



Getting Reorganization Right: How Bruce Chizen Drove Change and Innovation at Adobe Systems

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These days, Adobe Systems is on a roll. The San Jose, Calif.-based software company best known for having developed technology that allows PDF (Portable Document Format) documents to be exchanged around the world, has had the most profitable quarter in its history. In March, the company announced first quarter revenues for fiscal 2004 were \$423.3 million, compared with \$296.9 million in the same period last year. With a revised revenue target of \$1.5 billion for this year, Adobe Systems has come a long way since it was founded in 1982 by two alumni of the Xerox Palo Alto Research Center, John Warnock and Charles Geschke.

During the past two decades Adobe Systems' products have had a major impact on business processes in several industries. Its PostScript printer language, first shipped in printers by Apple and QMS in 1985, revolutionized digital typesetting and made desktop publishing possible. In 1993, Adobe's Acrobat software introduced PDF. Other products, such as Photoshop, won lots of loyal customers.

But brilliant technology does not necessarily create a successful business. By mid-1998 -- when most other technology companies were booming -- Adobe was in trouble, experiencing stalled product sales and a sagging stock price. As part of a major corporate overhaul in August 1998, most of Adobe's executive management left the company, and Bruce R. Chizen was promoted to executive vice president, products and marketing. Chizen led a drastic restructuring of Adobe's business, including instituting several rounds of layoffs and defending the company from a hostile takeover attempt by rival Quark. In 2000 Chizen was named the company's president and CEO.

Now Chizen is hoping to remake Adobe again -- betting that by combining the core electronic document capabilities of its Acrobat products with a new collection of server-based products, Adobe Systems can become a major supplier of application solutions to enterprise businesses. Last month Knowledge@Wharton editors met with Chizen to discuss past challenges, competitive strategy against rivals such as Microsoft, and future plans.

Knowledge@Wharton: Adobe just had the best quarter in its history. You beat analysts' expectations.

Chizen: We beat our *own* expectations.

Knowledge@Wharton: Photoshop and Acrobat are doing very well. Last December, *Fortune* magazine named you one of the two best companies to work for in Silicon Valley. Looking back five years, what strategy drove this level of performance? Can it be sustained?

Chizen: The answer to the second question is "yes." It can be sustained. Let me give you some background that can help show the strategy in context. Back in late 1998 we were a typical technology company. Our business processes -- how we operated and managed the business -- were not what they should have been. And we hit the wall sooner than everybody else.

Knowledge@Wharton: How so?

Chizen: In late August 1998, a couple of things were coming at us. We had missed a key milestone on delivering Adobe Illustrator which, at that point, was a critical revenue component. We got caught by the first version of the "Asian flu". The Japanese economy was tanking on us -- and we didn't know. We did not have the ability to understand how well the business was doing. So we had a terrible mess. And that



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was a wake-up call for the company.

The two founders, John Warnock and Chuck Geschke, decided there was a need for major change. They eliminated a number of people on the executive staff, and we decided to take a step back. We decided we were going to focus the company on doing a few things well. We needed to streamline the organization and execute our strategy.

Keep in mind, at that time the company had about \$850 million in revenues. We had about \$500-600 million in cash and no debt. Our market cap was all of \$1.6 billion. So, clearly, Wall Street had written us off. Anybody could have bought us with our own cash.

Knowledge@Wharton: And Quark tried, right?

Chizen: Quark tried, right around the same time. We were forced to grow up before everybody else. A lot of companies got caught in the dot-com bubble. By the time it burst, we had already refocused our business. Our strategy had several elements. First, we said, we were going to focus on some key markets. We decided to concentrate on creative professionals and people who really cared about the *quality* of the information they communicated. We also decided to focus on document workflows and to streamline the company.

Before August 1998, we had four divisions -- each with its own marketing and engineering organization. We had a strategic marketing group with its own budget and beliefs about what marketing should be. We also had four sales geographies, each with its own marketing budget. Technically, too, our systems were poorly integrated. We had an Oracle database in Europe, a version of SAP in Japan, and a different derivative of SAP here in the U.S.

