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Business Forum: The Big Blue blues

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It is with both sadness and trepidation that I have come to read about the recent profit slippages and layoffs at my former employer, IBM. It's been many decades since I was there, but IBM provided me with by first career job — a field engineer fixing IBM equipment in the 1950s. I was with IBM for eight years in five locations; three branch offices, a major factory, and their headquarters on Madison Avenue in New York.

IBM was a wonderful company in those days; solid growth achieved by offering good products, excellent service and never any layoffs. IBM was a bastion of both employee satisfaction and financial stability. It is interesting to note that one of the country's first company-paid-for major medical plans was financed not be the corporation per say, but by the Watson Fund — a fund set up by the CEO.

IBM's situation is much different today. As has been reported recently in the Star Tribune and elsewhere, the company is now plagued with revenue shrinkages, missed earnings estimates and layoffs. Employee satisfaction appears to be diminishing.

Revenue for the latest quarter was down more than 20 percent vs. a year earlier. Profits were off, too.

There may be some evolutionary explanations for IBM's recent slippage. Expertise in computers is now far less rare than earlier. Many people in many countries now possess the important skills of circuitry fabrication, software development, systems design and large scale manufacturing. It is therefore more difficult to maintain exceedingly high profit rates when everyone can do what you do.

An employee at the IBM plant in Essex Junction, Vt., worked on manufacturing microchips. Evolution of the industry may in part explain IBM's recent slippage. Many people in many countries now possess the important skills of circuitry fabrication, software development, systems design and large scale manufacturing.

IBM via AP,

But we should wonder if internal strategy and managerial priorities are more responsible for the company's recent problems. IBM has repurchased huge amounts of its stock— roughly $126 billion in recent years.

The heavy stock repurchases, combined with more competitive market conditions, plus a huge amount of intangible assets ($33 billion) have left IBM with a rather fragile balance sheet — especially compared with what it was in former years.

Bankers often look attentively at tangible net worth, which is stated total equity ($19 million in IBM's case) minus the intangible assets ($33 billion) — on the grounds that bankers do not lend money on intangible items. IBM's tangible net worth is therefore a negative $14 billion.

IBM is still big and has relatively high margins. Still we might wonder if IBM has fallen prey to the illusory instincts of financial operators who find it easier to employ financial manipulations than make meaningful long-term investments for a strong future. It is extraordinary for any company buy back $126 billion in stock and perhaps quite negligent to put the company in a position of negative tangible net worth.

Unfortunately, IBM is not alone in the dubious practice of repurchasing stock as a method of increasing earnings per share. Standard & Poor's 500 corporations repurchased $2.7 trillion of their own stock from 2004 to 2011 and the practice is still on the upswing.

But IBM remains a prominent lead purchaser of its own stock. Some observers have wondered about potential conflicts of interest surfacing when stock repurchases occur in concert with aggressive executive compensation plans closely linked to stock performance and growth in earnings per share.

Others have wondered how on Earth a company can keep doing it financially as they get closer to practical borrowing limits.

Records in the Securities and Exchange Commission's Edgar database have revealed that IBM officers and directors have recently been aggressive sellers of IBM stock. Former CEO Sam Palmisano sold $560 million since July 2011. Current CEO Virginia Rometty sold $66 million. Twenty-four IBM officers and directors reportedly sold or disposed of $1.7 billion worth of IBM stock in less than two years.

Not a bad deal. Get the company to buy back $126 billion in stock, which will make earnings per share grow — even if real progress is medium. Then, incorporate incentive programs so officers and directors can profitably sell or dispose of millions of shares. The only problem is that one of the world's most noble companies ends up with negative tangible net worth and now finds it has to lay people off because they didn't invest enough to keep the company going the way it was.

The question we should all ask is whether this is a good way to build a company or a country, let alone create long-term shareholder value. The economic foundations of our country are built upon the presence of strong, hardworking, creative companies. Perhaps the incentive plans surrounding the repurchase of stock need review.

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