What is the value of a company?

On the cover:
GRACE SUH, PROGRAM MANAGER, IBM CORPORATE COMMUNITY RELATIONS

Is value defined by market capitalization?
Earnings per share?
Is it measured by marketshare,
client satisfaction or employee retention?
Is it something more?

The idea that the value of an enterprise — ours or any other — should be evaluated on criteria that go beyond marketplace performance and business results isn't novel. Most companies aspire to be seen as great employers, trusted corporate citizens or valued members of the community.

What's different are the outcomes — the social and human benefits that result when enterprises like IBM elevate those aspirations to business priorities, and manage them with the same level of discipline and passion that the company applies to client service or product innovation.

This document — IBM's first Corporate Responsibility Report — was created to provide an integrated overview of the economic, environmental and social dimensions of our business activities, products and services. It also discusses areas in which we're working to improve.

And you will find here commentary from IBM experts on issues of broad concern in our industry, with ramifications for business and society at large.

Their observations reflect our culture and a management system that treats issues — of social responsibility or fiscal responsibility — with the same seriousness, thoughtfulness and care. And like the report as a whole, they express our understanding of the value of our company, broadly defined.

What is the value of IBM?

IBM MILESTONES

1914
IBM hires its first employee with a disability

1935
IBM declares that men and women will do the same kind of work for equal pay

1953
IBM establishes a formal equal opportunity policy

SOCIETAL MILESTONES

1990
The U.S. federal government enacts the *Americans with Disabilities Act*

1963
The U.S. federal government passes the *Equal Pay Act*

1964
The U.S. federal government passes the *Civil Rights Act*

A legacy of leading social change.

1973
IBM appoints first black manager in South Africa

1984
IBM adds sexual orientation to company policies regarding nondiscrimination

1995
IBM names a female as its most senior executive in Croatia

1998
South African government passes national Employment Equity Act

2003
U.S. Supreme Court strikes down laws that discriminated against gay, lesbian, bisexual and transgender individuals

1997
Croatian government adopts national policy for the promotion of equality, including broad protections of the rights of female workers

"There are certainly many places where a person can earn a very good living and build a highly gratifying career. You come to a big, complex company like ours if you want to be part of something whose impact is larger. And you come to this particular enterprise to be part of something whose impact will last, a company that explores, a company that matters."

SAMUEL J. PALMISANO — 2002

"In order to serve markets, we have to understand them, reflect their diversity and build a workplace in which every individual knows their opportunity to contribute is gated only by the quality of their ideas and job performance, and the integrity of their work."

LOUIS V. GERSTNER, JR. — 1994

A tradition of progressive leadership.

"Business conduct is not something that can be left to auditors and lawyers. It is the very cornerstone on which our business reputation is built, and it is one of our most prized assets. Ethical behavior starts with the individual; the principles that govern it must be a day-to-day way of life."

FRANK T. CARY — 1977

"We accept our responsibilities as a corporate citizen in community, national and world affairs; we serve our interests best when we serve the public interest.... We acknowledge our obligation as a business institution to help improve the quality of the society we are part of."

THOMAS J. WATSON, JR. — 1969

"Men and women will do the same kind of work for equal pay. They will have the same treatment, the same responsibilities and the same opportunities for advancement."

THOMAS J. WATSON, SR. — 1935

A pursuit of the grand challenges of the day.

The same global research organization that is exploring the frontiers of "nano" technologies, and decoding the mysteries of genetic protein folding, also created voice recognition software called Watch Me Read that helps students improve reading skills and comprehension.

ARGENTINA
AUSTRIA
BAHAMAS
BARBADOS
BOLIVIA
BRUNEI
BULGARIA
CHILE
COLOMBIA
CROATIA
CYPRUS
CZECH REPUBLIC
ECUADOR
EGYPT
ESTONIA
FINLAND
GREECE
HUNGARY
INDONESIA
ISRAEL
JAMAICA
LATVIA
LITHUANIA
MALAYSIA
MEXICO

A management system that's truly global — and truly local.

IBM employs up to 2,000 people in each of the 51 countries listed here and has a workforce of between 2,000 and 137,000 people in each of 20 other countries.

MOROCCO
NEW ZEALAND
NORWAY
PAKISTAN
PARAGUAY
PERU
PHILIPPINES
POLAND
PORTUGAL
ROMANIA
RUSSIA
SERBIA AND MONTENEGRO
SLOVAKIA
SLOVENIA
SOUTH AFRICA
SRI LANKA
SURINAME
TAIWAN
THAILAND
TRINIDAD
TURKEY
UKRAINE
UNITED ARAB EMIRATES
URUGUAY
VENEZUELA
VIETNAM

Product Engineering

IBM's product design standards prohibit the use of certain hazardous materials such as asbestos, PCBs, PBBs and PBBOs, and ozone-depleting substances

Product Use

IBM's pSeries servers consume at least 34 percent less power per unit of work relative to comparable previous-generation models

Product End-of-Life

IBM currently offers product reuse and recycling solutions in 35 countries

A belief that global enterprises have a responsibility to protect the globe.

All businesses today face a new reality—more important and lasting, in my opinion, than the advent of any game-changing technology or global market trend.

Samuel J. Palmisano
Chairman, President and Chief Executive Officer

Businesses now operate in an environment in which long-standing societal concerns — in areas from diversity to equal opportunity, the environment and workforce policies — have been raised to the same level of public expectation as accounting practices and financial performance.

At IBM, we have always viewed our responsibilities as a corporation in multiple dimensions. The standards we've set for ourselves in community, environmental and workplace policy and practice are matters of public record, and are reflected in this report. But the real importance of the current focus on corporate responsibility, in all its dimensions, is what it means for the new challenges that will face all of us in the near future.

This is why IBM is publishing its first consolidated corporate responsibility report — a companion to our annual report, and something to which we have devoted equal care.

As it happens, it is timely for us to gather together the information in this report. We are in the midst of an active, companywide discussion and reanimation of IBM's core values — principles that guide everything we do, from our investments, to our workforce policies, to our R&D, and very definitely to extending IBM's philanthropic, environmental, economic and other social dimensions.

These values speak to the commitments we make to our clients; our legacy of innovation; and relationships built on trust and personal responsibility. This is about the kind of company IBM has been, and the company we are determined it will be going forward.

These values also align directly with our definition of corporate responsibility, which includes:

- being an employer of choice and maintaining programs that attract, retain and motivate the best talent in the world
- being protective of the environment in our operations, manufacturing and product development
- contributing to the betterment of our world and its communities — through both contributions of funding, resources and expertise; and by creating products and services that help solve the world's problems

A BUSINESS AND ITS BELIEFS

This alignment shouldn't be surprising. There has always been a direct correlation between IBM's corporate citizenship and our mainstream marketplace activities. In fact, the focus on values goes back to IBM's birth. Tom Watson, Sr., and his son were among the great business leaders of the 20th century — not because of their inventiveness, their organizational skills or even their business or technical vision (though they possessed all in abundance), but because they pioneered the idea of a company built on and run by a common set of strongly held values, the famous IBM Basic Beliefs.

For nearly a century, those beliefs guided IBM to a number of notable firsts — from hiring and promoting women, minorities and the disabled, to innovations in employee health and environmental programs, to progressive policies in benefits and compensation. They have shaped the relationships between IBM and its clients, investors and the communities and nations in which we do business. And, importantly, they have inspired and guided the work of our scientists and researchers in bringing to life new capabilities and solutions that have helped people all over the world.

We are proud of this record. And I think you'll also see in this report that we are embracing an ambitious agenda for IBM in the years ahead — which is as it should be. Since the solutions to many of the world's major problems can be better understood and made real through information technology, we have a unique role in continuing to drive those technological advances.

TRUST IN THE FUTURE

The time is right for all of us at IBM to seriously re-examine our values, and to redouble our commitment to making IBM a great company. Obviously, the world that existed when IBM was founded nearly a century ago was vastly different from the world today. Tom Watson would not recognize our technological, economic and social realities — though he would surely savor the task of reinventing IBM for leadership in a new century. That work falls to all 316,000 of us in today's IBM.

During our company's near-collapse and hard-won recovery in the 1990s, we never abandoned our principles or progressive policies. But, frankly, in our efforts to adapt IBM to compete and lead in new times — and simply to keep the company alive — we didn't have the luxury of attending to all long-term implications.

For instance, we changed our pension plans in the United States in 1999 to introduce a cash-balance option that better meets the needs of a modern-day workforce. For a growing portion of that workforce, we were doing something very welcome. The world is changing, and most of our competitors don't even offer a pension benefit. However, some employees saw this change as a violation of trust. We listened to those concerns and did adjust, but some bitterness remains. The dispute is in the court system as I write this, and I can't comment on a matter of ongoing litigation. However, I can say definitively that the issue of trust is one I take seriously, along with the rest of my management team.

There are many other areas in which a new era gives us the chance to innovate and improve. While there are many accomplishments and pioneering moves of which we are deeply proud, there are also plenty of issues left to be addressed, and challenges we are itching to tackle.

The increasingly pervasive reach of information technologies makes continual improvement in our environmental programs and in the environmental attributes of our products ever more important. The advent of a global economy and society is enormously promising, but comes with new issues related to personal privacy, intellectual property rights and free speech. Those are all issues that have yet to be fully understood, much less managed.

This company, its management and its people have never been comfortable operating in a reactive mode, or resting on our laurels. Our desire to take on tough problems and grand challenges hasn't abated with time. In fact, it's grown more acute.

That goes for areas of social inequity and environmental concern, as well as for business and technology. These problems can, we believe, be meaningfully alleviated through the application of intelligence, science and the dedicated commitment of responsible citizens. And we are more determined than ever to do so.

Samuel J. Palmisano
Chairman, President and Chief Executive Officer

We've never been a "computer company."

Over nearly a century in business, our products and services have undergone continual reinvention — from scales and time clocks to mainframes, software and high-end consulting.

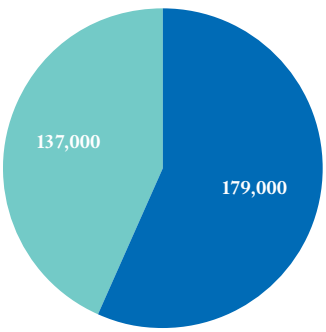
Today's portfolio of businesses is markedly different than it was just a few years ago, and we're quite certain we'll be in a host of different businesses another century down the road.

The fact is, we have never defined IBM in terms of a product, or a charismatic leader, or the location of our headquarters.

We simply committed ourselves to lead in the development of state-of-the-art technologies and in how they're applied to solve our clients' biggest and most pressing problems.

Of course, *being* that kind of company entails constant transformation, and not just of the product line. It requires progressive mind-sets and management systems. Because the technologies change. So do the problems. So do we.

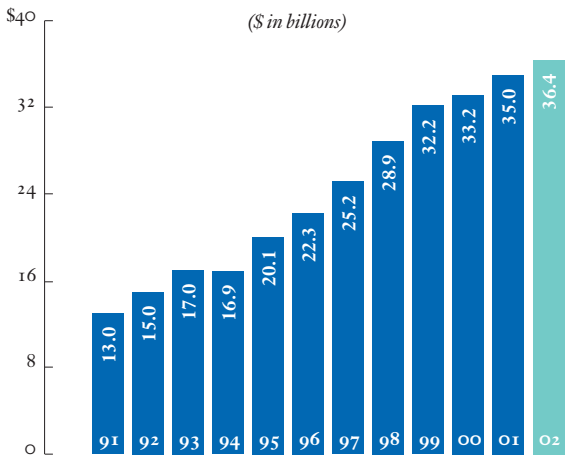
IBM 2002 GLOBAL WORKFORCE DISTRIBUTION



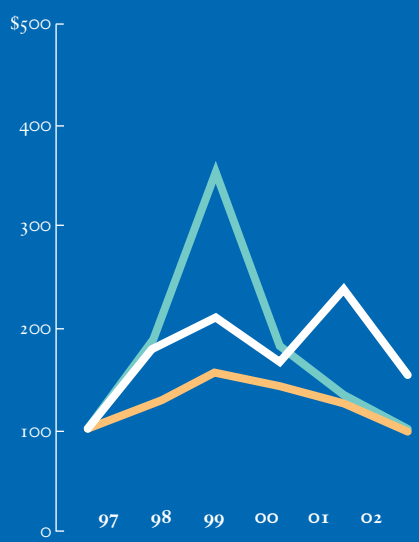
- *Rest of the World*
- *United States*

IBM GLOBAL SERVICES REVENUE

($ in billions)



COMPARISON OF FIVE-YEAR CUMULATIVE RETURN FOR IBM, S&P 500 STOCK INDEX, AND S&P COMPUTERS INDEX (EXCLUDING IBM)



- *IBM common stock*
- *S&P Computers (hardware) Index (excluding IBM)*
- *S&P 500 Stock Index*

$39 BILLION:

amount IBM spent on its supply chain in 2002 — buying goods and services from 33,000 suppliers

This is an important time for the information technology industry and, by extension, every institution and enterprise that relies on its products and services. The industry is changing in fundamental ways.

That starts with changes in the computing model itself — the infrastructure of products, systems, software and interconnections that allows computing to happen. For the first time in the history of the industry, all that underlying technology is going to be based on open standards rather than closed, proprietary architectures controlled by one or two companies.

This will shift the industry's competitive landscape in fundamental ways. Most important, it puts the client in the driver's seat. Technical architectures built on open standards give clients far more flexibility and control over their technology investments.

And an open infrastructure also is the key to any organization's ability to integrate all its internal systems, and then connect with all the computing devices, applications and business processes of its trading partners and clients.

In short, the shift in the computing model allows enterprises to tackle new kinds of business problems and explore new models of commercial activity; and it signals a basic redefinition of the value that clients expect from their investments in information technology.

IBM'S BUSINESS MODEL

This kind of tectonic plate shift in the IT industry obviously has major implications for IBM — the world's largest information technology company.

Our business portfolio ranges from services (including business transformation consulting, systems integration and strategic outsourcing) to software, hardware, fundamental research, financing and the component technologies used to build larger systems — in other words, virtually the full scope of the computing model referred to earlier.

Since 1987, **MOST OF IBM'S REVENUES HAVE COME FROM ITS NON-U.S. OPERATIONS**

However, the fundamental strength of our business model doesn't come from our breadth, but from our ability to combine the resources of the portfolio — including deep industry-specific insight — and deliver integrated business solutions.

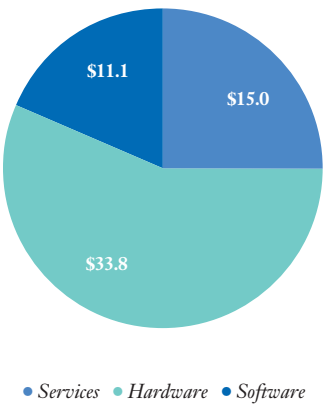
TOWARD AN 'ON DEMAND' WORLD

That approach — starting with a business issue and then assembling the right combination of technologies and skills to address it — has never been more important than it will be in the coming years. That's because there are forces converging on organizations today that are driving new choices about business designs and the computing infrastructures that support them. We call this evolution of business and computing "e-business on demand."

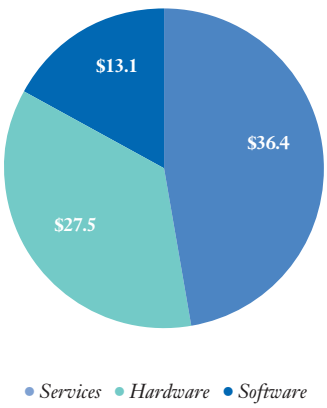
Essentially on demand is about achieving dramatically increased levels of responsiveness to all kinds of changing conditions — in financial markets, labor markets, or geopolitical and competitive arenas — in order to provide products or services in business, government, education or healthcare on demand.

Clients making this transformation increasingly will rely on partners that can deliver both the new computing infrastructure and, importantly, insight into the marketplace and competitive pressures of their industries.

1992 SELECTED REVENUE
($ in billions)



2002 SELECTED REVENUE
($ in billions)



This is why we believe that for the foreseeable future the IT industry will be led by those companies that can deliver value in the form of expertise, insight and relationships — rather than just product prowess alone, which has been the traditional basis of leadership.

