

The 15-Year Odyssey Behind VMware's Ascent To Corporate Greatness

It is no secret Palo Alto's VMware is one of the great American corporate successes of the 21st century. Created in 1998 by cofounders Diane Greene, a MIT-trained engineer, her husband Mendel Rosenblum, a computer science professor at Stanford, and three others, VMware began with an idea to increase the power of computers and servers by running multiple systems on a single station. The technology made the cloud computing age possible, became the bedrock of IT departments around the world and is now integrated with today's innovations like Amazon Web Services. Since its sale to EMC Corp. in 2004 for \$635 million, VMware's value has grown 100-fold to \$64 billion due to growth, and margins comparable to Microsoft and Google. Through nine months of 2018, it generated \$6.4 billion in sales, a 14% increase, and \$2.7 billion in operating cash flow.

The results are all the more impressive because, over the past 15 years, perhaps no other company has faced more pressure from outside forces like changing ownership and demanding shareholders, yet managed to better navigate trouble and work for stockholders—shares are up 550% since the pricing of its 2007 initial public offering—as well as employees, customers and society writ large. This week is a particularly good example.

In *Forbes* and *Just Capital's* 2018 ranking of America's best corporate citizens, released on Monday, few companies are doing better than VMware. It ranks as America's seventh-greatest corporate citizen, only bested by Microsoft in the software sector, and surged 20 spots from last year's list. The high ranking is unlikely to surprise VMware's workers and customers. Under CEO Patrick Gelsinger's watch, VMware has achieved 99% pay equity between female and male workers and full equity on the grounds of race. A month ago, VMware achieved carbon neutrality two years ahead of the schedule set by Gelsinger, who tells *Forbes* he plans to award 20 shares to every worker at the 21,700-plus person company, no matter their title. In India, VMware is working with Women Who Code to return 15,000 mothers to the technology workforce. In its hometown, VMware is funding a Stanford initiative called Seeds of Change to provide science, technology and engineering and mathematics training to women, and also partnering with the local government to create a renewable micro grid.

Then on Tuesday, VMware will be at the heart of one of the hardest fought battles in recent Wall Street memory.

In a hotly contested shareholder vote, billionaire Michael Dell will take a major step in merging a complex publicly traded security that was listed to mimic VMware's value with his PC empire, thus resolving complaints from hedge fund activists like Elliott Management, and billionaire Carl Icahn, who threatened to sue Dell in November. A week unlike any other for most companies, VMware's seen test-after-test of this sort and yet found the wherewithal to thrive for numerous constituents.

“VMware has been thrown in every economically difficult situation for a business, including large acquisitions and technological and strategic change,” says Martin Casado, cofounder of Nicira, a software company sold to VMware in 2012 for \$1.26 billion. Now a general partner at venture capital firm Andreessen Horowitz, Casado adds, “VMware’s story is one of skill and perseverance.”

The turning point for VMware came in December 2003 when Joe Tucci, then CEO of Hopkinton, Massachusetts-based EMC, decided to buy the privately held company for \$635 million. It was the type of merger history shows is likely to fail.

EMC, founded in 1979, had been a pioneer at the dawn of the PC age, inventing and commercializing much of the data storage technology that powered the mainstream adoption of the PC. By the time Tucci was installed as CEO, the dot-com bubble had burst and growth was petering out in EMC’s storage businesses. So he forged a new strategy of buying innovative startups to bolster services and capitalize on shifts in technology. Tucci’s most notable early deal was VMware, then a 370-worker startup growing in spades. It invented software to let companies multiply the power of a server or computer in a process called “virtualization,” which yields huge efficiency gains and fit EMC. “Until now, server and storage virtualization have existed as disparate entities. Today, EMC is accelerating the convergence of these two worlds,” Tucci proclaimed when announcing the acquisition.

