of the company, and a global operations council, which was responsible for day-to-day operations. This is in addition to a newly created board of directors that consisted of 11 members, three of whom were EDS executives. The executive council consisted of 9 top-level EDS executives, and the global operations council had 13, with 5 members providing continuity through joint membership on both councils. While this sounded somewhat confusing to outsiders, it was also confusing to many of the employees, and even some senior officers.

Alberthal and his senior executives tried to go to extraordinary lengths to show that EDS was not the same as it used to be. They conducted extensive training in leadership and in sensitivity to employees and customers. The members of the two councils insisted that they acted as a team, and that no one person exercised undue influence. At a critical time in its existence, when vision and direction were of paramount importance, EDS' top management often appeared to be more concerned with how they should act, rather than what their actions should be. This lack of guidance was readily apparent to a number of interviewees.

This confusion had a direct impact on the bottom line as well. As stated earlier, contract signings were down significantly, as was the average size of contracts. In October 1996, EDS announced in its third-quarter earnings report that, due to lower than expected signings, growth would be slower than expected, and earnings would be only slightly higher than previous year. In 1 day (October 23, 1996) the stock dropped from $59.50 per share to $48.38. Over a 10-day period the stock lost over 25% of its value, an $8 billion drop that sent a shock wave through the executive offices. On April 25, 1997, EDS once again rocked the market by revealing continued difficulties. Citing labor pressures and intense competition for contracts, EDS announced that its first-quarter earnings were once again below expectations. Despite assurances that the remainder of the year was looking much more positive, the stock plunged $9.50 to a record low of $32.50. Concurrently with this announcement, EDS also stated that it would again be making an unspecified number of employee cuts and indicated that it would involve its management consultant subsidiary, A. T. Kearney, in charting a course to turn things around.

THE INSIDERS' VIEW OF HISTORICAL AND CONTEMPORARY EVENTS

The interviews that we conducted gave us some very rich data. For the purpose of organizing it, we grouped the subjects into four distinct categories, based on organizational hierarchy. The four groups were:

1. The leadership group, which consisted of senior corporate officers.
2. The corporate group, which was made up of senior managers/officers who worked in functional departments within the corporate office.
3. Field/corporate support, which comprised those managers/executives involved in activities that directly supported field activities.
4. Field/SBU management, this group was made up of individuals that managed an SBU.

The members of the leadership group were highly involved in the “nuts and bolts” of the actual spin-off process. These individuals tended to have a broader perspective, as might be expected. They were the most positive of the four groups regarding the potential market for IT outsourcing and exhibited the most support for the current organizational structure. They saw the spin-off as an opportunity to grow the company more rapidly and more effectively, with the strategic use of stock, and saw very little risk to EDS from the separation. The concurrent and past employee reductions in force (RIFs) were seen by this group as a nonissue and viewed more as standard operating procedure in an outsourcing environment.

The corporate group was somewhat less engaged in the spin-off process and exhibited
less concern with it. This group also appeared highly confident of the market potential for the company. They were more focused on the individual use of technology as a driver for future development. This group perceived the current organization structure as not very different than it had been in the past, although there was some evident confusion as to the exact role of the company’s top leaders. They saw little financial risk from the spin-off and felt that any risk or cost that may exist was well worth the benefit of freedom from GM. This group exhibited greater concern for employee issues, such as the RIF, than the leadership group, and felt that the spin-off was somewhat traumatic for some EDS employees.

The field/corporate support group was obviously more likely to be in touch with the concerns of the field employees. This group also shared a positive view of EDS’ future, although it was not apparent that the spin-off was a major factor in this view. They tended to see the spin-off as something that others in the company needed to be concerned with, and not directly impacting them. This group also felt that the individual end-user was a key factor in the future growth of the company. Surprisingly, despite the feeling that the spin-off was basically a nonissue for them, this group expressed more concern about the financial risk of being separated from GM. This may simply be a result of them being less involved and subsequently less knowledgeable of the financial details of the separation, or it may be that this group did not feel they needed to exhibit an outwardly positive attitude because they were not directly involved. There was a distinctly less positive view of the current organization structure than that exhibited by the first two groups. They definitely felt that the organization impeded effective communication and felt that although the design of the organization’s structure may be sound, the actual performance of the members did not support effectiveness. The group was significantly more concerned with the RIF issues and tended to view then as a failure of leadership. They were also much more concerned with the impact of people issues on the company’s ability to grow.