AN INDUSTRY DIVIDING

This shift in what clients expect from their information technology providers is, in turn, driving a broad-based restructuring of the industry's economic fundamentals. We're watching the industry bifurcate into radically different types of businesses — one focused on creating high-value products and services for clients; the other devoted to delivery of lower-cost, and more standard products.

IBM has chosen to compete in the higher-value segments of the industry — a logical choice, given our range of capacities and unique ability to integrate them for clients.

That decision is driving changes within our portfolio of businesses — increasing our presence in such segments as high-end consulting, and reducing our presence in more cyclical or standard segments that no longer fit the parameters of our model.

In 2002, for example, IBM acquired 12 businesses and exited others. The need for this kind of responsiveness and adaptation to a rapidly evolving world is exactly what we are describing to our clients. And one of the issues we help them understand is the impact of these business decisions on people. That impact can't be eliminated, but IBM endeavors to minimize it, and provides a range of transition assistance described in greater detail in the Our People section of this report.

The largest of the 2002 acquisitions added roughly 30,000 professionals from the former PricewaterhouseCoopers Consulting — dramatically expanding our capability to deliver high-value business insight and strategic consulting services for clients in industries including financial services, healthcare, the public sector and telecommunications.

At the other end of the spectrum, 2002 saw IBM exit the market for hard disk drives. IBM sold its hard disk drive manufacturing business to Hitachi — effectively exiting that market segment, but doing so in a way that preserved opportunities for the affected IBM employees, who joined a technology leader with a long-term commitment to success in the HDD marketplace.

2002 Revenue	**$81.2 billion**
Income from continuing operations	**$5.3 billion**
Discontinued operations: Loss from discontinued operations	**($1.8 billion)**
Net income	**$3.6 billion***
Employees	**315,889**
Stockholders of record	**674,362**

An estimated additional 1,800,000 stockholders own IBM stock through brokerage firms, banks, credit unions and other financial institutions.

**Net income does not total due to rounding.*

WHAT DOES IT MEAN TO BE 'OFFSHORE'?

BY DOMINIQUE CERUTTI

General Manager, IBM Global Services, Europe, Middle East, Africa

THE TENOR of the current debate about what the media have dubbed "offshoring" suggests that business stumbled onto the concept of globalization sometime in the first half of 2003.

No doubt, this is a lightning rod issue in the IT industry in Europe and the United States right now. But attempts to explain it in terms of work that belongs in the developed world versus the rest of the world ignore the realities of global finance, trade and communications, not to mention the global nature of competition for everything from marketshare to talent.

The fact is, any workforce is a constantly evolving portfolio of skills that clients value. That's especially true in any services business, in which you are continually acquiring or developing new skills, while other skills fall out of demand.

IBM employs the world's largest professional workforce. We have been sourcing talented people the world over for more than 70 years, and will continue to invest and build capability around the world to better serve our clients.

That said, what's happening now isn't just garden-variety globalization. There is something new. And it's accelerating based on three factors: the rise of deep, technically proficient workforces in nations that have developed world-class educational systems; the well-documented wage differentials in many of these countries; and an economic environment that drives intense client focus on value and productivity.

Think about what has already happened with manufacturing in the United States and much of Europe. The simplistic view is that work left for lower-cost jurisdictions. What really happened is that processes were divided up, and some kinds of manufacturing — but not all manufacturing — moved to other regions. As that happened, the skills required and the talent available to perform the work became differentiating for the economies where the work was being done.

I suspect the progression in software and services will be very similar. Aspects of the process will move, at the same time growth occurs in other areas. I don't think too many people would be surprised by that, argue with the competitive realities that are at work here, or pretend that businesses have the choice of sheltering all the jobs in the developed world from new kinds of global competition.

We've gone through many periods of this kind of churn, and seen certain sectors or segments of the economy contract while others grew. The net outcome is always an economy and a commercial environment that are more productive, with higher real income and better jobs and more opportunities.

The near-term concern among IT workers is entirely understandable. It is a mistake, however, to confuse change with decline.

CORPORATE GOVERNANCE AND MANAGEMENT SYSTEM

The last two years have taken a serious toll on one of the cornerstones of a free economy and an open society — investor confidence in what businesses say and do. A succession of events — starting with the dot-com crash, exacerbated by the global economic downturn, and then the financial and ethical failures of a few public enterprises — has cast doubt on how companies govern themselves and conduct their business.

IBM's management system is designed around a consistent set of operating standards and objectives the world over. This is enforced along two dimensions: a set of commitments to ethics, integrity and standards of behavior made periodically by each employee; and a long-standing commitment to management oversight by a Board that's largely independent and free of any relationship that would interfere with its exercise of sound, impartial business judgment.

While the makeup of the Board may shift over time, IBM policy since 1994 has required that the majority of Board members are independent. Current committees include the Executive Committee, the Audit Committee, the Directors and Corporate Governance Committee, and the Executive Compensation and Management Resources Committee.

The Directors and Corporate Governance Committee periodically reviews Board member relationships with IBM to confirm their continued independence as defined by the U.S. Securities and Exchange Commission.

This committee was formed in 1993. All four members are independent directors. One of the committee's principal functions is to review and consider IBM's position and practices on issues of corporate public responsibility, including workforce diversity, protection of the environment and philanthropic contributions. It also reviews and considers stockholder proposals dealing with issues of public and social interest.

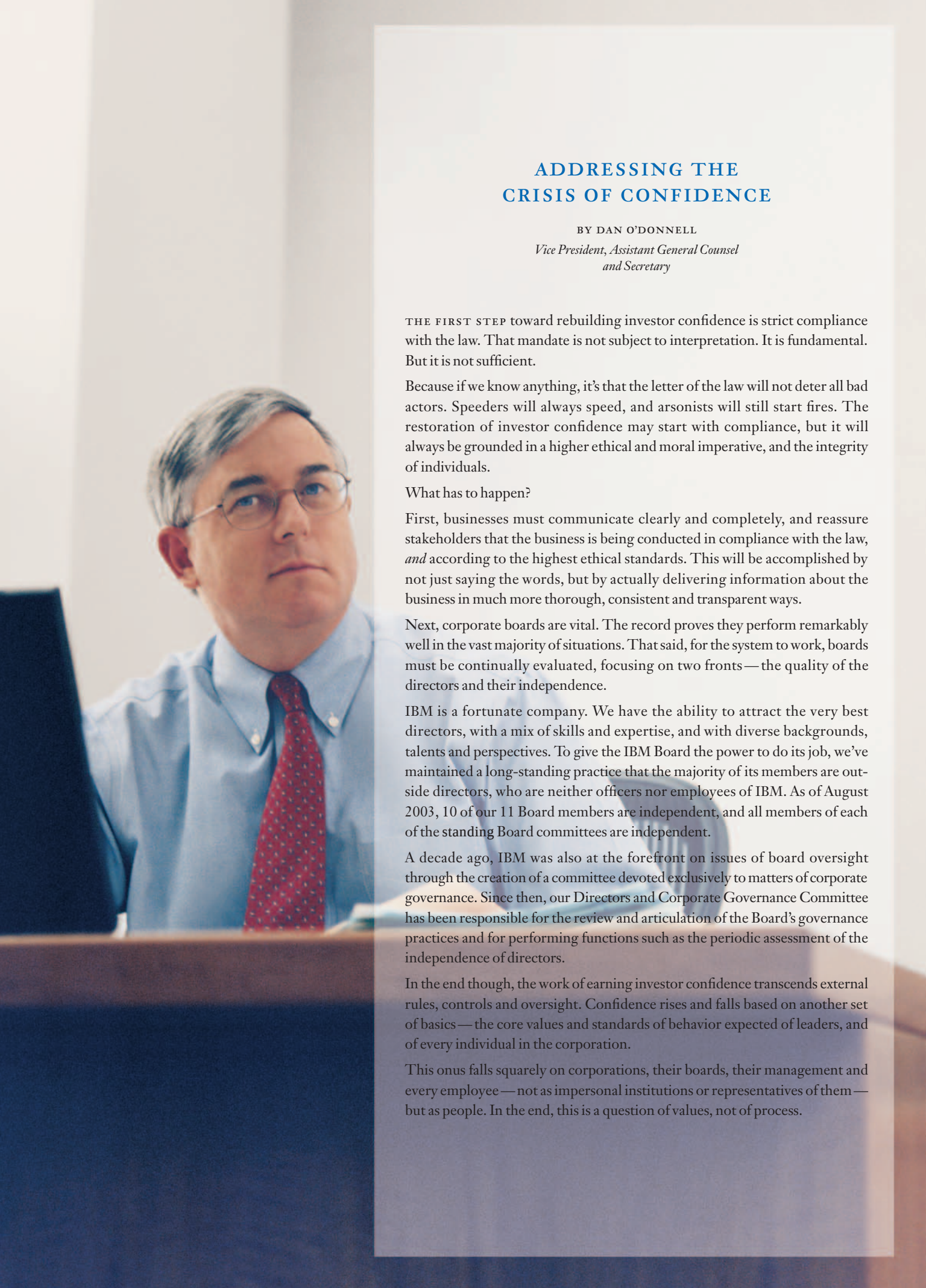
The committee also is responsible for identifying and selecting appropriate director candidates. It factors into its analysis the diversity of a candidate's experience, background and skills, with the goal of ensuring the Board reflects a diversity of race, gender, perspective and culture. The current Board meets this goal, with directors from academic and professional organizations, as well as leaders of corporations both within and outside the United States, and from both genders and various racial and ethnic backgrounds.

GLOBAL MANAGEMENT SYSTEM

Formal corporate policies issued by the IBM chief executive officer govern companywide actions within IBM and actions with all third parties.

Corporate policies address issues that are considered fundamental and of enduring importance while ensuring compliance with legal directives. Representative corporate policies include:

- Business Conduct and Ethics
- Workforce Diversity
- Political Contributions and Employee Participation in Politics
- Responsibility for Employee Well-Being and Product Safety
- Data Privacy
- Commitment to Diverse Business Relationships
- Environmental Affairs



ADDRESSING THE CRISIS OF CONFIDENCE

BY DAN O'DONNELL

Vice President, Assistant General Counsel and Secretary

THE FIRST STEP toward rebuilding investor confidence is strict compliance with the law. That mandate is not subject to interpretation. It is fundamental. But it is not sufficient.

Because if we know anything, it's that the letter of the law will not deter all bad actors. Speeders will always speed, and arsonists will still start fires. The restoration of investor confidence may start with compliance, but it will always be grounded in a higher ethical and moral imperative, and the integrity of individuals.

What has to happen?

First, businesses must communicate clearly and completely, and reassure stakeholders that the business is being conducted in compliance with the law, *and* according to the highest ethical standards. This will be accomplished by not just saying the words, but by actually delivering information about the business in much more thorough, consistent and transparent ways.

Next, corporate boards are vital. The record proves they perform remarkably well in the vast majority of situations. That said, for the system to work, boards must be continually evaluated, focusing on two fronts — the quality of the directors and their independence.

IBM is a fortunate company. We have the ability to attract the very best directors, with a mix of skills and expertise, and with diverse backgrounds, talents and perspectives. To give the IBM Board the power to do its job, we've maintained a long-standing practice that the majority of its members are outside directors, who are neither officers nor employees of IBM. As of August 2003, 10 of our 11 Board members are independent, and all members of each of the standing Board committees are independent.

A decade ago, IBM was also at the forefront on issues of board oversight through the creation of a committee devoted exclusively to matters of corporate governance. Since then, our Directors and Corporate Governance Committee has been responsible for the review and articulation of the Board's governance practices and for performing functions such as the periodic assessment of the independence of directors.

In the end though, the work of earning investor confidence transcends external rules, controls and oversight. Confidence rises and falls based on another set of basics — the core values and standards of behavior expected of leaders, and of every individual in the corporation.

This onus falls squarely on corporations, their boards, their management and every employee — not as impersonal institutions or representatives of them — but as people. In the end, this is a question of values, not of process.

Corporate Instructions are directives issued by corporate staff executives to help ensure uniform practices across the company. These instructions address processes and requirements in areas ranging from human resources, environmental affairs, community relations and governmental programs to marketing, finance, intellectual property, real estate, manufacturing and sourcing.

IBM maintains a
broad range of programs supporting
STAKEHOLDER ENGAGEMENT
including surveys, studies, councils,
focus groups and open communications
channels with publics including
Employees, *Suppliers*,
Clients, *Business Partners*, *Stockholders*
and Alliance Partners

In developing its plans and business objectives, IBM assesses a variety of external forces, evaluates the potential risks, and considers a range of industry, economic and social factors. Once developed, a system of measurement has been designed to track progress, communicate the areas most important to meeting IBM business goals, and alert management to potential problem areas so that corrective action can be taken. Among the standards applied are measurement and tracking of changes to:

- Client satisfaction
- Marketshare
- Financial performance
- Environmental performance
- Quality
- People

These internal controls, and an ongoing internal audit program, are designed to give management the operational controls to confirm for stockholders and appropriate government agencies that the recording of financial results conforms with generally accepted accounting principles and with assurance that transactions are executed in accordance with management authorization. They also help IBM operate in accordance with its own policies and directives.

BUSINESS CONDUCT GUIDELINES

The first version of the IBM Business Conduct Guidelines was drafted in the 1960s as a common set of principles to help each employee understand accepted standards of behavior. The Guidelines outline IBM's legal requirements and provide guidance on the company's business values. All employees worldwide are periodically required to read and certify their compliance.

Each section of the Business Conduct Guidelines covers an area in which employees have responsibilities to the company.

- Personal conduct and protection of IBM's assets
- Obligations in conducting IBM's business with other people and organizations
- Personal responsibilities, such as public service, use of insider information, and avoiding conflicts of interest

INTERNAL AUDITS AND CONTROLS

IBM has a comprehensive approach to providing the Board of Directors and management with the tools they need to measure risk and audit performance. These include:

- Independent and objective assessments of IBM's system of internal controls
- Guidance in managing control risks for IBM stakeholders
- Proactive support to improve control posture
- Assistance in performing self-assessments
- Independent investigations into allegations of fraud and violations of IBM's Business Conduct Guidelines

To promote compliance, the general auditor and the audit and business controls staff:

- Have unrestricted access to all functions, records, property and personnel.
- Allocate Internal Audit and Business Controls resources, define the engagement plan, and apply the techniques required to accomplish Internal Audit and Business Controls objectives.
- Require line management response to recommendations.
- Have full and free access to the Audit Committee.

The general auditor provides periodic updates to the Audit Committee and reports within IBM to the chief financial officer.

FIVE-YEAR COMPARISON OF SELECTED FINANCIAL DATA

($ in millions, except share amounts)

FOR THE YEAR	98	99	00	01	02
Revenue	$ 77,548	$ 83,334	$ 85,089	$ 83,067	**$81,186**
Income from continuing operations	5,469	7,359	7,874	8,146	**5,334**
Income/(loss) from discontinued operations	859	353	219	(423)	**(1,755)**
Net income	6,328	7,712	8,093	7,723	**3,579**
Earnings/(loss) per share of common stock:					
Assuming dilution:					
Continuing operations	2.84	3.93	4.32	4.59	**3.07**
Discontinued operations	0.45	0.19	0.12	(0.24)	**(1.01)**
Total	3.29	4.12	4.44	4.35	**2.06**
Basic:					
Continuing operations	2.92	4.06	4.45	4.69	**3.13**
Discontinued operations	0.46	0.20	0.12	(0.24)	**(1.03)**
Total	3.38	4.25*	4.58*	4.45	**2.10**
Cash dividends paid on common stock	814	859	909	956	**1,005**
Per share of common stock	0.43	0.47	0.51	0.55	**0.59**
Investment in plant, rental machines and other property	6,520	5,959	5,616	5,660	**5,022**
Investment in research, development and engineering — net	5,046	5,219	5,084	4,986	**4,750**
Return on stockholders' equity	37.2%**	39.1%**	40.0%**	35.3%**	**15.5%**

AT END OF YEAR					
Total assets	$ 88,160**	$ 89,571**	$ 90,412**	$ 90,303**	**$96,484**
Net investment in plant, rental machines and other property	19,631	17,590	16,714	16,504	**14,440**
Working capital	5,533	3,577	7,474	7,342	**7,102**
Total debt	29,413	28,354	28,576	27,151	**26,017**
Stockholders' equity	19,383**	20,426**	20,550**	23,448**	**22,782**
Employees (IBM/wholly owned subs)	291,067	307,401	316,303	319,876	**315,889**
Employees (less than wholly owned subs)	21,704	17,176	21,886	25,403	**22,282**
Complementary	36,900	29,800	25,500	21,300	**17,250**

** Does not total due to rounding.*
*** Reclassified to conform with 2002 presentation.*

IBM BOARD OF DIRECTORS — SEPTEMBER 2003

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SUPPLY CHAIN RELATIONSHIPS

There is at least one inevitable outcome of the increasingly interconnected nature of the world's markets, trading relationships and commercial business models. And it has everything to do with standards. Standards of behavior.