At the urging of VMware’s cofounder and CEO Diane Greene, Tucci made a critical decision at the outset that explains its success today. Instead of merging the Silicon Valley startup together with EMC to wrench out cost synergies, Tucci kept the business independent to grow on its own. VMware’s brand was left intact, as was its sales force and most of its management. Furthermore, he vowed to leave VMware alone to deal with its customers like IBM, NetApp and Hewlett Packard, which also happened to be EMC’s biggest competitors. Tucci even created a proxy board of sorts inside of EMC to work on VMware’s behalf and insulate it from pressure from its parent.

By mid-2007 Tucci agreed to list a minority stake in VMware on public markets, codifying an independent board and giving employees stock currency directly based on the results they produced, important for talent when recruiting against the likes of Google. A year after listing, VMware’s growth slowed and titans like Microsoft began to build their own virtualization businesses. From a high of nearly \$120, VMware plunged 60%. In July 2008, cofounder Greene was replaced by a former Microsoft executive Paul Maritz. Then came technological shifts like “containers” and public clouds. VMware adapted. It struck savvy acquisitions and became a leader in making virtualization software for the data centers that cloud networks run on. By mid-2012 sales and profits tripled and Maritz stepped aside for current CEO Patrick Gelsinger, who has smartly struck partnerships with Amazon Web Services, Google Cloud, HP’s successor DXC and IBM, which are making VMware’s services a force in the cloud.

“Culturally and structurally, from the very beginning, leaders from Diane Greene, to Paul Maritz, and now Pat Gelsinger have carried the flag for VMware being an independent company for employees, shareholders and customers,” says Jerry Chen, a partner at VC firm Greylock, who spent nearly a decade at VMware and helped lead its cloud business.

By 2014 VMware had a following on Wall Street. Investors could see its value in plain sight. Other successful EMC acquisitions like Pivotal and RSA were easy to spot in its financial statements, but shares in EMC toiled. It came feared activist fund Elliott, which bought 2.2% of EMC and urged a full spin-off of VMware. Instead, within a half year, Tucci found a

savior in billionaire Michael Dell. Two years prior Dell had taken his PC business private with the help of Silver Lake Partners, beating a challenge from Carl Icahn. Dell Technologies, a leader in low growth and low margin PCs and servers was a good fit for EMC's storage business, but the crown jewel was VMware and its billions in profits.

In October 2015, Dell and Silver Lake led a \$67 billion takeover of EMC. To fund the buyout, they listed a stock, DVMT, to replicate the performance of EMC's 80% interest in VMware. After, growth and profits accelerated at VMware. At the beginning of 2018, they looked to return Dell to public markets. One idea, quickly stamped out by VMware's board (Michael Dell is chairman), was to merge it with Dell Technologies. Then, in July, Dell announced a deal to pay a \$11 billion dividend using cash on VMware's balance sheet and take a \$9 billion cut to buy DVMT. Analysts took the move as positive for VMware's independence, but shareholders like Elliott resisted, arguing it undervalued the company. By November, Carl Icahn bought a massive stake and vowed to sue his foe Michael Dell. Last month Dell and Silver Lake changed their deal to give DVMT shareholders billions more cash for their shares. A handful of large shareholders agreed to support the new deal, causing Icahn to back down facing an "unwinnable" fight with Dell. Shareholders will vote Tuesday in what's now a formality.

The saga, mostly focused on VMware's surging worth, leaves it in a familiar position as a separate public company with its own management and culture. As Dell was bracing for another Icahn brawl, VMware's Gelsinger was making acquisitions to prepare for the next waves in technology. In November, he acquired Heptio, an open source cloud software pioneer that has a lot in common with the VMware of 2003.

After Tuesday's vote, Gelsinger appears relieved. "We have a unique position where Dell is now more economically aligned with VMware success," he says, adding: "You have a growing hardware juggernaut in a unique partnership with a growing software innovation leader. They are independent but also increasingly interdependent. It's a very superior outcome for all involved."

As for Tucci, the architect of one of Silicon Valley's greatest deals, he believes keeping VMware separate was critical to its excellence. "The culture of VMware is a technology and developer culture first," he says, "Any great technology company needs the ability to pivot and pivot fast."

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