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Sun Microsystems: Shining Bright, or Risking Eclipse?

By Charles King

Since its launch in 1982, Sun Microsystems has influenced and even dominated the network and Internet server sector by playing a smart, tough game that matched its own product strengths over the real and perceived weaknesses of its rivals. The company's overt self-confidence and self-promotion is personified in its vocal founder and CEO, Scott McNealy, whose gift for exploiting the media to his and Sun's advantage rivals Apple Computer's spin-meister extraordinaire Steve Jobs. During the late 90s, McNealy gleefully embraced a public role as the high tech industry's loudest anti-Microsoft voice during the course of the Redmond Giant's anti-trust travails. At the same time, the Internet boom was reaching sonic proportions, and Sun's position as a key Web hardware vendor gave the company an unbeatable aura. No competitor, it seemed, was adequately able to challenge Sun's contention that its proprietary, high-priced, UltraSPARC processor-based UNIX servers and Solaris operating system offered business customers unmatched levels of performance. For a time, the virtual cotton was high, the online living easy, and Sun shone bright as a golden child in a Golden Age.

Came the fall...

The Sageza Group, Inc.
900 Veterans Blvd, Suite 500
Redwood City, CA 94063-1743
650·366·0700 fax 650·649·2302
Europe (London) 44·020·7900·2819

Since its launch in 1982, Sun Microsystems has influenced and even dominated the network and Internet server sector by playing a smart, tough game that matched its own product strengths over the real and perceived weaknesses of its rivals. From the company's initial focus on UNIX workstations and Network File System (NFS) protocol when much of the rest of the industry was directing its attention toward the fledgling PC industry, to Sun's early work in RISC technology and symmetric multi-processing, the company regularly moved in the right direction or arrived at its destination ahead of the competition. Aggressive Web hardware product development and the introduction of the Java language led Sun to an industry leadership position that was enhanced by high profile partnerships with fellow network/Internet technology boosters including Oracle and America Online.

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We have neither the space nor inclination to rehash point by point the disastrous events that have touched the computer industry during the past year, but some recent occurrences offer an opportunity to stop and consider the current shape of the high tech stage, and how Sun's position among the players in this ongoing drama has been affected. Does Solaris continue to reign as Sun King, or is UltraSPARC flickering feebly? Is Old King Sol still head-and-shoulders above his laggardly competitors, or in the hurried, harried press of hungry vendors searching for customers is he, like Julius Caesar in his final moments, feeling the awful, sharp caress of daggers probing for a fatal weakness?

2001 Has Been A Bear

While the past year has arguably been one of the most difficult periods server computer manufacturers have ever faced, it also stands as something of a triumph. As the malaise of the dotcom bust spread across the technology infrastructure sector and the greater economy spiraled downward toward recession, hardware vendors continued to announce remarkable technological advances, tactical shifts, and unprecedented industry cooperation and consolidation. The year's biggest surprise was likely HP's announced purchase of Compaq, which threw virtually everyone but the dewy-eyed principals for a loop. IBM continued aggressive rollouts of server and storage products, and the company's eLiza Project, aimed at migrating self-managing and self-healing technologies from IBM mainframes to its server products, was intriguing, as was the company's "Peace, Love and Linux" advertising campaign. Compaq's retirement of the famed DEC Alpha processor line in favor of Intel's Itanium products was not especially surprising, given the company's long-standing relationship with Intel, and the company's cheery acknowledgement of Itanium as the 64-bit chipset of the future was seconded by most other vendors.

For that matter, the year found Sun with its own list of crow-worthy announcements. In late 2000, the company finalized its acquisition of Linux server

appliance manufacturer Cobalt Networks, and also rolled out several iPlanet product announcements. Early in 2001, Sun introduced the Sun Open Net Environment (Sun ONE), a thinly veiled answer to Microsoft's loudly trumpeted .NET initiative. Sun ONE's anti-Redmond tone was bolstered, in turn, by Sun's sponsorship of the Liberty Alliance, an industry group whose primary aim is to develop an online user authentication alternative to Microsoft Passport. Along the way, Sun rolled out the new UltraSPARC III processor, as well as products including Sun Blade workstations, Sun Fire workgroup servers, "mid-frame" computers, and in late September, the Sun Fire 15k (AKA Starcat), a high-end UNIX server that replaced the company's venerable E10000 product line.