That's because enterprises making the transition to "on demand" ways of working and managing themselves will seek much tighter integration of their business processes with those of their trading partners — to distribute risk, share accountability, and create far more flexible and variable cost structures.

That, in turn, drives new thinking about any company's responsibility to promote standards of behavior across these new business ecosystems — business practices, environmental practices, safety and working conditions.

At the same time we're working with clients to help them implement these more integrated business relationships, we're also building such relationships with our own suppliers — and either instituting new practices or reaffirming existing policies, such as our commitment to work with environmentally responsible companies.

Our first corporate directive in this area was issued in the late 1970s to prevent the transfer of responsibility for environmentally sensitive operations to any company lacking the commitment or capability to manage them properly.

While this corporate directive initially applied to hazardous waste disposal vendors only, its scope has been expanded over the years to include production-related suppliers and product disposal vendors. IBM evaluates these vendors, their facilities and methods prior to approving them. In order to verify that their environmental operations remain satisfactory, vendors are periodically re-evaluated.

Any concern arising during one of these evaluations is addressed with the supplier or vendor and must be resolved to IBM's satisfaction. IBM's conformance with these evaluation programs is part of its comprehensive audit program.

As part of the commitment to environmental management leadership, IBM encourages its suppliers to pursue ISO 14001 registration. A copy of IBM's letter to suppliers regarding ISO 14001 can be found at www.ibm.com/procurement.

IBM also shares expertise and technology as appropriate with many of its suppliers. This not only helps support the company's environmental objectives; for suppliers, it helps improve their own environmental performance.

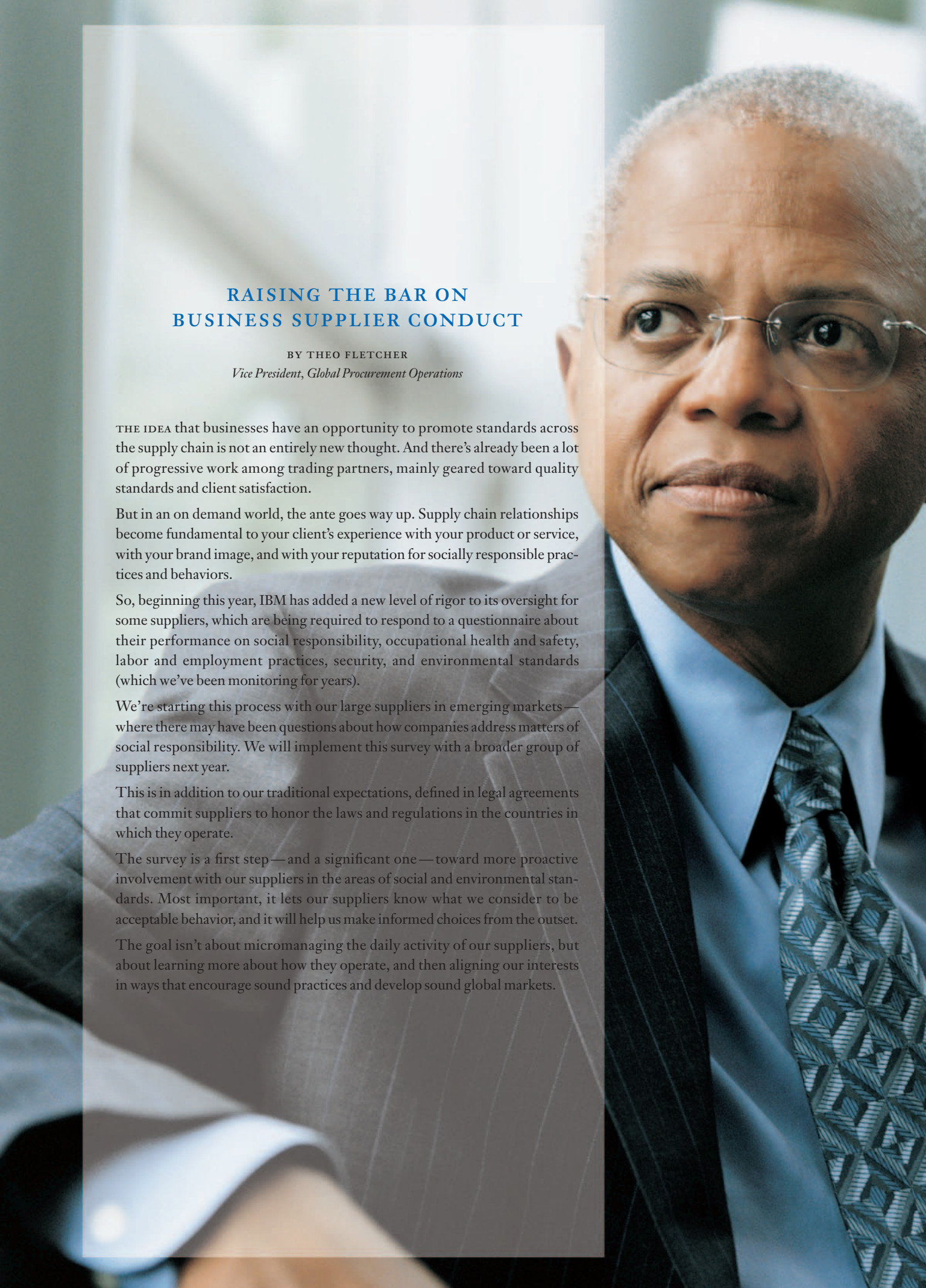
For example, IBM Brazil was instrumental in establishing two industry groups focused on sharing their environmental expertise with small- and medium-size businesses. Their efforts not only helped those businesses and the environment, they also helped create responsible suppliers for IBM.

FOSTERING DIVERSITY

Building a community of diverse suppliers increases IBM's opportunity to hear new ideas, apply different approaches, and gain access to additional solutions that respond to client needs.

Our supplier diversity program expands purchasing opportunities for businesses owned and operated by minorities, women, gays, lesbians, people with disabilities and veterans. This program increases opportunities for nonprofit organizations that employ people with disabilities and for small businesses located in historically underutilized business zones.

In 2002, IBM procured $1.4 billion of goods/services from 582 businesses owned and operated by minorities, women, veterans, people with disabilities, gays and lesbians — the third year in a row we exceeded $1 billion.



RAISING THE BAR ON BUSINESS SUPPLIER CONDUCT

BY THEO FLETCHER
Vice President, Global Procurement Operations

THE IDEA that businesses have an opportunity to promote standards across the supply chain is not an entirely new thought. And there's already been a lot of progressive work among trading partners, mainly geared toward quality standards and client satisfaction.

But in an on demand world, the ante goes way up. Supply chain relationships become fundamental to your client's experience with your product or service, with your brand image, and with your reputation for socially responsible practices and behaviors.

So, beginning this year, IBM has added a new level of rigor to its oversight for some suppliers, which are being required to respond to a questionnaire about their performance on social responsibility, occupational health and safety, labor and employment practices, security, and environmental standards (which we've been monitoring for years).

We're starting this process with our large suppliers in emerging markets — where there may have been questions about how companies address matters of social responsibility. We will implement this survey with a broader group of suppliers next year.

This is in addition to our traditional expectations, defined in legal agreements that commit suppliers to honor the laws and regulations in the countries in which they operate.

The survey is a first step — and a significant one — toward more proactive involvement with our suppliers in the areas of social and environmental standards. Most important, it lets our suppliers know what we consider to be acceptable behavior, and it will help us make informed choices from the outset.

The goal isn't about micromanaging the daily activity of our suppliers, but about learning more about how they operate, and then aligning our interests in ways that encourage sound practices and develop sound global markets.

What is the employment relationship for 21st century work, and 21st century workers?

What are the mutual commitments and expectations of employer or employee with regard to effort, ethics, results and rewards?

How does that relationship create the ongoing ability to learn, to be heard and to grow a career?

At IBM, we think the answer is simple to state — and tough to accomplish. It's expressed in the recognition that every individual in the company is an adult with the smarts, skills and responsibility to direct his or her own life.

It's premised on the opportunity — available to all employees — to contribute to the upper limits of their potential, and be compensated for it.

We believe it includes the guarantee of a safe, inclusive work environment that rewards excellence, fosters innovation, and values diversity of culture, background and thought, as well as an unflinching commitment to marketplace success.

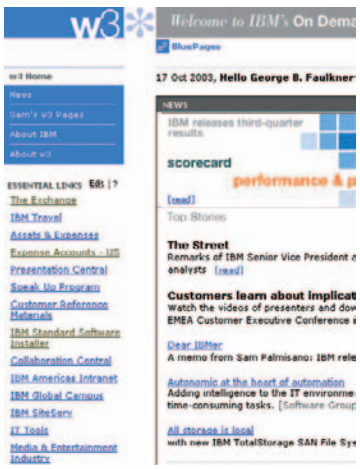
Only then can a company create the highest level of opportunity, and the broadest employment for the greatest number of people.

In the three years that
Training Magazine has ranked

top 100

CORPORATE PROGRAMS,

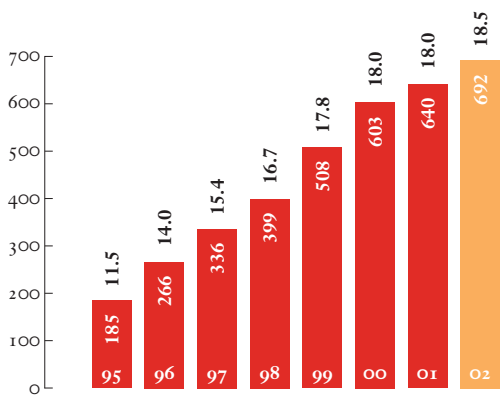
only IBM has made
the top five each year



Nearly 70% OF IBM EMPLOYEES view the company intranet as vital to their jobs

More than half of IBM's
SENIOR-MOST MANAGEMENT TEAM
are women,
U.S. ethnic minorities,
or non-U.S. born

WOMEN EXECUTIVE POPULATION GROWTH
(percent of total executive workforce)



The IT industry of the 1960s, '70s, and even the early 1980s had far fewer participants, meaning IBM faced far less competition for marketshare, as well as talent. Our compensation systems reflected that environment — focused more on job security than on continual learning and evolving job opportunity; more on the consistency and predictability of pay than on pay based on individual performance and on the company's overall competitiveness. That was then.

Today, employee compensation and rewards at IBM are designed to drive a culture of high performance. During the last 10 years, the company revamped its reward strategy, focusing far more of its total compensation investment on programs that reward and recognize results, and minimizing rewards based on tenure.

Our overall compensation strategy is designed to:

Pay competitively — based on market rates in the IT industry and within any geography where we compete for talent.

Pay for performance — focused on results, not for effort and years of service, and recognizing the relative contribution of team members.

Differentiate strongly — distributing a proportionately larger share of the rewards to our highest contributors.

This broad-based focus on market-based pay reflects a significant departure from the past compensation investment strategy at IBM.

The pay-for-performance strategy is essential to attract and retain the talent we need to drive marketplace performance, and to re-establish IBM as the agenda setter for the industry, as well as our clients' most expert and capable partner.

Investment in Pay

Business performance directly affects how much money a company can — and should — invest in pay for its people.

During the recent IT industry downturn in many countries, IBM continued to invest in its people, reflecting our generally stronger business performance relative to competitors and the commitment to pay for performance. As a result, IBM was one of the few major IT companies able to provide employee base pay increases in both 2002 and 2003, and to pay employee bonuses in both years, as well.

ADDITIONAL PAY OPPORTUNITY

In addition to competitive base pay, every IBM employee worldwide has additional pay opportunities directly tied to individual and business performance. The type of opportunity depends on an individual's job responsibilities. Consultants in our services business are eligible for performance bonuses; salespeople receive sales commissions; executives are eligible for incentive pay; and everyone else is eligible for a program called "variable pay" that provides the opportunity for additional payments based on business results and individual performance.

Starting in the mid-1990s, IBM has issued approximately $11 billion in variable pay to employees worldwide. Today, variable pay is designed to deliver between 6 percent and 9 percent of an employee's base pay when business and individual targets are met.

EQUITY OWNERSHIP

In recent years, IBM has also embarked on an aggressive expansion of equity ownership, making changes to align the interests of top contributors at all levels with those of our other shareholders.

As part of this effort, IBM has dramatically expanded the number of nonexecutive employees who are granted equity awards, increasing from fewer than 1,500 nonexecutive stock option holders at the end of 1995 to more than 78,000 in 2002, a year when about 3,800 executives held options.

GROWTH IN EMPLOYEE STOCK OPTIONS
(total number of nonexecutive employees with stock options)

Year	Total
1995	1,418
1996	1,995
1997	3,256
1998	13,712
1999	36,479
2000	60,136
2001	70,192
2002	**78,012**

Our approach to equity awards contrasts with the trend at most other IT companies, which typically grant options annually to a broader percentage of employees. IBM (which has a longer history of public ownership than any other IT company) has adopted a strategy that is more selective. While employees at every level are eligible for equity consideration, by design, grants are typically awarded only to top performers, whose skills are most critical to business success.

Employees' options vest 25 percent each year over four years, but remain eligible for exercise for a total of 10 years.

In addition to the global stock option program, IBM also makes a global stock purchase program available, so that IBMers can periodically buy discounted company stock. More than 150,000 employees worldwide participate in this voluntary program.

Today, nonexecutive employees own more than 7 percent of outstanding company shares. Directors and executive officers own just under 1 percent, as disclosed in the financial annual report.

Since 1995, an average of 4.4 percent of all stock option awards at IBM went to the top five company executives. In 2002, the total was less than 1 percent. That compares with an average of 29 percent awarded to the top five executives at the 1,500 largest U.S. companies between 1992 and 2001, according to research conducted at Rutgers University.

EXECUTIVE COMPENSATION

Both employee and executive compensation are built on a fundamental commitment to pay for performance. The differences are primarily of degree — all executives have a much greater share of overall compensation at risk than employees, reflecting their higher levels of direct influence over company results. There is also greater focus on equity ownership for executives, further reflecting their ability to influence business results.

While all executives are eligible for incentive and equity awards, not all executives receive them, in keeping with the broad focus on performance. In 2002, due to business conditions, IBM did not provide merit increases to executives. However, as noted earlier, nonexecutive employees did receive merit increases. In 2003, we took further steps to lower the overall value of executive compensation, leading market trends in this area.

IBM's senior-most leaders — about 300 men and women worldwide — are expected to own defined levels of company stock, linked to their responsibilities and pay levels, and they are not allowed to sell any company stock unless these ownership requirements are met.

Finally, IBM's executive compensation practices and programs are regularly reviewed by a committee of the Board of Directors that is made up solely of independent directors.

OTHER AWARDS AND RECOGNITION

The commitment to pay for performance is complemented by a wide range of other award and recognition programs.

In 2002, 107,180 awards were granted to employees, ranging from gift certificates to cash awards. Also in 2002, 66,838 employees sent a company-provided gift to a peer in recognition of a job well done.

Benefits

Total compensation also includes the value of the IBM benefits programs—an investment that can add as much as 25 percent or more in value to an employee's pay. Benefits, and the value delivered, vary country by country, due to differences in local customs and laws.

IBM benefits are designed to attract and retain employees in ways that are both sensitive to local customs and competitive within the IT marketplace. Benefits help employees pay for healthcare and set aside money for retirement, and encourage time off and provide support during periods of crisis, such as disability.

To the greatest extent practical, programs provide employees with choices to meet personal needs that may change over time. In many countries around the world, IBM offers employees a flexible menu of benefit options. In Canada and Australia, for example, employees are provided with a core set of benefits plus an allocation of "credits" that they can use at their discretion to choose additional levels of coverage under those programs that matter most to them.

Through "You and IBM," the company's global human resources intranet, employees have access to detailed information on benefit plans, along with reminders and features to help employees make the most of the available programs.