As a result, it took us three weeks after the close of a quarter to report our earnings. There were some quarters in which, on the Wednesday night prior to the disclosure deadline, we were still trying to figure out what the real numbers were.

So, the first thing we did was to blow up the geographies. We blew up the marketing organizations. We created a functional organization. We centralized all our systems. This allowed us to execute. And from September 1998 on, we have delivered on what we said we were going to do.

In the meantime, we've transformed the company in two ways. Our mission hasn't changed. It's always been about developing, designing, marketing, selling software to help people to communicate better. But being able to stay with what we do well -- and then growing the number of our constituents -- was a major transformation for the company. The fact that we could *articulate* our mission was a huge change for us.

For example, look at a company like Honda, which -- whether consciously or not -- realizes that what it does well is build engines. Once Honda has figured that out, it can go from making engines for lawn mowers to building motor-scooters. From motor scooters, it could go to building really good motor cycles, and then cars. Now, recently, Honda has begun to build jet engines. Adobe is similar. We know what we do well -- we make software where "good enough" is not acceptable. Over the last five years, we've managed to take our core competence and reach many more constituents.

We have grown from being a "point product" company to a technology platform provider. What we've done recently with the Creative Suite allows us to provide not only a great solution for our customers but it provides a vehicle in which to build more products and services.

We've also made changes around Photoshop technology. More than half the people who use Photoshop -- a product targeted at professionals -- are not professionals. We've been able to use that leverage by creating an entire line of Photoshop products. In the future you'll see us building products and services on top of that desktop platform. You can imagine, over time, providing services that might allow us to participate in mobility as well as in print workflows for photo finishing. We might do this directly or through partnerships.

The biggest growth opportunity for Adobe is around document workflows -- both digital and paper. On the desktop, our approach has been to use Acrobat. To date we've only sold about 14 million new units of Acrobat. According to Microsoft, there are at least 200 million knowledge workers who have Microsoft

Office. We believe at least 60 million of them want to send reliable documents -- either through e-mail, or on the web, or through peer-to-peer networks. We think Acrobat is a great solution for that.

We now have a number of server solutions that allow enterprises to better integrate their document workflows into the enterprise. Over the last several years, most organizations, corporations, educational institutions and government agencies have spent a lot of money getting their back-end operations in shape. Most of their front-end is digital. Yet -- in the U.S. alone -- one study I read said that companies spent \$16 billion key punching information that was once digital. By providing servers to fill the gap between front-end document workflows to the back-end, we can help eliminate a lot of that cost.

So, we have gone through two or perhaps three transformations. One involved changing the way we do business. The second involved focusing on new platforms. And the third involved moving toward new customer bases, especially the enterprise.

Knowledge@Wharton: What you've described is a massive organizational shift...

Chizen: I started out with hair!

Knowledge@Wharton: What did it take to formulate the vision for this change and to get people to buy into it -- internally as well as externally? Further, how did you go about executing the plans that followed from the vision?

Chizen: The first part was relatively easy, because it was about survival. And this was in an environment where employment was easy and attractive, so someone who left Adobe could get a job somewhere else with relatively little risk and a great deal of upside. In fact, back then 20% of the people in the company were leaving on an annualized basis, which is a lot.

So the people who chose to stay really saw the potential in this company. And because we had committed employees, the motivation to change was there. That was the biggest change.

The second was delivering on the promise and demonstrating success. It was important that the employees felt proud about what they were doing; that they believed what they were doing was having an impact on the world.

We truly have made a difference in the world. In the early days our challenge was about taking pretty stuff on a screen and expressing it on paper through PostScript. Then think about our graphics applications; just about any logo you see was probably created with Illustrator. The type you see is probably an Adobe font. The image you see on the web was probably touched by Adobe Photoshop. The title effect you see in a movie was probably enhanced by Adobe After Effects. And just about any important document you see on the web is communicated with PDF and Acrobat.

The fact that we have had *that* kind of impact on society -- and the belief that we could continue to have that impact on society -- is, I believe, what has motivated our employees more than anything else. It certainly wasn't the money, because they could have gone to a lot of other places to get rich. It was the *potential* that we had as an organization, the richness of technology and innovation, and our ability to direct that against real customer solutions.