But the last quarter of 2001 began ominously and/or ignominiously for Sun. In late September, Sun filed papers with the SEC to write off $51 million from three failed late-1990s acquisitions; Diba, Encore and NetDynamics. Additionally, company COO Ed Zander was quoted as saying that the Cobalt Networks acquisition had not produced the results the company hoped for. A few days later, Sun announced that it would absorb the assets and most of the staff of iPlanet, the ecommerce workgroup spun out from the once highly touted 1998 Sun-Netscape Alliance. On October 5, Sun announced preliminary financial results for the quarter ending September 30, 2001 with an expected loss of between five and seven cents per share. As a result, the company declared its intention to lay off 4,000 employees (about 9% of its workforce), and to take a $500 million charge. CEO McNealy spoke of Sun's ills in parallel to "well-documented macroeconomic factors," and promised that the company would emerge from this environment "stronger and more focused." But do his words ring especially clear or true given Sun's current direction and the larger changes shaping the server industry?

We believe not.

Swimming Against Changing Currents

Well-documented macroeconomic factors aside, to our way of thinking much of Sun's difficulties lie in the fact that the company is swimming against two essential industry currents: Itanium and Linux. While following the crowd is a strategy that seldom pushes a company to the head of its sector pack, sitting still in a burning theater while those around you head for the exits is an inadvisable course of non-action.

From a purely strategic standpoint, the willing migration of major hardware vendors towards Itanium chipset and open source Linux solutions at the expense of proprietary UNIX operating systems qualify as 2001's major industry trends. While IBM has led the charge in this direction, Compaq and HP are following close behind. Conspicuously absent from the Itanium and penguin love fests, however, was Sun Microsystems. Sure, the company claimed that it would support Itanium, though Sun's concrete moves in that direction have been sketchy at best. Sun also insisted that its acquisition of Linux-based server appliance vendor Cobalt Technologies provided clear evidence that the company understands the needs of open source advocates, and followed up the deal by releasing several Linux developer tools and programs. But Sun's claims that the most appropriate place for enterprise Linux lay in limited or single purpose server appliances contradicted the more sweeping open source strategies of its rivals. Additionally, Sun's reported disappointment with the Cobalt acquisition suggests that its Linux strategy is not resonating especially well with either its customers or the larger market.

Sun's lack of interest in both Itanium and Linux is hardly surprising, since both essentially contradict the assumption of UltraSPARC and Solaris superiority that drives Sun's corporate identity and marketing strategy. But the devotion of

Sun's competitors to Itanium and Linux belies the growing importance of commoditization across the business computing industry. As hardware performance continues to rise and profit margins fall, vendors are looking to increase revenues by aggressively expanding their service and software offerings. The strategic notion underlying these efforts suggests that ongoing income from these areas will help raise bottom lines with an infusion of new sales and help to bulletproof companies against cyclical downturns. By favoring the Itanium as a *de facto* 64-bit industry standard, vendors shave needed cash from their R&D expenses. By embracing Linux and offering to assist customers develop and deploy open-source solutions, they create income streams with the potential to last for years or even decades. IBM has shown how the service=success model can work during what has been a soft economy in general and a vicious downturn for most of the competition. A close look at the company's recent earnings statements shows that IBM's revenues from hardware sales and services are roughly equal. Sun, on the other hand, receives about $4 in product sales for every $1 it makes in services.

Introspection: Rekindling One's Sol or Navel Gazing?