HEALTH BENEFITS

IBM defrays the costs of health services for employees, either directly through private employer-sponsored coverage in the United States and Canada; or indirectly through government-required contributions to state-sponsored programs, which are common in Europe and parts of Asia.

In 2003, IBM completed work on a global healthcare strategy that focuses on quality as well as cost, and promotes prevention as a key plank in the overall health benefits platform. We have been actively involved in groups focused on improving healthcare quality while lowering costs in the United States, where the approach to healthcare differs from the approach in many other countries where we do business.

While IBM's primary commitment is to provide access and to help defray the cost of healthcare for active employees, the company also contributes to post-employment healthcare or provides access to IBM health plans, depending on local practice. In the United States, for example, IBM spends approximately $600 million annually on retiree healthcare and an additional $200 million in Medicare taxes to provide health coverage for about 120,000 U.S. retirees, plus family members.

IBM benefits programs can add as much as **25 PERCENT OR MORE** in value to base pay

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RETIREMENT BENEFITS

IBM provides retirement benefits to regular employees directly through company-sponsored plans, through contributions to state-sponsored programs, or through a combination of both, depending on local practices. Plans are funded according to country requirements and guidelines.

In most countries, IBM offers either a defined benefit or a defined contribution retirement plan, with both available to at least half our population. In the United States, the company's 401(k) match is made entirely in cash, with employees free to invest the money among more than 20 different investment options.

In mid-2003, a U.S. federal district court judge ruled that in his view the way IBM's U.S. pension plan accrues benefits violates the age discrimination provisions of the Employee Retirement Income Security Act (ERISA), as amended. IBM strongly disagrees with the ruling and plans to appeal. The ruling stems from a lawsuit filed in 1999.

Workforce Reductions

As indicated in the profile of IBM's business portfolio in the first section of this report, a workforce — especially in this hyper-competitive and constantly changing industry — is not a static asset. There's an ongoing rebalancing — adding skills that are in high client demand, as well as reducing our presence in areas that no longer fit the strategy to lead in high-value market segments.

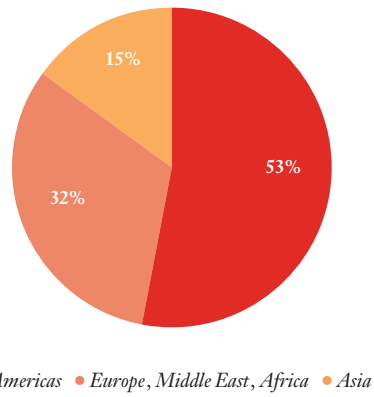
In 2002, for example, IBM hired more than 12,000 people, and about 20,000 IBM employees (roughly 6 percent of IBM's total workforce) lost jobs in resource actions. This was in addition to the changes from acquisitions and divestitures mentioned in the Our Company section of this report.

Having resource actions affect 6 percent of the global workforce in 2002 was atypical. The average for the prior three years was 2 percent each year.

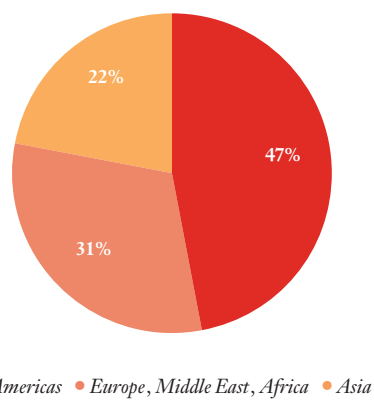
During 2002, a nearly equal number of people left IBM — through divestitures, outsourcing or resource actions — as joined, so that IBM ended the year with about 316,000 employees, compared to roughly 320,000 the year before.

IBM's assistance package for employees affected by resource actions includes a range of benefits to help them through the transition period to their next job. Specifics vary by country. For example, in the United States, this support includes advance notification, so employees have time to look for a new position, supported by an internal job posting system that allows them to see and apply for job openings throughout the company. If they leave IBM, these employees receive severance pay, plus career transition services for 120 days, as well as financial planning services, retraining assistance ($2,500 to help develop skills for a new career), subsidized post-employment medical benefits plus group life insurance during the period of transition.

2002 GEOGRAPHIC WORKFORCE DISTRIBUTION



2002 GEOGRAPHIC REVENUE DISTRIBUTION*



**Excludes OEM revenue, which accounted for 4 percent of IBM's total revenue in 2002.*

EMPLOYEE WELL-BEING

The creation and maintenance of a contemporary workplace is about more than an environment that's safe and free of harassment of any kind. IBM's programs to promote employee well-being span proactive wellness initiatives through innovative workplace design.

All these initiatives are directed by IBM's Well-Being Management System (WBMS) — the company's holistic approach to managing the health and safety of employees wherever they work. To achieve that, our management system integrates and centralizes several previously self-standing programs, including occupational medicine, safety, industrial hygiene, employee well-being and ergonomics. This management system has been implemented in manufacturing, development and services organizations across IBM.

Programs include training for employees joining IBM via acquisitions, support for employees working in client locations and initiatives to enhance safety at newly acquired facilities.

While the WBMS is designed to drive improvements consistently around the world, it also accommodates customized programs that meet particular local needs. Examples include accessibility management in Guadalajara, Mexico; online ergonomics training in Japanese, French, German and Spanish; drinking water quality issues in India; injury/illness case management in China and Japan; establishing the foundation for medical Employee Assistance Programs in India and China; Occupational Safety and Health Administration (OSHA) Voluntary Program Protection plan certification in the United States; and work/life balance programs in Germany and Hungary.

Each year, a targeting process considers new global objectives and links them with local well-being activities. IBM identified 14 programs for special emphasis in 2002, including ergonomics, contractor safety, health promotion, indoor air quality, life safety, business transformation, mobility, workplace climate and medical services.

As one example, 34 IBM locations set specific targets for further improving ergonomics programs. These objectives ranged from upgrading chairs and workstations, to increasing ergonomics awareness among laptop users, boosting participation in ergonomics classes and reducing ergonomic-related injuries in manufacturing.

WORKPLACE SAFETY

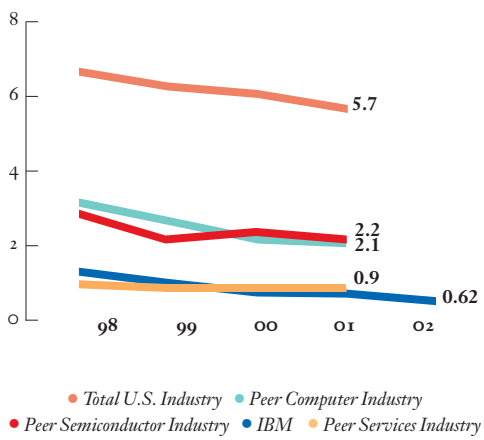
The commitment to workplace safety was first formalized as a corporate policy in 1967. Today, IBM's safety record continues to be among the best in industry, as documented in continued year-to-year reductions in the rates of illness and injury as measured by the U.S. Occupational Safety and Health Administration. In 2002, IBM recorded a 17 percent drop from 2001 in the OSHA rate.

A number of IBM sites in the United States have received OSHA's highest recognition as Voluntary Protection Program (VPP) Star sites. They include IBM's sites in Rochester, Minn.; San Jose, Calif.; and Yorktown Heights, N.Y. Sites are re-evaluated every three to five years for continual improvement.

The chart below presents IBM U.S. rates, along with the rates for general industry and peer industry sectors. Even as IBM has made the transition from a company with a large manufacturing workforce to a company with a larger number of services professionals, the OSHA rate for this mixed occupation workforce is significantly below the peer computer and semiconductor injury rate, and is below the peer services rate.

U.S. WORK-RELATED INJURY/ILLNESS RATE COMPARISONS

(rate per 100 employees)



These are the rates for total work-related injury/illness cases reported under the U.S. Occupational Safety and Health Act. In addition to lost-time cases, they include cases that required medical treatment or restricted the employee's work activity. Some numbers have been updated from prior years. Industry peer data for 2002 is not yet available.

The table on page 33 details the performance results of IBM's safety programs in a sampling of countries with manufacturing or hardware development operations in 2002. IBM consistently demonstrates low lost workday case rates (a measurement of injury/illness severity and business impact).

When an illness or injury occurs, the objective is threefold: help restore the employee's health as soon as possible, prevent further occurrence, and help support the employee during his or her time off from work. In many countries, IBM employees injured in the workplace are eligible for workers' compensation benefits.

In the United States, the 2002 number of claims per 100 employees decreased by 22 percent from the previous year. The total claims cost rose by 2.5 percent, reflecting factors including increased medical costs and inflation.

IBM's focus on workplace safety extends to contractors working on IBM premises and includes providing information regarding working safely, reviewing potentially high-risk work activities and, where concerns are identified, directing that they be addressed.

CRISIS MANAGEMENT

The IBM emergency planning process has successfully handled the response to numerous emergencies and disasters over many years. However, the events of September 11, 2001, raised both the nature and potential magnitude of these events, creating the need to build on our response processes on a national and global basis.

In order to handle crisis management situations that have companywide implications, IBM added in 2001 a Corporate Crisis Management Team (CCMT) to its existing emergency process.

Structure

The CCMT supports the existing crisis management structures at the country level or at an individual site by providing corporate advice and counsel, and resources as required.

Members

The CCMT is represented by the following primary functions: communications, finance, human resources, global well-being services, legal, security, facilities/real estate, technology, manufacturing and development, and sales and distribution.

Principles of Operation

The executive team members for an affected country or site have the flexibility to act without direct senior executive management approval as long as the actions are appropriate to their immediate responsibilities or to the location(s) they manage.

Corporatewide guidance will be provided by the CCMT or by the appropriate corporate or geographic senior executive using the existing communications infrastructure. Any public statement concerning IBM's response to a crisis must be reviewed by corporate communications.

Crisis management teams in individual locations receive annual training that includes possible responses to hostilities and terrorism, and course materials regarding management of a terrorist event are available to the entire global well-being services community.

WHO'S ON THE local crisis team?

The crisis team includes the location executive or manager and representatives from human resources, communications, finance, legal, security, global well-being services and facilities.

Since September 11, 2001, at least two members of the well-being staff have been assigned to help each local team. They can access experts in ionizing radiation, anthrax, personal protective equipment, heating, ventilation and air conditioning, smallpox, and nerve agents.

These global well-being services experts also stay current with changes in threat potential, detection, remediation and cleanup.

GLOBAL WELLNESS & HEALTH PROMOTION

Health promotion brings preventive health services to all IBM employees. The wellness process is designed to promote behaviors conducive to good health, and allow employees to take full ownership of their well-being with the support of global well-being services and health benefits and their management.

Preventive Health Services

Programs include primary prevention efforts, including immunizations, fitness and nutrition, stress management, weight control, smoking cessation, ergonomics and prevention of injuries. Secondary prevention efforts include programs that focus on early diagnosis and prevention, such as screenings, targeted examinations and disease management.

The objectives of these programs are global, but their program development and implementation are customized to address local issues and cultures.

One of the main portals on IBM's w3 intranet Web site — "Your Health" — enables all IBM employees in the United States to find information about their healthcare benefit options (13 in all, covering medical, dental and mental healthcare), along with material on ergonomics, personal wellness and workplace safety.

Employees also have access to tools for interactive health risk assessments, creating an electronic health record, tracking targeted health improvement programs, analyzing medical symptoms, learning about medical tests and procedures, evaluating potential medication interactions and searching a vast health library.

A Web portal released in 2002 provides well-being professionals with resources and information on organizational contacts, references, forums, professional self-assessment tools, skills and education toolkits, ongoing learning, measurements and best practices.

CLEANROOMS

As noted in last year's IBM Environment and Well-Being Report, questions have been raised about possible adverse health effects associated with chemicals in semiconductor and disk drive cleanrooms. Lawsuits have been filed in New York, California and Minnesota by some current and former IBM employees against chemical suppliers, and in some cases against IBM. While IBM sympathizes with anyone who develops a medical problem, the company does not believe there is a causal relationship between these health issues and the chemicals used in cleanrooms.

The company has programs in place for regular reviews of cleanroom operations. These reviews show that the use of chemicals in cleanrooms and other areas is being properly managed, and that employees are well-informed about both the substances present and the requisite safety procedures.

WORK/LIFE BALANCE

For the last quarter century, a major focus of IBM's efforts to help employees balance the demands of the workplace and the pressure of their private lives has come in the areas of child and eldercare.

In response to the increasing number of dual-income households and working single parents, IBM in 1983 launched the first national corporate childcare initiative, giving employees immediate access to childcare experts. Then, in the late 1980s, issues related to the aging population began to drive a new set of requirements — on individuals and employers.

In 1990, IBM created its Funds for Dependent Care Initiatives (FDCI) to increase the availability and quality of dependent care programs, and provide referrals to senior housing, meal delivery and transportation services. Funded at $25 million for the first five years, the program enabled IBM to invest in more than 400 child and eldercare projects in more than 50 communities.

LOST WORKDAY CASE RATE PER 100 EMPLOYEES

Country		98	99	00	01	**02**
Canada	IBM	0.06	0.07	0.11	0.08	**0.10**
	Available Peer Industry	0.71	0.61	0.61	n/a	**0.44**
China	IBM	0.00	0.16	0.15	0.12	**0.05**
	Peer Industry	n/a	n/a	n/a	n/a	**n/a**
France	IBM	0.36	0.34	0.24	0.25	**0.18**
	Available Peer Industry	0.93	0.93	0.94	0.87	**n/a**
Hungary	IBM	0.36	0.50	0.57	0.24	**0.19**
	Peer Industry	n/a	n/a	n/a	n/a	**n/a**
Ireland	IBM	0.28	0.23	0.29	0.25	**0.11**
	Available Peer Industry	n/a	1.29	1.20	1.06	**n/a**
Japan	IBM	0.01	0.01	0.00	0.01	**0.02**
	Available Peer Industry	0.02	0.09	0.06	0.04	**0.06**
Mexico	IBM	0.12	0.00	0.00	0.02	**0.00**
	Peer Industry	n/a	n/a	n/a	n/a	**n/a**
Singapore	IBM	0.22	0.11	0.05	0.14	**0.43**
	Available Peer Industry	0.06	0.12	0.06	0.43	**0.39**
U.K.	IBM	0.21	0.30	0.19	0.22	**0.14**
	Available Peer Industry	0.51	0.54	0.56	0.56	**n/a**
U.S.	IBM	0.34	0.46	0.36	0.36	**0.23**
	Available Peer Industry	1.85	1.70	1.35	0.80	**n/a**

n/a = Not Available

The injury rates in this sampling of countries assume an average of 2,000 hours worked per employee per year. The U.K. and Singapore data pertain only to injuries with three or more days lost time. Because of the differences in governmental reporting requirements, a direct comparison between countries is not appropriate. Where available, the peer industry rate is an estimate of the average rate for companies doing a type of work similar to that done by IBM in that country. Some country numbers have been updated from prior years.

During the latter half of the 1990s, the program was expanded to include investments in 1,200 child and elder-care projects in 66 communities, leading to programs that created 61,000 new "spots" for children or seniors in need of care.

In 2001, responding to employee surveys that indicated child and eldercare were increasing concerns worldwide, the program was transformed into the Global Work/Life Fund with a five-year, $50 million commitment. It was the first fund of its type to address employee issues on a global basis. Among the program's goals:

- Global work/life — providing a complete range of dependent care services, with the specific objective of increasing the number of women in the workforce.
- Use of IBM technology — providing IBM computers with age-appropriate educational software to childcare centers and school programs. IBM is a major supporter of SeniorNet, an organization that teaches older adults how to use computers, and the genesis of Generations On Line, a software program that makes it easier for seniors to use the Net.

Since 1983, IBM has committed more than $200 million to dependent-care programs and services around the world.

ACCESSIBILITY

IBM's history of leadership in developing accessible solutions for people with disabilities is backed by a corporate instruction that calls for the company to make its information technologies widely available and accessible to people with special needs.

A worldwide Accessibility Center in IBM Research supports IBM's commitment to accessible software, hardware, documentation and services.

Central to our nondiscrimination policies is a commitment to integrate people with disabilities into the workplace so that they have the necessary access to the facilities and technology to perform their jobs.

In 2002, IBM's Real Estate Site Operations function enhanced its programs to better prioritize and accelerate appropriate accessibility improvements in our facilities.