The big change for us has been trying to become more customer focused. We're not exactly where I think we need to be, but we're much better than we used to be. We used to develop the technology, ship the product, and then figure out who should buy it. I'm overstating this to some degree, but in some cases it's true.

Now, we still allow for a lot of experimentation, but when a technology gets to a point where we think there's really something there, we go through a rigorous product life-cycle process. We have concept approval meetings and a whole series of milestones that a project has to get through before we go to market -- many of which include customer perspective and customer validation. It doesn't mean we believe everything the customers tell us, but at least we factor that into our thinking.

I think to the outside world, we had such a loyal customer following, and the quality of our products historically was so high, that there were many, many customers who wanted to see us succeed. We also

are a company that people like doing business with. We believe we work with customers fairly. It doesn't mean we give them everything they ask for -- but we think we're fair and reasonable. Our partners like doing business with us.

And, in fact -- to go back to the Quark takeover example -- right after Quark announced its takeover bid, there was the Seybold publishing show. There was a session where the people in the audience were asked to vote -- how many people want Quark to take over Adobe and how many people don't? I don't think anybody raised their hand [to express] their desire for Quark to take over Adobe. That is because our customers like what Adobe does and stands for, and that gives us a great deal of permission.

Knowledge@Wharton: What have been your biggest challenges?

Chizen: One of my biggest challenges in taking over from two great founders has been trying to figure out how to change the company without destroying the culture that John and Chuck built. It's tough -- because the company needs to mature, needs to be much more business focused. Yet, at the end of the day, innovation is about the employees. We're an I.P. [intellectual property] company -- it's what's in people's heads that makes a difference. And the fact that we keep making the Fortune "Best Places to Work" list is refreshing. The fact that we *improve* on the list is even more refreshing, despite the company having become much more performance oriented.

Back in late 1998, when I took over all of the engineering and products and marketing, less than half the people here received an annual review. Everybody got merit increases, but less than the half the people received actual feedback -- or, at least, written feedback, which implies any kind of feedback. Last year it was 100% of the employees.

Now, with that comes both a carrot and a stick. You have to be tougher. We identify weak performers. We help them either up or out of the company. That was something that the company didn't have a very rigorous process [for] in the past. As a matter of fact, it's safe to say we didn't have *any* process for which to do that in past. But despite that, it's still a great place to work.

As we focus on the enterprise market, I would say our biggest challenge is that large corporations, universities and agencies don't know that we have mission-critical enterprise solutions. Yet, because of our reputation, they're willing to listen to us. So, when I go knocking on the door, I don't have a problem meeting with the CIO or, if it's critical, with the CEO, to talk about what Adobe's doing. They know us. They already use our products.

The third major challenge concerns outsourcing. In our case it's not outsourcing, it's positions in low-cost labor markets. Adobe, I believe, made the right decision, back in the 1998-1999 timeframe to establish a site outside New Delhi, India. And it's been very productive for us. Trying to do what's right for the business -- at the same time making sure that the employees feel like their job is relatively secure -- is a tough balance. Every CEO I speak with who's honest about it, is struggling with the same issue. I think it's even harder for Adobe because we're so employee centric.

Knowledge@Wharton: Is it true that it's mostly work at the low-end of the value chain that is being outsourced, and the more innovative work is still being done in the U.S.? Or is that changing as well?

Chizen: For Adobe it's a little bit different because of the ways we established the India site. We had somebody who worked for Adobe here -- in our Advanced Technology Group -- who was a native Indian, who wanted to move back there. And when he moved back, he established a high-end research and development laboratory. They do a great job there.

We *are* a global company. Last quarter we had 57% of the business come from outside the U.S. We have to have global presence. Otherwise we won't have products that recognize the cultural diversity of our customers.

Knowledge@Wharton: You have had alliances with SAP and IBM, and you've used them to good effect. How have you managed them?

Chizen: We are one of the few companies that has figured out how to create alliances with companies that compete against one another. If you think back to the early days, we were selling PostScript to

Hewlett-Packard *and* Xerox. We were doing work in digital imaging with Kodak *and* Fuji.

