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Business - Out of the blue

How IBM became an AI darling

It has pulled off yet another striking turnaround

Throughout its 115-year life IBM has shown itself to be a master of reinvention. In the mid-1990s the mainframe pioneer rescued itself from collapse by shifting its focus to the booming business of IT services. A decade later it sold its struggling PC division to China's Lenovo.

Over the past half decade or so "Big Blue" has been through another striking transformation. During the 2010s its business was disrupted by the rise of cloud computing, which undermined not only sales of mainframes but also the work of servicing them at a time when low-cost outsourcers from India were pinching share. Revenues and margins shrank, and investors once again lost interest.

That has all changed in the past three years, during which IBM's share price has more than doubled. As a multiple of net profits, it is now valued similarly to Microsoft and other software champions (see chart). On January 28th it reported that its revenue and net profit rose by 8% and 14% in 2025—a sharp reversal from its years of stagnation. How did IBM pull it off?

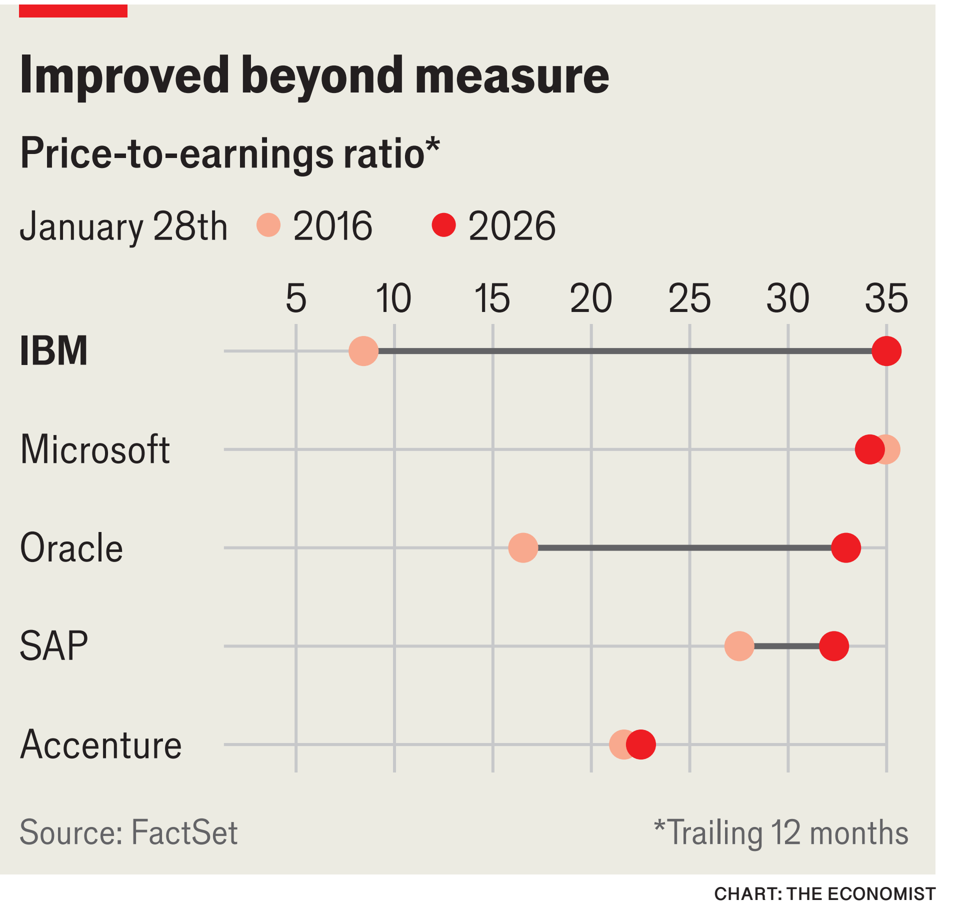

CHART: THE ECONOMIST

The strategy began with the acquisition in 2019 of Red Hat, a platform that, among other things, helps companies manage their workloads across data centres. Rather than trying to compete with Amazon, Google and Microsoft in the so-called public cloud, IBM created a layer between that makes it easier to mix and match among the hyperscalers while continuing to use on-premise mainframes or dedicated private clouds (including those run by IBM) for sensitive tasks. Deals in 2024 and 2025 to buy HashiCorp and Confluent, two more software firms, have solidified IBM's role as an orchestrator of hybrid clouds.

IBM has also created a space for itself in AI. The company has long dabbled in the technology—including using it to beat Gary Kasparov, the world chess champion, in 1997—but missed the latest wave of large language models. Rather than trying to beat OpenAI and other model-makers at their own game, it has released a series of small language models, under the name Granite, which are tailored to business applications and require less computing power. These and other open-weight models, which make their numerical parameters freely available, are accessible through its watsonx platform, which enterprises can use to build AI agents trained on their own data.

IBM's growing strength in AI has been helped by another big strategic shift over the past few years—the refashioning of its services arm. In 2021 the company spun off its struggling outsourcing business, now called Kyndryl, which at the time accounted for about a quarter of its workforce. That left it with a smaller consulting division focused on technical expertise, which has come in handy as clients grapple with AI. IBM has booked over $10bn-worth of consulting contracts related to generative AI since the middle of 2023. It has also been using the technology to digitise its own consultants' work, a move the division's boss has described as moving to "service as a software".

Meanwhile, IBM continues to innovate in its original metier of hardware. It is still by far the world leader in mainframes. The z17, released last year, has been a hit. It offers access to IBM's new Spyre chip, designed for running AI models. Then there is IBM's work on quantum computers, where it is at the leading edge. McKinsey, a consultancy, reckons the market for the technology could reach nearly $100bn by 2035. IBM thinks it can capture about 20% of the business by selling machines and renting out capacity. It hopes to deliver Starling, a "fault-tolerant" quantum computer that can spot and correct the errors the technology is prone to, by 2029.

Lately investors in legacy technology companies have become increasingly jittery over the prospect of disruption from AI. In the past three months software businesses in America's S&P 500 index have shed a seventh of their value. Shares in Accenture, the world's biggest provider of IT services, are down by a quarter over the past year amid fears that bots could soon replace much of what the company does. But IBM, with its unique portfolio of businesses, looks well positioned to make it through the upheaval. ■