Full assessments have been completed for 57 of the highest-priority sites globally (85 percent) and upgrade work has begun. Among identified improvements: constructing or upgrading ramps, modifying door widths, adjusting heights of telephones and elevator controls, installing visual alarm strobe lights and Braille signs, and modifying showers and closets in some IBM residence facilities.

WELLNESS AND HEALTH PROMOTION

	LIFE AT HOME	LIFE IN THE WORKPLACE
Preventive and Wellness Programs	• Work/Life Balance Programs • Flexible Work Options • Leaves of Absence *Programs that allow employees to work with their managers to modify their work schedules, or to take months off to balance their work and life* • Employee Assistance Program *Professional counseling for a broad range of concerns, including substance abuse and depression* • Health Promotion *Tools and information that help employees to take responsibility for their health*	• Accident/Illness Prevention *Workplace health and safety programs, such as protective equipment and safety training* • Quality of Workplace Environment *Programs to make the workplace more comfortable, including proper lighting and other ergonomic considerations* • Quality of Facilities *Building and fire safety, and accessibility for persons with physical disabilities*
Healthcare Management Programs	• Disability Management *Support to help employees obtain appropriate healthcare, and to identify and obtain the accommodations necessary to facilitate their return to work* • Disease Management *Voluntary, free program to help people with certain conditions take an active role in managing their health*	• Temporary Assignment • Progressive Return to Work *Accommodations that allow an employee with health-related limitations to continue working or to return to work after an illness leave*

WHEN STANDARD HEALTH PLANS ARE NOT ENOUGH

BY GWYNNETH STAPLES
Nurse and Director of IBM's South Africa Medical Center

AIDS CLAIMED more than 3 million lives in 2002. An estimated 5 million people acquired the human immunodeficiency virus (HIV) last year alone.

One of the highest rates of HIV/AIDS in the world is here in my home country, South Africa. In some areas, more than 30 percent of the population is HIV positive.

In the face of this threat, IBM launched an HIV/AIDS education and awareness program for its South African employees and suppliers. Voluntary counseling and testing have been available since the early 1980s.

More recently, we installed two self-service information kiosks in our South African headquarters in Johannesburg, because for many people, lectures or seminars simply don't work. People either don't want to be seen at the lectures, or can't organize their work schedules to fit them in.

With the kiosks and our intranet, people can access this content in their own time and at their own pace, finding the information that is relevant to their own circumstances. In addition to providing self-service access to potentially life-saving information, the local prevention program includes treatment, including Highly Active Anti-Retroviral Therapy (HAART), condom distribution, sexually transmitted infection treatment, and regular monitoring by doctors and counselors.

Since we launched this awareness program, absenteeism for HIV-positive employees dropped from approximately 25 days to three days per year. That's good for the company, but better for our colleagues.

IN JAPAN, IBM'S STRESS MANAGEMENT COURSES ARE
A MODEL AMONG OTHER INFORMATION TECHNOLOGY COMPANIES

IN 2002, MORE THAN 12,500 U.S. EMPLOYEES TOOK ADVANTAGE
OF FREE SCREENINGS FOR CHOLESTEROL, BLOOD PRESSURE, BLOOD SUGAR,
BODY COMPOSITION AND BONE DENSITY.
AFTER SCREENING, AN E-MAIL-BASED PROGRAM PROVIDES
TARGETED INFORMATION AND REFERRALS TO OTHER IBM INTERVENTIONS
BASED ON THE HEALTH RISK PROFILE

IBM SET THE TRENDS — BEFORE THEY BECAME TRENDS

1937 *Paid vacation schedule*
1944 *Sickness and accident income plan*
1956 *Leave of absence program*
1966 *Special care for children assistance program*
1972 *Adoption assistance*
1980 *Flexible work schedules*
1983 *Childcare referral service*
1988 *Eldercare consultation and referral service*
1990 *Funding for dependent care initiatives*
1997 *Regular part-time work options*

Leadership accessibility products include:

Home Page Reader, which brings the Internet to blind and low-vision users, applying voice to guide users in exploring the World Wide Web. It enables people with low vision to resize windows and panes; change font size, type and color; and change background colors to make the screen easier to see. In addition, the Voice of Home Page Reader uses the IBM ViaVoice text-to-speech synthesizer to speak Web-based information aloud as it is presented on the computer screen.

WebSphere Voice Server, which includes tools that enable developers to build and deploy voice-enabled e-business solutions, using industry standard technology such as Java technologies and VoiceXML.

Workforce Relations

IBM and its employees continue to maintain strong relationships based on fairness, open communication and mutual respect. The company places a premium on understanding and responding quickly to employee concerns, and has established several formal channels, which are detailed in the Communications Channels discussion beginning on page 42.

Throughout the company's history, IBM has respected the rights of employees to organize, and has made managers at all levels aware of those rights. It is our long-standing belief, however, that the interests of IBM and its employees are best served when managers and employees deal directly with each other. However, IBM complies with legal requirements worldwide regarding employee and third-party involvement.

IBM is committed to acting responsibly with respect to the treatment of employees wherever we do business — either directly or in conjunction with others. IBM does not tolerate child labor or forced labor in its own operations, or in those of its suppliers or contractors.

A SAMPLING OF RECOGNITION

In 2003, IBM received the "Stevie Award" from the American Business Awards for the Best Human Resources Organization, the first time this award was granted.

IBM Colombia was recognized by the Consejo Colombiano de Seguridad from the Secretaria del Trabajo y Prevision Social (equivalent to OSHA) for achieving one of the highest Occupational Health and Safety standards in Colombia.

IBM Singapore received the H.E.A.L.T.H. Award from the Singapore government for its health/wellness programs, policies and safety aspects in the company.

IBM Australia received the National Corporation Award of Employer of the Year recognizing businesses employing people with disabilities. IBM was chosen from more than 230 nominees.

IBM in Belgium, France, Germany, Italy and the U.K. was recognized with awards for its successful prevention of psychosocial risks at work, particularly stress, by the European Agency for Safety and Health at Work.

GLOBAL WORKFORCE DIVERSITY INITIATIVES

We've come a long way over the course of the last century on the issue now called "workforce diversity." A series of legislative measures, along with enlightened private sector leadership and populist pressure for social change, have opened doors and expanded the dialogue.

But what might have been considered enlightened or progressive as recently as 10 or 15 years ago may not be adequate today, either as business strategy or as social policy.

The reality is that workforce diversity is no longer an issue that can be categorized solely as "ethical" or "social." The moral imperative never goes away. But now it is joined by a business imperative for enterprises whose fortunes rise or fall based on the quality of their workforce. Increasingly, companies depend on their ability to understand and reflect the range of human characteristics found in any market where they hope to do business.

So, yes, we take our commitment to a diverse and inclusive workforce seriously. And that's why, over nearly a century in business, we've built a reputation as one of the world's most progressive employers. We want it to be obvious to every public that our workforce reflects the values, cultures and differences of race, gender, culture and thought found in markets and communities the world over.

Rather than run our diversity programs from a headquarters organization or centralize them in the human resources function, we've chosen to integrate them into the fabric of our management systems and infuse them into our culture. These workforce policies cut across race, color, religion, gender, gender identity or expression, sexual orientation, national origin, disability, age, veterans' status and human differences such as culture, economic status, lifestyle and marital status.

We manage our diversity commitment — across our workforce and in our perspective on the marketplace — in three principal areas: equal opportunity, affirmative action and work/life balance programs. This management system is governed by a short set of diversity imperatives, which the general manager of each IBM country organization must accept and be held accountable for results. They are: the advancement of women; the diversity of the management team; cultural acceptance and awareness (ethnic minorities, multi-lingualism and individual differences); the integration of gay, lesbian, bisexual and transgender individuals and people with disabilities; work/life balance; and reflecting the global marketplace.

For these reasons, IBM has taken aggressive steps to mirror the demographics of the marketplace.

- Women represent 29% of IBM's global workforce, and 22% of global managers.
- Since 1995, the U.S. Asian executive population has grown 572%, the largest of any of IBM's constituency groups.
- The number of Hispanic employees in the United States has increased 121%, and the Hispanic executive population has grown 211% since 1995.
- The number of IBM gay, lesbian, bisexual and transgender employees enrolled in the company's Domestic Partner Benefits Plan is the largest in the industry.

DIVERSITY TRAINING

Though the company has made significant progress, it continues to promote programs and investments that will drive further improvements.

Diversity training is required for managers and employees, and several recruiting programs focus on hiring under-represented and minority groups.

2002 U.S. EMPLOYMENT DIVERSITY

	Men	Women	All Minorities	Black	Asian	Hispanic	Native American	Total
Officials & Managers	13,027	4,991	2,760	1,095	1,022	565	78	**18,018**
Professionals	41,420	20,720	15,037	4,765	7,325	2,616	331	**62,140**
Technicians	11,561	1,507	2,794	1,070	798	852	74	**13,068**
Marketing	29,077	11,620	9,573	2,975	4,952	1,457	189	**40,697**
Office & Clerical	1,545	5,125	2,293	1,560	208	466	59	**6,670**
Craft Workers	1,028	659	342	130	125	83	4	**1,687**
Operatives	2,053	1,372	1,057	312	496	236	13	**3,425**
Total	99,711	45,994	33,856	11,907	14,926	6,275	748	**145,705**
Total	68%	32%	23.2%	8.2%	10.2%	4.3%	0.5%	**100%**

Note: Table reflects all regular and complementary U.S. employees. The company's complementary workforce includes various workers hired under temporary, part-time and limited-term employment arrangements.

EXECUTIVE TASK FORCES

Eight Executive Task Forces — Asian, Black, Hispanic, Native American, Gay/Lesbian/Bisexual/Transgender, People with Disabilities, Men and Women — were established in 1995.

Each task force is chaired and staffed by executives from that particular constituency. They are charged with looking at IBM from the perspective of these special interests and making recommendations about how:

- *IBM can make that group feel welcomed and valued.*
- *IBM can partner with that group to drive up its productivity.*
- *IBM can influence buying decisions of that group in the marketplace.*

NETWORKS THAT CROSS BORDERS

IBM encourages the formation of internal diversity councils, and has 67 Diversity Councils and 145 Diversity Network Groups that help women and multicultural employees meet, mentor and coach; perform community outreach; implement social, cultural and education events; and develop professional skills.

AFFIRMATIVE ACTION AND EQUAL OPPORTUNITY

The IBM Global Equal Opportunity Project Office assists in assuring full compliance with both the letter and spirit of the law wherever IBM does business.

IBM has successfully responded to letters of compliance for more than 670 government audits. IBM has never failed an equal opportunity audit. When the U.S. Office of Federal Contract Compliance Programs issued its directive for Functional Affirmative Action Programs, permitting compliance by lines of business, IBM received and finalized a compliance agreement.

IBM works with regulatory, governmental and non-governmental agencies to assure full compliance with legal, moral and strategic imperatives of equal opportunity.

GLOBAL EMPLOYMENT DIVERSITY
Women in the IBM Workforce 2002

	Americas	Asia Pacific	Europe Middle East and Africa	Total Worldwide
Total Women	31.0%	23.5%	28.4%	**29.0%**
Women Managers	27.5%	15.1%	16.6%	**22.4%**

A SAMPLING OF RECOGNITION

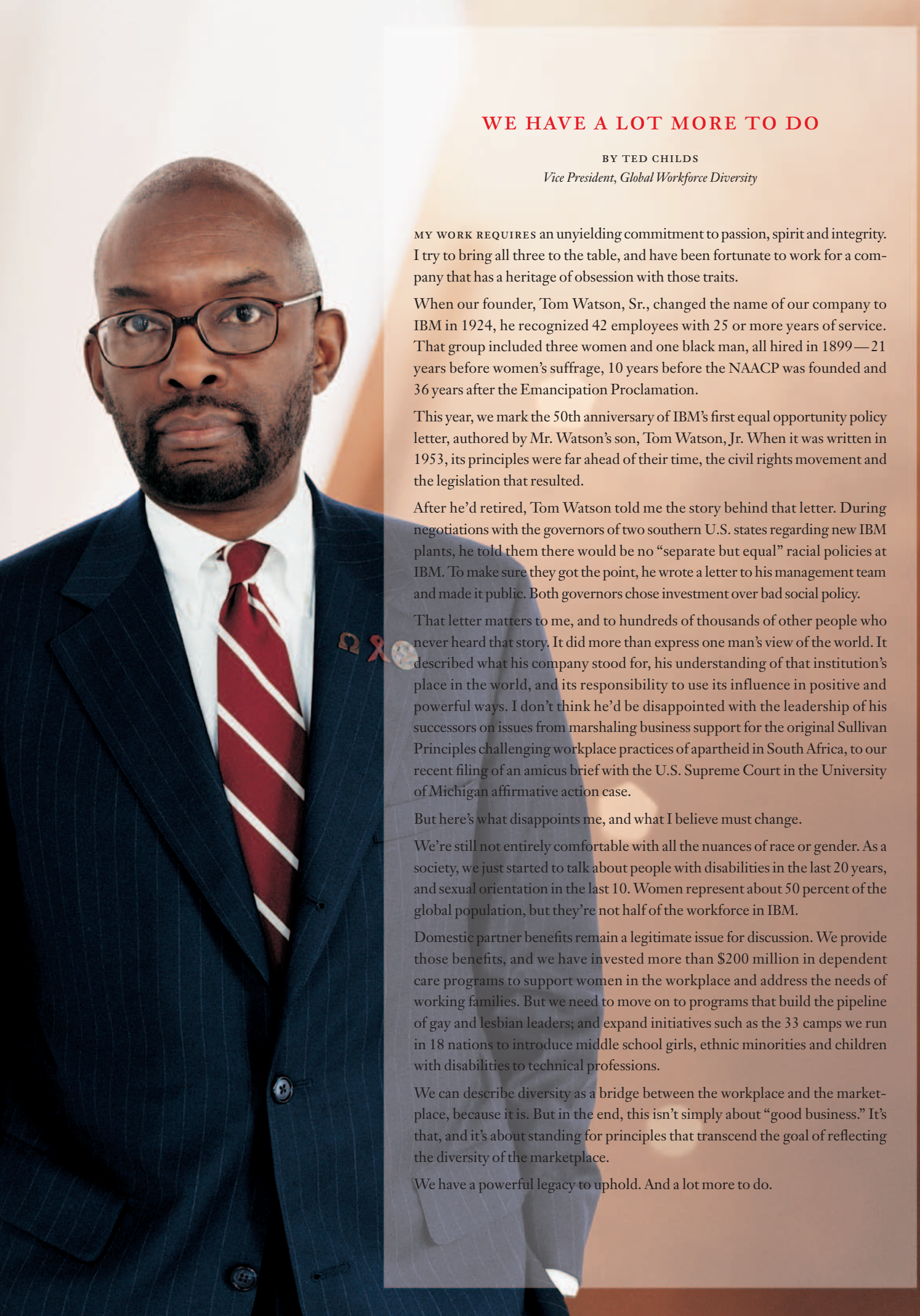
In 2002, members of the National Society for Black Engineers voted IBM the place they would most like to work — for the 12th time in 14 years.

In 2003, IBM was one of only 21 companies to receive a perfect score on the Human Rights Campaign Corporate Equality Index, which specifically recognized progress made on behalf of the gay, lesbian, bisexual and transgender community.

In 2003, *Working Mother Magazine* recognized IBM as a top 100 employer for working mothers and among the top 10 exceptionally progressive companies. IBM has been on both lists for 18 and 16 years respectively, the only company so recognized.

In 2003, the Society of Hispanic Engineers named IBM its Company of the Year.

Since 1998, IBM has been named the top company for women executives by the National Association of Female Executives.



WE HAVE A LOT MORE TO DO

BY TED CHILDS
Vice President, Global Workforce Diversity

MY WORK REQUIRES an unyielding commitment to passion, spirit and integrity. I try to bring all three to the table, and have been fortunate to work for a company that has a heritage of obsession with those traits.

When our founder, Tom Watson, Sr., changed the name of our company to IBM in 1924, he recognized 42 employees with 25 or more years of service. That group included three women and one black man, all hired in 1899—21 years before women's suffrage, 10 years before the NAACP was founded and 36 years after the Emancipation Proclamation.

This year, we mark the 50th anniversary of IBM's first equal opportunity policy letter, authored by Mr. Watson's son, Tom Watson, Jr. When it was written in 1953, its principles were far ahead of their time, the civil rights movement and the legislation that resulted.