Obviously the field/SBU group was the most removed from the day-to-day process of the spin-off, and this was apparent from the information they provided. This group was much more concerned with the company’s ability to compete. Although they shared the view of the other groups that there was an immense market for IT outsourcing, they were much less positive about EDS’ ability to compete effectively. This group was greatly confused about the current organization structure (one individual sarcastically implored us to get back to him/her if we were able to “figure it out”). They felt that the current structure did little to support their efforts and was disappointing in light of this. There was little concern regarding the spin-off from either a financial or people perspective. There was substantial concern regarding the RIF and its negative impact on the morale of employees, plus the difficulty that public knowledge of the RIFs placed on recruiting. This group was understandably very concerned with people issues and the company’s ability to attract and retain good employees in a highly competitive hiring environment.

Overall, our interview subjects painted an intriguing and diverse picture of the future of the IT services industry. Although each subject put his or her own spin on the story, there was obvious agreement that the future holds tremendous opportunity. The question of how EDS should position itself to take advantage of future opportunities understandably brought somewhat less agreement. Co-sourcing, which the company had often touted as a major tool to increase market share, was not generally seen by the interview subjects as a significant item. In general, co-sourcing appeared to be merely one small way in which the company should proceed. The acquisition of management consultant A. T. Kearney was largely seen as a very positive move that would enhance the overall effectiveness of the company.

A substantial majority of the subjects expressed their belief that the future for
EDS, in this environment, was extremely positive. This was not an unexpected result. There was, however, a definite concern regarding the situation the company was in at the time. The substantial drop in the stock price that took place during the final days of October 1996, was an obvious worry to all of the subjects.

The interviews revealed some fascinating insights into why EDS has come to find itself in this current turbulent situation. A total of 8 of the 15 subjects expressed concern regarding the “council” approach to leadership at EDS. This concern ranged from outright confusion as to how it was supposed to work, to disappointment over the system’s perceived ineffectiveness. Despite the advantages of a “team” approach, there was a definite feeling that flexibility and decisiveness had been negatively impacted. The lack of strong, visionary, decisive leadership was seen by many of the subjects as a major stumbling block to EDS’ future success.

The benefits of the split from GM were not a major issue with many of the interviewees. Although each expressed that the split was a positive move, no one heralded it as a major turning point for the company. Instead it appears that this is merely one more in a number of evolutionary steps the company has, and will, take. When asked how the split affected the average frontline EDS employee, the response was almost universally that it was a “non-event.”

One idea that surfaced during the interviews was that EDS had so dominated the market for IT services that it did not have to rely on marketing, per se, to secure new contracts. The business simply came to them in abundant quantities. With the increased competition in the marketplace, the company found itself without a core marketing function at a critical time. This is a primary reason why companies such as IBM, guided by marketing wizards like Lou Gerstner, were able to preemptively capture so much of the business that EDS might otherwise have been in line for.

A number of the subjects expressed a concern regarding the amount of “overhead” that EDS must deal with. In part, this was blamed on the GM association and the profitability that the company enjoyed with GM contracts prior to the spin-off. In their current market, with increased financial pressures, this excess overhead was viewed as a distinct liability. Despite this agreement, there was not a consensus on what needed to be done about the problem. One individual indicated that EDS’ impressive home-office complex was itself a prime example of excess overhead, one that was obvious to both employees and stockholders. The market analyst we interviewed echoed this sentiment.

A number of human resource issues surfaced. The downsizing that was announced at the time of the spin-off created some troubling unrest among employees. Part of the reason for this feeling was that there had been at least one previous downsizing event, in 1993, that was done somewhat covertly. The effect was to heighten distrust. The need for employee reductions was viewed by most of our subjects as a practical necessity of the type of business that EDS is in. When large numbers of employees are acquired through the attainment of contracts to outsource IT functions, and the intent of this outsourcing is to gain efficiency, then RIFs must occur regularly. The problem as voiced by our subjects was in the way the reductions have been handled.

The RIFs are especially significant in light of a second human resource issue that was discussed, the need to attract and retain qualified workers in a highly competitive industry that is facing a labor-supply shortage. Several interviewees indicated that EDS does not have a reputation as one of the high-paying players. This is somewhat offset by the better than average training that the company provides. For several interviewees, human resource issues, particularly those involving recruitment and retention, were rated by far the most significant problem that EDS faces in its uncertain future.

The challenge of the formalization stage arrives when the bureaucracy that has been created results in so much “red tape” that it begins to stifle the very employees it was designed to control.