Knowledge@Wharton: How do you manage those relationships?

Chizen: We're direct. We're honest. We treat our partners with a great deal of respect, and we look for opportunities that are clear win-win. If you think about the two most recent [alliances] -- IBM and SAP -- IBM has great infrastructure with server products. For information that's critical -- meaning that HTML is not good enough -- they don't have a way to get to the user. They have a choice of two partners -- Microsoft or Adobe. Clearly, Microsoft is more of a competitor to IBM than Adobe is.

SAP has 20,000 customers standardized on SAP systems around the world. Many of those customers are saying, "Look, I want to go outside my firewall. And, your solutions around HTML are OK. But if I need to do things like contracts, or I need to create reliable forms, or create applications that meet regulatory requirements -- you don't have a solution for me, SAP." We have a solution for that. The only other company that could potentially have a solution for such companies is Microsoft. And that's another area where Microsoft could be a potential threat to SAP.

We're lucky in that there are so many companies that see Microsoft as a competitor or potential competitor, or too strong of a partner, that they look to Adobe as a great alternative.

Knowledge@Wharton: Since Microsoft has figured a couple of times in this conversation, how do you view the competitive landscape as you've tried to implement your strategy? What keeps you up at night?

Chizen: We have a whole bunch of "point product" competitors: Quark against InDesign; Corel Draw is still alive against Illustrator; Global Graphics against PostScript; Macromedia Dreamweaver against GoLive. But when I think about competitors, there's only one I really worry about. And it's one that happens to have \$35 billion in revenues and \$50 billion in the bank. And it happens to be in the software business. Microsoft is the competitor, and it's the one that keeps me up at night.

Fortunately, Microsoft's problems and challenges are so great that as a competitor it is less of a threat to Adobe. Microsoft has to grow its business -- even conservatively, if you believe in 5% growth, which is a pretty conservative number -- it has to grow the size of Adobe every single year. Microsoft also has lots of enemies, including the U.S. government, many of the state governments, and the European Commission -- among others.

Most of Microsoft's competitors are big, with a lot of resources. So, on the enterprise side it competes with IBM and SAP -- and both those companies are not anxious to see Microsoft win. On the consumer side, there are companies like Sony, which is not anxious to see Microsoft win. On the online services business, you have AOL and Yahoo, which are not happy to see Microsoft win. Microsoft has to worry about those very large competitors. Adobe is not its major concern.

Meanwhile, we get to partner with all of Microsoft's enemies, because we're a great alternative, and we don't really compete head-on with any of their big competitors. That's our strategy against Microsoft.

The other is -- we have learned, historically, if we stay close to what we really do well, we win. Microsoft has tried [to enter Adobe's markets]. It tried in the early days coming up with a PostScript clone -- and it actually shipped one printer with an OEM. It was a total failure. It tried with Microsoft Draw and Microsoft PhotoDraw, and gave away the product free with Microsoft Office to kind of "nitch up" Illustrator and Photoshop. Again, it was total failure -- these products no longer exist. For eBook publishing, it tried Microsoft Reader, as a end run around PDF. You never hear about Microsoft Reader anymore. Microsoft tried, once again, to go at Photoshop with Microsoft Picture It. The company has never been able to move Picture It above the consumer level. So, I am *confident* that, as long as we do what we do well, as long as we continue to execute, we'll be very successful, despite Microsoft's monopoly.

Knowledge@Wharton: Why have Microsoft's attempts not worked? What's the source of your confidence?

Chizen: The reason is that our customers care a lot about the visual integrity and reliability of the information that is being presented. And that's just not a core competency of Microsoft. We've been at

this now for 20 years. Everything we do is based on Adobe's imaging model and rendering engine -- that layer between the operating system and the application, that allows us to express information in a way that Microsoft has trouble figuring out. It doesn't mean Microsoft won't eventually get it right, but as long as we keep moving ahead rapidly, they'll never be able to catch up. PDF -- which is an open standard -- is already adopted by most government agencies around the world, most institutions around the world, and most corporations around the world. It gets harder and harder to displace us as time goes on. And that -- combined with just not a lot of affinity towards Microsoft today on the part of their customers and others -- gives us a lot of confidence.