After he'd retired, Tom Watson told me the story behind that letter. During negotiations with the governors of two southern U.S. states regarding new IBM plants, he told them there would be no "separate but equal" racial policies at IBM. To make sure they got the point, he wrote a letter to his management team and made it public. Both governors chose investment over bad social policy.

That letter matters to me, and to hundreds of thousands of other people who never heard that story. It did more than express one man's view of the world. It described what his company stood for, his understanding of that institution's place in the world, and its responsibility to use its influence in positive and powerful ways. I don't think he'd be disappointed with the leadership of his successors on issues from marshaling business support for the original Sullivan Principles challenging workplace practices of apartheid in South Africa, to our recent filing of an amicus brief with the U.S. Supreme Court in the University of Michigan affirmative action case.

But here's what disappoints me, and what I believe must change.

We're still not entirely comfortable with all the nuances of race or gender. As a society, we just started to talk about people with disabilities in the last 20 years, and sexual orientation in the last 10. Women represent about 50 percent of the global population, but they're not half of the workforce in IBM.

Domestic partner benefits remain a legitimate issue for discussion. We provide those benefits, and we have invested more than $200 million in dependent care programs to support women in the workplace and address the needs of working families. But we need to move on to programs that build the pipeline of gay and lesbian leaders; and expand initiatives such as the 33 camps we run in 18 nations to introduce middle school girls, ethnic minorities and children with disabilities to technical professions.

We can describe diversity as a bridge between the workplace and the marketplace, because it is. But in the end, this isn't simply about "good business." It's that, and it's about standing for principles that transcend the goal of reflecting the diversity of the marketplace.

We have a powerful legacy to uphold. And a lot more to do.

LEARNING PROGRAMS

It was once the case that competitive position was defined based on assets such as land, market presence or capital. Those still matter. But in the information-based economy of the 21st century, the single greatest competitive differentiator — especially in terms of innovation and speed — will be the ability of any organization to *learn*.

IBM currently invests more than $750 million annually to develop the knowledge and expertise of its workforce. Employees spend an estimated 17 million hours each year (about 55 hours per employee) in formal training — either online, through experiential learning activities or in a traditional classroom. IBM conducts half of all employee training via e-learning, realizing a cost avoidance of nearly $750 million over the past two years.

These investments are supported by a methodology designed to move people along a development continuum, so that as demand declines for certain skills or for competencies in yesterday's technologies, applications or platforms, our investments in training prepare people with the skills they need now and in the future.

For example, right now, areas like Web services — especially WebSphere and integration services — are in high demand. So are project management, data management and networking expertise. In technical development areas like these, IBM will spend more than $200 million to upgrade the talents of more than 100,000 employees this year and again in 2004.

Training Magazine again ranked IBM second overall in its Training Top 100 for 2003, and we received the top ranking for a technology company. IBM is the only company that has been rated in the top five in the three years the magazine has compiled the list.

NEWLY BLUE

The learning process for new employees begins with Your IBM — a learning program specifically designed for recent hires and employees who come to IBM via acquisitions. Rather than define learning as something that takes place in a classroom or at the computer, this process identifies a range of opportunities for learning and blends them with a rich mix of Web-based training, collaborative learning, online references and class time. Your IBM received a best practice citation from the American Society of Training and Development.

PROFESSIONAL DEVELOPMENT

All employees create an individual roadmap for learning and development through their Individual Development Plan. Professional development addresses the set of foundational competencies necessary for all employees, as well as the development of skills and competencies within specific career paths. IBM Global Campus, our online educational catalogue, provides more than 11,000 course options.

Focused training is provided to technical and sales professionals so their expertise remains the best in the industry. IBM also provides support for skill certification for the technical and sales workforce.

In addition to internal development opportunities, IBM leverages the best education available externally. Worldwide, there are programs available for employees interested in pursuing outside academic interests, including master's and Ph.D. degrees.

In the United States alone, nearly 6,000 employees participated in the Academic Learning Assistance Program in 2002. The program covers tuition, registration, books and software, and represented an investment of $30 million in 2002.

MANAGEMENT DEVELOPMENT

In today's matrixed global companies, corporate strategy and direction can be set by a handful of leaders. But for those strategies to be executed with speed and precision requires leadership at all levels and at all times — as people collaborate without regard for organizational or geographic boundaries, and traditional reporting structures are supplemented by ad hoc teams of individuals who come together "virtually" to create, innovate, build and deliver client solutions.

- Basic Blue: provides new managers with the skills they need to create the most effective and engaging working environment for employees. Basic Blue won the Sodexho Pass Award for HR Excellence at the World HRD Congress as the most innovative HR practice in the corporate sector.
- Role of the Manager@IBM: mobilizes managers into global, virtual teams to identify and resolve business issues. It received an Excellence in Practice citation from the American Society of Training and Development.
- Shades of Blue: develops management skills and awareness in managing employees from varied backgrounds. It received Excellence in Practice Citations from ASTD in five categories: Electronic Learning Technologies, Organizational Learning, Performance Improvement, Valuing Differences and Managing Change.
- Edvisor: a patent-pending, intelligent agent that helps managers assess gaps in their skills and training, and then presents a prescriptive, customized plan to close the gaps. Edvisor won a Copper 2003 Axiem Award, which recognizes the best in all forms of electronic media.

EXECUTIVE DEVELOPMENT

Most companies have a program or process for developing leaders, and some are famous for their management training programs. However, few companies have the process of developing leaders as deeply embedded in their business operations as IBM.

In June 2002, *Chief Executive* magazine named IBM the top company for building leaders. The ranking was the first to comprehensively examine the factors that allow companies to build great leadership depth. In announcing the report's findings, Marc Effron, practice leader at Hewitt Associates, said: "Leadership development has become recognized as a critical business tool that has a direct impact on a company's bottom line and future growth. Clearly IBM is using the right tools, the right way, throughout its organization."

Training Magazine rated IBM

BEST IN CLASS FOR TECHNOLOGY COMPANIES

in 2003

One distinguishing element of IBM's executive training is the rigor applied to experiential development, based on a belief that 80 percent of leadership development happens in the context of real work.

Annually, several hundred IBM executives attend executive education programs and conferences. Designed to reflect the current business challenges faced by participants, each session provides opportunities for the participants to apply their learning directly to their business challenges.

All of IBM's executive development is designed to accelerate the growth of our highest-potential executives and "early-in-career" high-potential employees.

COMMUNICATIONS CHANNELS

Sustainable business transformation occurs only, or occurs most effectively, when it is accompanied by real cultural change in support of new modes of operation, new decision-making constructs, and new ways for work to get done.

IBM's corporate intranet has emerged as both a carrier of communications on the transformation of culture inside IBM, and one of the most tangible manifestations of a company that's faster, more fluid and collaborative. It has become the locus of work and idea movement — in addition to communications — and a tool that nearly 70 percent of our workforce deem critical to their jobs.

In addition to the company intranet, IBM maintains multiple channels and media through which management communicates with the workforce, and employees communicate with management:

"Dear IBMer": electronic memos from the CEO on business results and topical issues that concern the company, its clients, its partners and its people.

Web and video broadcasts: by the CEO and a variety of executives to provide business updates, address questions raised by employees and other issues affecting IBM and its major business units.

Ideas: a formal program in which managers and employees suggest ways products, operations and programs can be improved. Suggestions can earn awards ranging from $50 to $5,000. Since 1992, when the earlier IBM Suggestion Program was modified, employees have submitted 173,000 ideas; more than $15 million has been awarded; and more than $731 million has been saved.

Speak Up!: a program implemented in 1962, enables employees to express concerns or ask questions beyond their immediate management chain, or report serious issues such as management misconduct or violations of the IBM Business Conduct Guidelines. Their messages are electronically submitted. At the option of the employee, they can be handled confidentially. They are reviewed by appropriate managers for a decision and the result is confidentially communicated to the employee.

Internal Appeals Process: There are two vehicles in the Internal Appeals Process:

- The Open Door investigation assigns an independent, experienced manager to thoroughly investigate an employee's issue, which is then reviewed by a senior executive for approval.
- The Panel Review is a peer review in which three employees and two managers hear both the employee and the management perspective on an issue and then determine the validity of the issue and the recommended outcome.

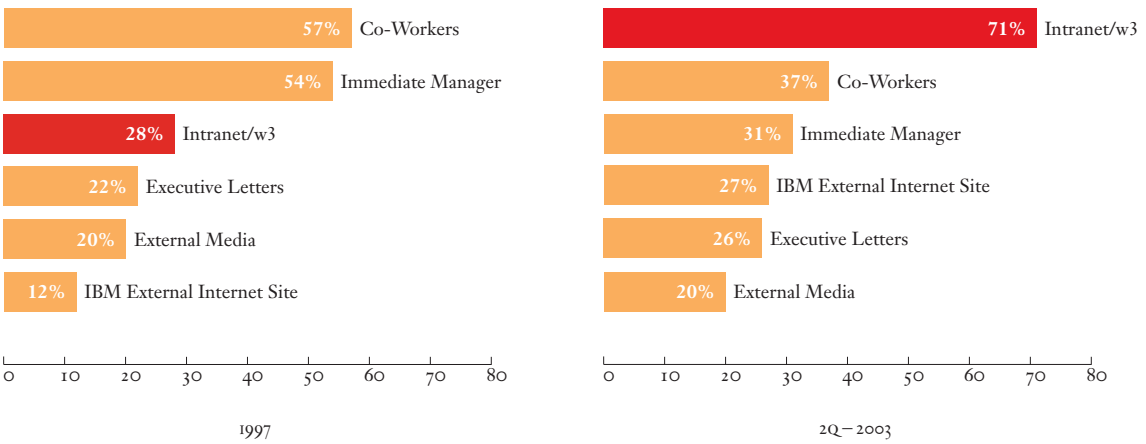
GLOBAL PULSE SURVEY

Every eight weeks, this survey goes out to a scientific, random sample of the workforce.

The survey, which can be taken in any of 13 languages, focuses on questions that influence employee satisfaction with the company, their jobs, retention issues and client satisfaction.

CORPORATE INTRANET: FROM ONLINE MAGAZINE TO DYNAMIC WORKPLACE

IBM's intranet has become employees' most trusted source for company information — surpassing even the grapevine.



Survey results are benchmarked with other global companies to identify strengths and areas for improvement.

GLOBAL PULSE SURVEY

(percent responding favorably)

2002	IT Industry Average	IBM
Overall Job Satisfaction	66%	71%
Clarity of Direction	57%	63%
Organizational Teamwork	54%	57%

Recognition

Only half of IBM employees agree that they receive adequate special recognition for excellent work. New management training programs seek to make recognition — above and beyond the standard compensation package — an integral part of our culture.

"New Blue: Focused to Win" is a global recognition program that establishes clear, consistent criteria for awards. The program both simplifies and improves the awards process.

Workload

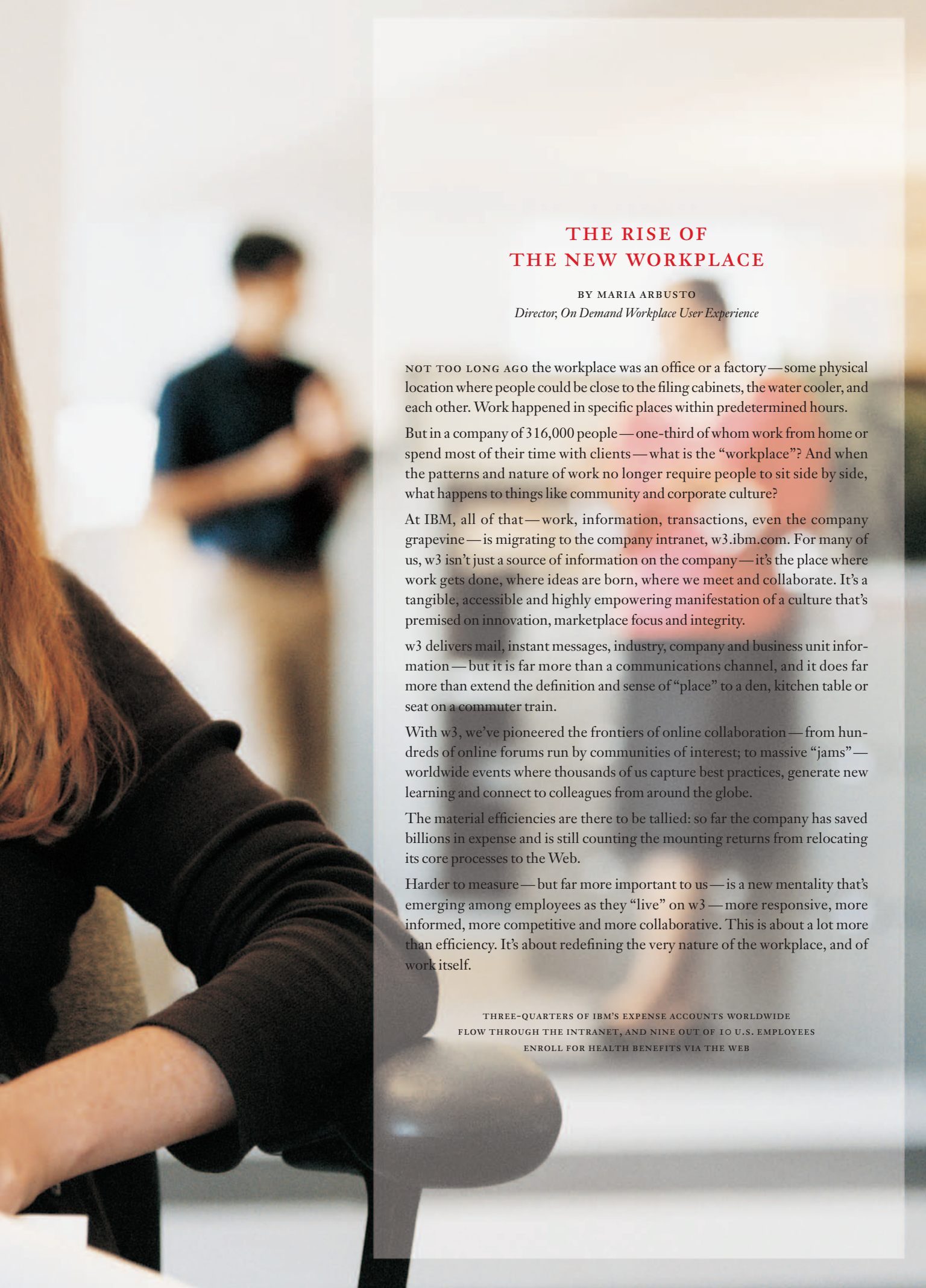
IBM employees consistently report that work/life balance is critical to their job satisfaction, and that workload issues are among the strongest factors that would prompt them to think about leaving the company. More than one-third of IBM employees say they spend at least 15 percent of their time on unnecessary work related to inefficient processes, inadequate technology or poor planning.

IBM is addressing these concerns by: first, reducing or removing bureaucracy and low-value activities; and second through programs that address issues of work/life balance (page 32), in combination with policies and programs that foster a work environment that gives employees more options to manage and control where, when and how they do their jobs.

More than one-third of IBM employees already work outside a traditional office. This reflects our support for the idea that employees who have more latitude over their schedules and where they work; i.e, from home or at a client location — and are equipped with the right technologies — are able to better manage their business and personal lives, and stay in closer contact with their clients.

By 1995, IBM had equipped 10,000 mobile employees, primarily in the United States. By year-end 2002, flexible work options were implemented in all 18 targeted nations. In 2003, the program was broadened globally, with more than 115,000 employees now considered "mobile" workers.

IBM offers six flexible work options ranging from compressed or part-time schedules to extended leaves. More than 1,100 managers worldwide have been trained on supporting employee use of flexible options as a way of getting work done — not simply as an employee accommodation.



THE RISE OF THE NEW WORKPLACE

BY MARIA ARBUSTO
Director, On Demand Workplace User Experience

NOT TOO LONG AGO the workplace was an office or a factory — some physical location where people could be close to the filing cabinets, the water cooler, and each other. Work happened in specific places within predetermined hours.

But in a company of 316,000 people — one-third of whom work from home or spend most of their time with clients — what is the "workplace"? And when the patterns and nature of work no longer require people to sit side by side, what happens to things like community and corporate culture?