Where exactly does Old King Sol stand as the rest of the industry retools and refits to these new standards? At the sidelines for now, vocally declaiming his overwhelming charms and superiority to customers growing increasingly uncertain of what they should make of the guy, and rivals who are beginning to play the game by a new set of rules. This image illustrates two of Sun's biggest challenges moving ahead. First, if a company has lived and died on claims of technical superiority, it will hit the skids when product performance reaches, as it has recently, a kind of parity that touches nearly every product class. A hardware market where performance is uniformly high across vendor offerings, where price points are key in virtually every deal, will and has hurt Sun badly. Second, Sun has always been a company that lived and died on a fairly narrow range of business hardware sales, an ugly place to live when demand goes south. Despite the company's recent push to expand its service offerings, time may be running out. In both of these areas, Sun's past victories and recent woes closely resemble Apple Computer's. Apple's devotion to its own innate charms and its staunch insistence on the technical superiority of the company's pricey, proprietary Macintosh product line is a horse the company has ridden hard to a low single digit market share. Since Apple has little if any remaining relevance in corporate computing, crises in consumer confidence and spending tend to beat the company like a Taiko drum. Is Sun in danger of becoming the Apple of the UNIX server world? Perhaps so, we are sorry to say.

What Does It All Mean?

From where we stand, the view of Sun's achievements and travails over the past year reveals a company in the throes of reinventing itself on the run while carrying a huge load of excess baggage, a bit like a sumo wrestler training to become a tri-athlete. Another peek at the company's list of recent accomplishments show Sun attempting to gain traction or establish precedence in ecommerce platforms and software, Web-based services, application provision, high-end storage and online user authentication. At the same time, Sun has launched a new SPARC chipset and maintained a steady stream of hardware product announcements.

Despite its obvious aspirations, serious questions remain regarding Sun's chances for success. The history of the technology industry is littered with the forgotten graves of companies that tried and failed to move beyond their original areas of expertise. In fact, even successful companies have had difficulties making the transition. Compaq's attempt to move from the desktop to the high-end server market was clouded by badly executed acquisitions of DEC and Tandem, and the company is still regarded by many as essentially a PC manufacturer. The freewheeling and highly autonomous corporate culture that

served Hewlett Packard so well in its early years led to mixed messages, wasted effort and divisiveness as the company achieved world class status and size. IBM originated the DOS-based PC and poured billions of dollars into consumer products before finally and wisely withdrawing from that market earlier this year. Microsoft committed any number of missteps, including Windows 1.0, MS-DOS 4.0 and the infamously lame "BOB" interactive interface.

Even Sun has suffered and survived imploding products and economic downturns. However, failure may exact a higher price from Sun this time around. In our view, the company's days as a proprietary UNIX hardware power hitter are nearing an end, not because its products are obsolete but because of the growing market for different sorts of solutions that Sun is essentially ignoring. Do any of the company's recent efforts portend re-vitalization? Maybe so, considering Sun's past successes, but vendors are coming to rely more and more on cooperative agreements to bolster and extend their product offerings. Sun's continuing push of a proprietary product model is practically and strategically at odds with other server vendors, and its cultivated character as the Lone Gunman of the high tech industry has made it at least as many enemies as friends. How many of the company's good old buddies will stick around to help out when things turn ugly is hard to say, and will likely depend on just who Sun decides it needs to meet and beat for the role of king of whatever particular hill it sets its sights on.

As for who the opponent of Sun's next battle royal will be, a close reading of the company's recent announcements and pronouncements suggests that Sun has lined up two competitors clearly in its sights: IBM and Microsoft. To take on either of these companies would be difficult at the best of times. To pursue both simultaneously during an economic downturn bespeaks an enormous amount of confidence and ambition, or a wild degree of confusion and disarray in Sun's corporate brain trust. Determining why Sun has targeted these two technology behemoths hardly requires a psychiatrist; IBM and Microsoft are each the sort of company Sun wants to be, but clearly is not. Both companies possess huge degrees of clout across multiple industries and demand respect from their competitors. Both offer widely diversified products and services, and both are leaders in setting and extending the limits of their respective technologies. Both successfully survived near-fatal mistakes, learned from their errors and became thriving, successful global entities.

Can Sun take on and best either or both of its chosen foes? Wise people say that no matter how grim circumstances might seem, the sun always rises. But any experienced astronomer will tell you that even the brightest and hottest solar entities eventually burn out, victims of their own unbridled energies.