Knowledge@Wharton: You've documented a number of your key architectures: PostScript, PDF, and -- albeit somewhat reluctantly -- the Type-1 font format. But these are not open source initiatives, nor are they "official" standards controlled by standards bodies like the Worldwide Web Consortium. Although Adobe documents these formats, you, alone, still control them. Have you found a profitable middle ground between proprietary architectures and open source?

Chizen: With PostScript and PDF we found that publishing the specifications, making them open -- but not open standards, but not providing open source -- is the right path for us. Once something becomes a standard driven by a standards body, it moves at a glacial pace. And innovation slows down significantly, because you have to get everybody to agree, and there's lots of compromise. If you make it *totally* open source, you don't get a return on investment.

We believe that by opening up the specification, we allow other people to take advantage of it. But because we still own the source, we get to innovate around that standard more quickly than anybody else. We have found that to be a great balance. PDF is the best example of that. We work on Acrobat, we work on PDF, we announce the product, we ship it, we open up the specification. We're already working on a whole series of applications, and we're already working on the next version of PDF. It seems to work. Customers are willing to pay a price, and even a premium, if they believe what they're buying is innovative and reliable.

You can get [the open source imaging program] GIMP for free; you can get Photoshop for \$699. Clearly people are spending \$699 on Photoshop. So, we think we've struck the right balance.

Knowledge@Wharton: You talk about the need to make a profit on your work -- Acrobat is an interesting case in this regard. Throughout most of the ten-and-a-half years that it's been a product, it didn't make a profit. Now it's Adobe's most profitable product -- having surpassed Photoshop a couple of years ago. Why did Adobe keep investing in a product that was losing money for such a long time?

Chizen: We believed that if we could create the standard, we would have an advantage in building more and more applications, and we could make a lot of money on it. If you look at what Reader has done for Adobe, we are able not only to build Acrobat on top of it -- this quarter I think we did \$108 million in Acrobat -- but we're able to build a server business on top of it. It's that vision about the future that helped us stay with Acrobat for those years.

Let me give you an example of how Acrobat evolved. In late 1998 or 1999 one of our customers, Pfizer, was trying to get us to make PDF more open -- in terms of extracting data and inputting data -- because the company wanted to do their clinical trials around PDF. The pharmaceutical business is all about getting to market fast. The quicker you get to market, the more money you make on the drug.

Pfizer would do field surveys -- and they could take years, because people would fill out a piece of paper, it would have to be mailed back to Groton, Conn., somebody would type it into their Oracle database, and then they'd submit *paper* to the Federal Drug Administration. By moving over to PDF, they ended up getting the first two drugs to market early enough to a point where Pfizer publicly said it would generate an additional \$140 million in revenues on those two drugs. We said, "Well, this is ridiculous -- we just sold a couple of [copies of] Acrobat." They're using PDF. They spend a lot of money on custom development. Why don't we build *tools* to replace the need for all that custom development, so we could then sell them to everybody else?

That's what we've been working on for the past few years. That's where our server products are coming from. Now we can help anybody with document workflow, not just those with a great deal of money and

foresight.

Knowledge@Wharton: If you were to look out five years, where would you expect Adobe to be?

Chizen: Today many customers still think of us as a graphics company. Some think of us as the Photoshop company, and some as the Acrobat company. Five years from now we'll probably be thought of as the enterprise company -- unless you're a creative professional, or unless you're into digital photography.

That's where the analogy goes back to Honda. If I said "Honda", we'd all say "automobiles" -- unless you happen to be a motorcycle enthusiast, or unless you happen to be mowing your lawn in Japan. Five years from now, will we think of Honda as the jet engine company? Maybe. I don't know. But for Adobe, I believe we'll be thought of as the enterprise company. However, we'll continue to have a very loyal following of creative professionals, and we'll continue to provide solutions for the digital photography enthusiast.

But, more so, we will be the enterprise software company, providing document services to bridge that document-to-backend workflow. The opportunity is so big. It's unique and exciting.

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