At IBM, all of that — work, information, transactions, even the company grapevine — is migrating to the company intranet, w3.ibm.com. For many of us, w3 isn't just a source of information on the company — it's the place where work gets done, where ideas are born, where we meet and collaborate. It's a tangible, accessible and highly empowering manifestation of a culture that's premised on innovation, marketplace focus and integrity.

w3 delivers mail, instant messages, industry, company and business unit information — but it is far more than a communications channel, and it does far more than extend the definition and sense of "place" to a den, kitchen table or seat on a commuter train.

With w3, we've pioneered the frontiers of online collaboration — from hundreds of online forums run by communities of interest; to massive "jams" — worldwide events where thousands of us capture best practices, generate new learning and connect to colleagues from around the globe.

The material efficiencies are there to be tallied: so far the company has saved billions in expense and is still counting the mounting returns from relocating its core processes to the Web.

Harder to measure — but far more important to us — is a new mentality that's emerging among employees as they "live" on w3 — more responsive, more informed, more competitive and more collaborative. This is about a lot more than efficiency. It's about redefining the very nature of the workplace, and of work itself.

THREE-QUARTERS OF IBM'S EXPENSE ACCOUNTS WORLDWIDE FLOW THROUGH THE INTRANET, AND NINE OUT OF 10 U.S. EMPLOYEES ENROLL FOR HEALTH BENEFITS VIA THE WEB

The truest test of any institution's vision, strategy and values is how it does two things: responds to change, or inspires it.

Important change. Not just in global markets, but in global politics. Not just in technologies, but in cultures and societies. Not only among employees or clients, but among their children. In schools, in our air and water. In the ways the technologies contribute to making the world safer, more secure and more prosperous.

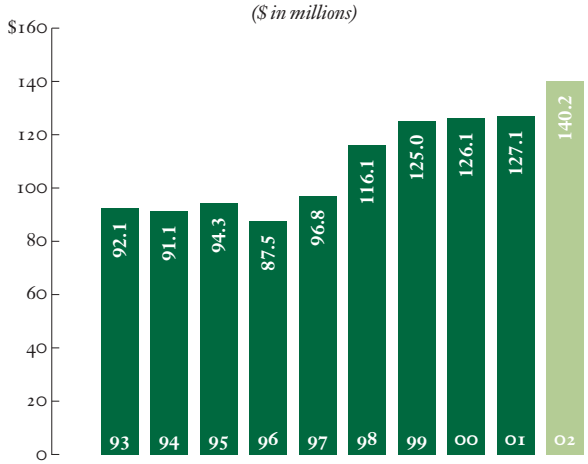
As this report has documented, we don't think our role in these social, human, legacy issues is all that different from our role in technical fields or in financial markets.

Frankly, we believe a company with IBM's wherewithal is expected to handle these changes, by investing in their solution, and by applying its resources, expertise and the discipline of its management systems to step up to the tough issues and the coming generation of unknowns.

We believe that a leader leads — guided by principles that endure, and a willingness to change everything else.

28% of all IBM's corporate community giving takes place **OUTSIDE THE UNITED STATES**

GLOBAL CORPORATE CONTRIBUTIONS
($ in millions)



By the end of 2003, Reinventing Education will touch **80,000 TEACHERS AND MORE THAN 8 MILLION STUDENTS** in the United States and nine other countries

#1 RANKING: FOR WORKPLACE PRIVACY POLICIES in a 2003 *Wired* magazine survey of organizations including the Privacy Foundation and the American Civil Liberties Union

$934 MILLION

invested over the past five years to build, maintain and upgrade infrastructure for environmental protection and to manage worldwide environmental programs

CONTRIBUTING TO COMMUNITIES

Over the last decade, IBM's contributions of cash and technology to worthy organizations exceeded $1 billion — considerable, by any definition. Yet even that's overshadowed by the impact of the broad-based volunteerism that saw IBM employees contribute 4 million hours of their time in 2002.

In the decades of the 1980s and '90s, IBM's philanthropic programs were the largest in the world. But as in business, investment is important, but results are what matter. So we've reoriented our community investments from just cash contributions to an approach that more fully integrates cash with technology and our people to drive sustained and meaningful change.

In terms of company giving, in 2002 IBM contributed $140.2 million at market value in cash, equipment and technical services to nonprofit organizations and educational institutions worldwide — an increase of $13.1 million from 2001.

The $140.2 million represents 1.9 percent of IBM's 2002 income from continuing operations before income taxes. Our total level of giving continues to place IBM among the very top corporate contributors.

Of the total contributed, $108.9 million, or 78 percent, represents donations of IBM technology and technical services; the rest is cash. IBM contributed another $1.8 million to local nonprofit organizations and K-12 schools where 1,250 employees and retirees have volunteered.

In addition, $18 million was given by IBM employees and retirees through our Matching Grants and Pre-K/K-12 Matching Grants Programs. Those individual contributions were matched by IBM with $23.5 million in cash and equipment at market value.

Those employee gifts came on top of more than $30 million that employees and retirees contributed to more than 10,000 health and human services agencies through our Employee Charitable Contribution Campaign.

GLOBAL CORPORATE CONTRIBUTIONS
($ in millions)

	98	99	00	01	**02**
Cash	37.1	43.0	39.4	35.6	**31.3**
Technology	62.0	82.0	64.9	62.2	**78.3**
Services	17.0	—	21.8	29.3	**30.6**
Total	**116.1**	**125.0**	**126.1**	**127.1**	**140.2**

GLOBAL CORPORATE CONTRIBUTIONS BY GEOGRAPHY
($ in millions)

	98	99	00	01	**02**
U.S.	103.6	114.1	110.5	102.3	**100.7**
Europe, Middle East, Africa	6.3	6.3	9.9	12.5	**11.8**
Canada	1.8	1.0	1.8	2.7	**14.1**
Latin America	1.9	1.7	1.4	2.3	**1.2**
Asia Pacific	2.5	1.9	2.5	7.3	**12.4**
Total	**116.1**	**125.0**	**126.1**	**127.1**	**140.2**

In the fall of 2003, IBM formalized its support for employee volunteerism with an initiative called the "On Demand Community." The initial goal is to mobilize 25,000 volunteers within two years and equip them with the tools and technologies to improve education and community organizations worldwide.

Reinventing Education

For years, companies have sent computers of all kinds into the schools. And for years, hopes and expectations have exceeded what those mix-and-match donations could achieve.

So, about 10 years ago, former IBM Chairman and CEO Lou Gerstner pulled together experts from IBM's research and consulting groups, educators, policy makers and administrators to look for ways that people and technology could be used to achieve positive changes in our schools.

That effort led to the creation of IBM's flagship philanthropic grant program, Reinventing Education, which puts IBM's technologies and expertise to work to improve schools throughout the world.

The program started in 1994 with $25 million in grants. Based on its early success, IBM announced another series of U.S. grants, valued at $10 million, through Reinventing Education 2, in October 1997. International grants in Europe, Asia and Latin America, valued at $10 million, were added to the program in 1998. In 2002, $15million in grants were awarded as part of a new $25 million Reinventing Education 3 commitment, bringing IBM's total investment in Reinventing Education to $70 million.

While money is a critical element, Reinventing Education is not just a grant program. From its inception, the program has sent IBM researchers, educational consultants and technology into schools to improve learning and teacher preparation.

REINVENTING EDUCATION 3 GRANTS

- Teacher Education: Nine collaborations with colleges of education and school districts or state departments of education to improve teacher education and professional development.
- Data to Improve Instruction: Projects in two school districts to give teachers and educators at all levels of the system access to instructional tools and educational data that can enrich learning.
- Reinventing Education Change Management Toolkit: With the support of many educational organizations, IBM adapted the work of Harvard professor Rosabeth Moss Kanter to create our interactive Internet technology guide. Since its introduction in 2002, the program has been used by more than 1,000 educators in 37 U.S. states, the U.K., Mexico and Australia. www.reinventingeducation.org

Additional information on Reinventing Education can be found at www.ibm.com/ibm/ibmgives/grant/education.

Metrics and Results

IBM's Reinventing Education programs now reach 65,000 teachers and more than 6 million students. By the end of 2003, plans call for that to grow to 80,000 teachers and more than 8 million students in the United States and nine other countries—Australia, Italy, Ireland, Japan, Singapore, the United Kingdom, Vietnam, Mexico and Brazil.

An independent evaluation by the Center for Children and Technology found that students in grades 7–11 who were exposed to Reinventing Education programs made significant gains in core academic areas. The evaluation also found that many of the technological and educational changes induced by the grants are becoming institutionalized.

The *Harvard Business Review* characterized Reinventing Education as "a new paradigm" for partnerships between business and schools, and the Harvard Business School prepared Reinventing Education case studies that are being used in three courses.

Reinventing Education achievements in 2002 included:

- Ireland adapted a localized version of IBM's Learning Village for schools in Dublin, Cork and Dundalk. Teachers use the technology to create, share and search for standards-based lesson plans; and parents can now see their children's assignments online and electronically communicate with teachers.
- West Virginia made the IBM Learning Village available to all state high schools. Teachers not only access existing materials in core subjects such as math, social studies and languages, but also are able to submit their own lessons for rigorous review and improvement suggestions by subject experts. A federal grant will help West Virginia extend the program to elementary grades and programs for teacher training.
- Japan's Mitaka Prefecture has extended IBM Learning Space throughout its 15 schools and registered more than 2,000 users to encourage problem solving, independent thought, and broader understanding of various cultures.

PHILANTHROPY BACKED BY EMPLOYEE ACTIVISM

BY STANLEY LITOW

Vice President, Corporate Community Relations; President, IBM International Foundation

CORPORATIONS THRIVE ONLY in communities that thrive. No matter how strong the business plan, if the social structures surrounding a company are weak, there's very little opportunity for sustainable business success.

So it's enlightened self-interest — not merely reputation enhancement — that leads businesses to invest in making sure that people are well-educated, safe, have good jobs, and can enjoy and participate in the community's artistic vitality. That's the traditional role of corporate giving — so-called "checkbook philanthropy."

IBM has written and will continue to write our share of checks. Most of our $140 million global corporate contribution programs, however, come in the form of technology and talent directed at solving pressing educational and social problems. In addition to the corporate programs, IBM employees and retirees contributed nearly $50 million of their own money to thousands of schools, universities, cultural and environmental organizations, hospitals, hospices, nursing homes and other human services agencies in 2002 alone.

Yet, over decades of community work, we've come to the deeper realization that money alone isn't enough. In fact, giving by individuals and government funding always will outstrip what corporations give in support of schools or community organizations. What individuals can't do — but what corporations can and must do — is mobilize volumes of expertise, time or technology on behalf of these efforts, and then roll up their sleeves and work as full partners.

In 2002, IBM employees volunteered millions of hours of their time and talents to social causes in their communities — a quarter of them working in schools. The multiplier effect of corporate giving — integrated with the full spectrum of our resources, skills and technical innovation — is enormous.

And the impact on communities goes beyond the application of information technology. IBM managers help schools and community organizations set expectations, establish accountability, manage for high performance, and yes, develop technology plans.

These are skills we may take for granted. But they are in high demand in schools and community organizations that need creative solutions and must husband scarce resources and time for work that's core to their mission — building communities that thrive.

BRIDGING THE DIGITAL DIVIDE

BY DORIS GONZALEZ
Program Manager, Corporate Community Relations

DOES CLOSING the "digital divide" involve more than access to information technologies and the Internet? We think it does.

The debate about the gap between the world's information "haves" and "have nots" typically centers on whether information technology is the culprit — an expensive and complex barrier between people and the world of information and enlightenment — or whether the technologies that created the divide also happen to be our best chance for bridging it.

Here, there is hope, as one barrier — the cost of the Net access device — plummets. Half of all Internet users in 2005 — about a billion people worldwide — are expected to connect to the Net using wireless, handheld, low-cost devices like Web-enabled cell phones and PDAs (rather than full-blown personal computers). China alone is currently adding 5 million new cell phone users per month.

But as the technical trifecta of low-cost IT devices, increasing telecommunications penetration in emerging nations, and reductions in telecommunications rates creates more prevalent and affordable access, we must not lose sight of an equally serious source of disparity.

No amount of bandwidth and processing power will close the gap between the advantaged and disadvantaged until every child has access to a high-quality education. Only by addressing the disparities in the world's systems of education can we ensure that the extraordinary opportunities of the networked world are available to all.

As just one example, Americans with a college degree are more than eight times as likely to have access to a computer as those without a high school education, and more than 16 times as likely to have Internet access. The gaps are even more dramatic globally, and for the one-fifth of the world's people who live in extreme poverty, Net access is of little immediate consequence, or likelihood. Education is often subordinated to the requirement to earn a living wage.

Yet even in the United States, where there have been dramatic increases in the numbers of students using IT, access doesn't necessarily lead to increased educational attainment. The challenge is to use the technology to advance education, to break down barriers to non-English speaking people or people with disabilities, and move people from the wrong side of the digital divide, to access, and then to digital opportunity.

The access issue is critical and must continue to be pushed forward aggressively at all levels and in all societies. But let's not delude ourselves into believing that technical price points are the answer.

Technology is seldom a silver bullet. And it's certainly not on an issue as intensely human as whether all people — rich or poor, citizens of developing nations or those of advanced industrial nations — have affordable access to the Internet and the quality education needed to fully benefit from it.

Beyond Reinventing Education

IBM KIDSMART LEARNING PROGRAM

More than 13,000 Young Explorer computers (encased in kidproof plastic) have been donated to 5,500 nonprofit childcare centers and preschools serving about 2 million children in 450 cities throughout the United States. Over the next two years, IBM will invest $56 million to donate another 15,000 early learning centers and expand the program to more than 50 countries in Europe, Asia, Latin America and Africa, bringing the program to an estimated 4 million more preschoolers.

TRYSCIENCE

The first online, global science museum makes it easy and fun for kids ages 8 to 15 to explore the world of science. More than 600,000 patrons of 450 science museums around the world have visited www.tryscience.org, which is a collaborative effort by IBM, the New York Hall of Science, and the Association of Science-Technology Centers. IBM also sponsors the complementary "TryScience Around the World" kiosk donation program in more than 25 countries.

TEAMING FOR TECHNOLOGY

Since 1997, IBM has teamed with the United Way of America and AmeriCorps*VISTA to assist nonprofits with technology plans, using technology and software and developing special applications.

PROMOTING ACCESS FOR HISPANICS

In 2002, IBM launched ¡TradúceloAhora! Automatic Translation Project to help fill the void created by the low number of Spanish language Web sites. IBM will work with some 30 nonprofit organizations serving the Hispanic community while continuing to develop and refine English-to-Spanish automatic translation online.

ADDRESSING ADULT LITERACY

IBM will donate Reading Recognition software to more than 100 adult literacy sites across the United States under a two-year program started in June 2003. The state-of-the-art speech recognition program gives emerging readers support and practice to improve their reading skills.

JAPAN'S 'E-ELDER' INITIATIVE

A national program using training materials and other support from IBM Japan will hire and train seniors as instructors for other seniors in an effort to help elder citizens (expected to make up one-fifth of Japan's population by 2008) more fully participate in a Web-based society.

MENTORING

The IBM-sponsored MentorPlace (www.mentorplace.org) is a site for IBM employees who want to apply their talents in local schools. The site provides training and support for volunteers, and matches IBM employees with interested students.

More than 5,000 IBM employees in 11 countries currently participate in the MentorPlace program, which has won awards from such organizations as the National Mentoring Partnership, Points of Light Foundation and Calgary Educational Partnership Foundation.

UNIVERSITY PROGRAMS

IBM invested $49 million in 2002 to promote the programs and scholars that are preparing students to enter the global workforce, and to encourage research into promising information technology fields that deal with some of society's most complex challenges.

IBM centers its efforts around these worldwide competitive programs:

- IBM Scholars University Web Portal: This site provides university faculty members in 60 countries with software downloads, hardware discounts, access to training and other information regarding IBM products and open source initiatives. More than half of the faculty participants are from outside the United States.
- Shared University Research: In 2002, this 10-year-old program awarded equipment to 55 universities. Thirty-nine percent of the awards went to institutions outside the United States.
- Faculty Awards: For eight years, this program has recognized exceptional faculty with cash awards — with 214 research or curriculum development projects receiving awards in 2002.
- Ph.D. Fellowships: Since 1962, IBM has awarded more than 6,000 Ph.D. Fellowships, which enable recipients to work closely with leading IBM technologists around the world. For the 2002-2003 academic year, IBM supported 60 doctoral candidates.
- Diversity Programs: IBM assigns more than 40 executives to act as Diversity Campus Executives, with nine executive women serving as university partnership executives. More than 400 IBMers, both men and women, volunteered to participate in university-based diversity programs in 2002-2003.

"*Line management in IBM* must be continuously on guard against adversely affecting the environment. This effort must include constant attention not only to the waste incident to producing a product but also to the consequences of the processes established during product development."

IBM CHAIRMAN THOMAS J. WATSON, JR.
FROM IBM'S FIRST ENVIRONMENTAL POLICY IN 1971

It's a nontrivial fact that IBM has had a worldwide environmental management system for decades, especially as a more global and more culturally interconnected world wrestles with questions about who can be trusted to operate in ways that respect and protect an increasingly networked planet.

Chemicals needed for research, development and manufacturing processes must be properly managed from purchase through storage, use and disposal. Some processes are energy- and/or water-intensive. Obviously, we have to design products so that they are efficient in their use of energy and can be reused, recycled or disposed of safely at the end of their useful lives.

As discussed in the Our Company section of this report, as IBM outsources more of its manufacturing and makes greater use of the supply chain, the environmental responsibility of suppliers and the environmental attributes of their products become more important.

Global Environmental Management System

IBM's corporate environmental affairs policy calls for environmental affairs leadership in all of the company's business activities. Its objectives range from workplace safety, environmental programs and energy conservation to environmentally conscious products, audits, continual improvement and applying IBM's products and expertise to help address some of the world's most pressing environmental problems.

The policy is supported by corporate instructions that govern IBM's worldwide operations. These instructions cover areas such as chemical and waste management, energy management, environmental evaluation of suppliers, environmentally conscious products, and incident prevention and reporting.

Every employee is expected to follow this policy and report any environmental, health or safety concern to IBM management. Managers are expected to take prompt action.

IBM's environmental policy and more information on the company's environmental management system may be found at www.ibm.com/ibm/environment.

ISO 14001

In 1997, IBM became the world's first major multinational to earn a single worldwide registration to the ISO 14001 Environmental Management System Standard. The registration covers IBM's manufacturing, product design and hardware development operations across its business units worldwide.

IBM has since expanded its global ISO 14001 registration to include chemical-using research locations, and several IBM country organizations have obtained ISO 14001 registration covering nonmanufacturing locations. IBM was able to earn the single worldwide registration to ISO 14001 based on the effectiveness of our long-standing global environmental management system.

VOLUNTARY PARTNERSHIPS & PROGRAMS

IBM has joined a number of voluntary performance initiatives with governments and nongovernmental organizations.

Governmental partnerships: U.S. EPA's Project XL, National Environmental Achievement Track, Climate Leaders and ENERGY STAR programs.

Nongovernmental partnerships: Membership in the Pew Center on Global Climate Change and the World Resources Institute's Green Power Market Development Group; charter member of the World Wildlife Fund's Climate Savers program.

IBM is also managing its own lands in ways that enhance habitats. Six sites, including corporate headquarters, have had their land management and wildlife habitat programs certified by the Wildlife Habitat Council.

Support of environmental organizations: IBM has matched contributions made by U.S. employees to more than 575 environmental groups ranging from international organizations such as the Nature Conservancy and the World Wildlife Fund to smaller groups preserving lands and habitats in local communities.

IBM also works with and supports organizations such as the Alliance to Save Energy, the Conservation Fund, the Environmental Law Institute, the World Environment Center and the World Resources Institute.

INVESTMENT AND RETURN

Over the past five years, IBM has spent $382 million in capital and $552 million in operating expense to build, maintain and upgrade the infrastructure for environmental protection at its plants and labs and to manage its worldwide environmental programs.

ENVIRONMENTAL CAPITAL AND EXPENSE WORLDWIDE
($ in millions)

	98	99	00	01	**02**
Capital	64	80	54	132	**52**
Expense	101	107	110	115	**119**
Total	**165**	**187**	**164**	**247**	**171**

For the past six years, IBM has compared its environmental expenses to estimated savings resulting from the pursuit of environmental leadership. These expenses include items such as personnel, laboratory testing, waste treatment and disposal, water and wastewater management, groundwater protection, remediation and other environmental system operations.

The savings come from reductions in chemical use and waste; recycling; energy, material and water conservation; reusable packaging initiatives; and process improvements from pollution prevention. Ongoing savings from previous years' initiatives are not carried over in this comparison, yielding very conservative estimates.

IBM also realizes savings through the avoidance of costs that likely would occur in the absence of its environmental management system. These savings are not measurable in the same way that expenses are, but avoiding these environmental-related costs does result in savings for IBM, and a reasonable attempt has been made to quantify them, as shown in the tables on the following page.

Since initiating this effort, IBM's estimated annual savings from its focus on pollution prevention and design for the environment have exceeded environmental expenses by an average of approximately two to one.

2002 ENVIRONMENTAL EXPENSES WORLDWIDE
($ in millions)

Personnel	**46.8**
Consultant Fees	**3.7**
Laboratory Fees	**3.1**
Permit Fees	**0.7**
Waste Treatment & Disposal	**18.2**
Waste & Wastewater Management Operations	**23.5**
Air Emission Control Operations	**0.6**
Groundwater Protection Operations	**2.1**
Other Environmental Systems Operations	**1.9**
Waste & Materials Recycling	**3.0**
Superfund & Former IBM Site Remediation	**11.4**
Miscellaneous/Other	**3.8**
Total	**118.8**

2002 ESTIMATED ENVIRONMENTAL SAVINGS AND COST AVOIDANCE WORLDWIDE
($ in millions)

Site Pollution Prevention & Operations	**80.0**
Corporate Operations	**5.6**
Packaging & Packaging Waste Reductions	**6.2**
Recycled Materials Usage Savings	**2.9**
Energy Conservation & Cost Avoidance	**36.7**
Superfund & Site Remediation Efficiencies	**0.5**
Insurance Savings*	**8.0**
Spill Remediation Cost Avoidance**	**32.0**
Compliance Cost Avoidance**	**66.5**
Total	**238.4**

** Savings achieved through the use of RCRA financial assurance in lieu of environmental impairment insurance.*

*** These savings are estimates based upon assumptions. The figure for spill remediation cost avoidance is estimated from IBM's actual experience with remediation costs. Compliance cost avoidance includes consideration of potential penalties, legal fees and business interruptions that are avoided. A figure for potential penalties and legal fees was estimated from an analysis of 2002 U.S. EPA data. An estimate for business interruption was based upon potential impact of a plant shutdown.*

Product Stewardship

IBM's Environmentally Conscious Products program was established in 1991. Its objectives are to:

- *Develop products with consideration for upgrading to extend product life.*
- *Develop products with consideration for their reuse and recyclability at the end of product life.*
- *Develop products that can safely be disposed of at the end of product life.*
- *Develop and manufacture products that use recycled materials where they are technically and economically justifiable.*
- *Develop products that will provide improvements in energy efficiency and/or reduced consumption of energy.*
- *Develop products that minimize resource use and environmental impacts through selection of environmentally preferred materials and finishes.*

IBM's environmental product design requirements are integrated into our environmental management system and are also part of the Integrated Product Development Guide used by process and product development engineers.

PROGRAM PERFORMANCE

Progress is measured against specific goals that address IBM's focus on the use of recycled plastics, powder coatings (versus liquid paint), landfill use for end-of-life product waste and product energy efficiency.

Recycled Plastics

Recycled resins accounted for 6.64 percent of the volume of plastics purchased for IBM products in 2002 against a 10 percent goal. Price, sourcing and available applications affected results.

Powder Coatings

IBM suppliers used 877,727 pounds of powder coatings in 2002 for the decorative metal finishing of IBM products. This represents a 10.4 percent increase in powder usage (based upon total surface coverage) versus a 10 percent target. Last year, 93.4 percent of all decorative metal finishing of IBM products was achieved using powder coatings. Use of powder coatings in lieu of liquid paint avoided an estimated 458,358 pounds of volatile organic compound emissions and the generation of significant solid waste.

Product Landfill Use

Of the 51,173 metric tons of end-of-life products and product waste processed by IBM's 73 Product End-of-Life Management locations included in the company's year-end 2002 landfill use metric, IBM sent only 2.92 percent to landfills, compared to the corporate not-to-exceed objective of 4.5 percent for the year. This represents an 11.25 percent reduction in landfill use from 2001.

WHERE DO OLD COMPUTERS GO?

BY WAYNE BALTA

Vice President, Corporate Environmental Affairs and Product Safety

THE CURRENT DEBATE around "e-waste" — or the management of the "end of life" of IT products — comes down to two very concrete questions, demanding very concrete responses.

One is whether these products are being dumped into the world's landfills. The other is whether the products are being exported to places where their recycling and disposal is done in ways that expose workers and the environment to harmful substances and untreated chemical waste.

These are important questions, as some studies suggest that as many as 500 million computers will have become obsolete in the 10 years ending in 2007.

To help address the landfill concern, in 2002, IBM handled more than 51,000 metric tons of end-of-life equipment and product waste, and sent only 2.92 percent of the materials collected to landfills (mostly packaging and mixed plastics).

But what happens to all the PCs and monitors that end up in the attics or basements of people who just don't know how to dispose of them properly? While some municipalities have begun to offer electronic products recycling programs, these programs cost money, and may be difficult for local governments to operate.

So, how should all these products be collected and recycled? We think the best and most workable framework will combine the efforts of government and industry.

IBM began offering recycling solutions, primarily to large commercial clients, in 1989. By the late 1990s, we began to extend these offerings to small businesses and households.

In November 2000, IBM became the first computer manufacturer to establish a product recycling service in the United States for consumers and small businesses.

In addition, IBM is among the supporters of legislation establishing "visible advanced recycling fees" collected at the time of sale to cover the costs of collection, transportation and recycling. Our experience in Europe with advanced recycling fees for PCs and monitors indicates that a nominal fee — $5 to $10 — collected at the time of sale can fund municipal product collection and recycling programs.

As for responsible recycling operations, for more than 10 years, IBM has evaluated the product end-of-life suppliers that carry out our product recycling and disposal to determine that their operations are environmentally responsible. But to address the new concerns about recycling operations in the extended supply chain, IBM is pushing those efforts further down the line.

This will include assessments and on-site evaluations of suppliers and certain subcontractors they may use to handle recycling and/or disposal operations in non-OECD countries.

Product Energy Efficiency

PRODUCT	PERFORMANCE
Personal computers, printers, monitors	One hundred percent of all applicable products announced in 2002 met ENERGY STAR criteria, versus the goal of 90 percent of personal computers and 100 percent of the other applicable products.
Servers	• pSeries models reported a 34 percent to 61 percent reduction in operating power consumption per unit of work against comparable previous-generation models. • For iSeries, a new model was introduced, the i890, which features mainframe-class technology and the POWER 4 microprocessor, while delivering a power consumption per unit of relative performance of 0.30 watts. It had no previous-generation model. • There were no new zSeries 900 models introduced in 2002.
Hard disk drives	• Ultrastar: 48 percent reduction in watts per gigabyte. • Deskstar: 23 percent reduction in watts per gigabyte. • Travelstar: 50 percent reduction in watts per gigabyte.
Point-of-sale terminals	Upgrades in energy efficiency ranged from 59 percent to 65 percent for the maximum power consumption in watts per composite theoretical performance.
Storage subsystems	Energy efficiency improvements in 2002 ranged from 54 percent to 92 percent in watts per gigabyte, depending upon the drive type and number of drives.
Storage area networks	Energy efficiency improvements in watts per gigabyte ranged from 23 percent to 66 percent, depending on the model.
Tape drives	Increased energy efficiency from 33 percent to 62 percent in watts per gigabyte, depending on the model.

Note: Product energy efficiency goals vary by product type but all are measured by their increase in energy efficiency over previous-generation products or models.

DESIGN FOR THE ENVIRONMENT

Initiatives in 2002 focused on three specific areas: materials substitution; harmonizing product design standards across the industry and IBM supply chain; and the application of life cycle assessment to understand the environmental consequences of certain material substitutions.

Materials Substitution

IBM's environmental design standards and corporate engineering specifications on environmental requirements for products prohibit the use of certain hazardous materials such as asbestos, polybrominated biphenyls (PBBs), polybrominated biphenyl oxides (PBBOs), polychlorinated biphenyls (PCBs), and ozone-depleting substances. They also restrict the use of potentially hazardous substances such as lead, chromium, cadmium and mercury in noncritical applications such as plastic housings, paints and packaging materials.

The further reduction and feasible elimination of hazardous materials — particularly in critical applications — requires the help of suppliers and the evaluation and identification of suitable replacements that are environmentally preferable. Two examples of material substitutions follow, and more on this subject may be found at www.ibm.com/ibm/environment/products/materials.shtml.

Lead: Lead is used in computers primarily in solder for interconnections between components and printed wiring boards. The European Union passed legislation restricting the use of lead, based on its concern that lead may leach from products when landfilled. IBM is addressing this concern through a program developed to reduce lead in its products.

IBM's Microelectronics Division is investigating a variety of lead-free materials for components, developing lead-free assembly processes, and testing to assess the reliability of lead-free interconnections. This is particularly important for the high-end products used in mission-critical client applications where reliability is imperative, yet field reliability data on lead-free alternatives is unavailable. We continue to work aggressively to identify reliable lead-free alternatives and to create appropriate specifications for multiple lead-free applications.

In addition to our internal development program and interaction with clients and suppliers, we're working with several universities, including Northwestern, Michigan State, Cornell and the University of California Los Angeles; with consortia; and with Sandia National Laboratory in the United States to help define lead-free development directions, specifications and standards.

Hexavalent Chromium: IBM has qualified hexavalent chromium-free sheet metals with acceptable corrosion resistance and electrical shielding properties for product housings. Initially, these alternatives must be qualified in each potential design application — a process that is now under way — and worldwide sources of acceptable material will be established. Selected product lines have begun a worldwide transition to the hexavalent chromium-free sheet steels.

In Pursuit of Standards Harmony

Growing legislative attention on electronic product design criteria has emphasized the need for coordinated recognition and adoption of requirements across the industry and its supply chains.

IBM led a technical working group within ECMA International, the former European Computer Manufacturing Association, to draft requirements for electronic product attributes that demonstrate environmentally conscious design. ECMA-341, "Environmental Design Considerations for Electronic Products" was approved and released by ECMA in January 2003. The standard is available at www.ecma-international.org/publications/standards/ecma-341.html. In addition to mandatory criteria, the standard includes numerous design recommendations and offers a model design checklist to assist companies wanting to integrate environmental aspects into product design.

Life Cycle Assessment

IBM supports the use of Life Cycle Assessment (LCA) to examine the potential environmental consequences and tradeoffs of material substitutions. We recognize the need to characterize the environmental impacts of alternatives to lead-based solder to determine expected environmental improvements, as well as possible concerns, with replacement materials. So we have joined other electronics companies, industry associations and the U.S. EPA's Office of Pollution Prevention and Toxics in a voluntary, cooperative project to fund a comprehensive LCA of selected lead-free solders.

The project is presently investigating the life cycle impacts of lead-free solder candidates for both reflow and wave solder applications, comparing their results to the LCA baseline of tin-lead bar and paste solders. Additionally, the project is supplementing life cycle impact evaluations with assessments of recyclability and leachability of tin-lead solder and lead-free alternatives.

The results of the project will be published through the U.S. EPA's Design for the Environment Program, making this data available across the IT industry.

LOW-POWER INITIATIVE

IBM's product-energy-efficiency objective is supported by a worldwide Low-Power Initiative based at the company's Austin Research Laboratory. The lab focuses on high-performance/low-power VLSI (very large scale integration) design and tools, system-level power analysis, and new system architectures. In addition to its own research, the center is leading a companywide energy efficiency team, which is helping to coordinate low-power and energy-efficiency activities across IBM.

PRODUCT END-OF-LIFE MANAGEMENT

As part of its product end-of-life management activities, IBM began offering product takeback programs in 1989 in Europe and has extended and enhanced the programs over the years. IBM currently offers commercial clients and/or consumers solutions for the end-of-life management of their computer equipment in 35 countries across Asia, Europe and the Americas through voluntary IBM programs or country programs in which IBM participates.

ENGINEERING SPECIFICATIONS FOR SUPPLIERS

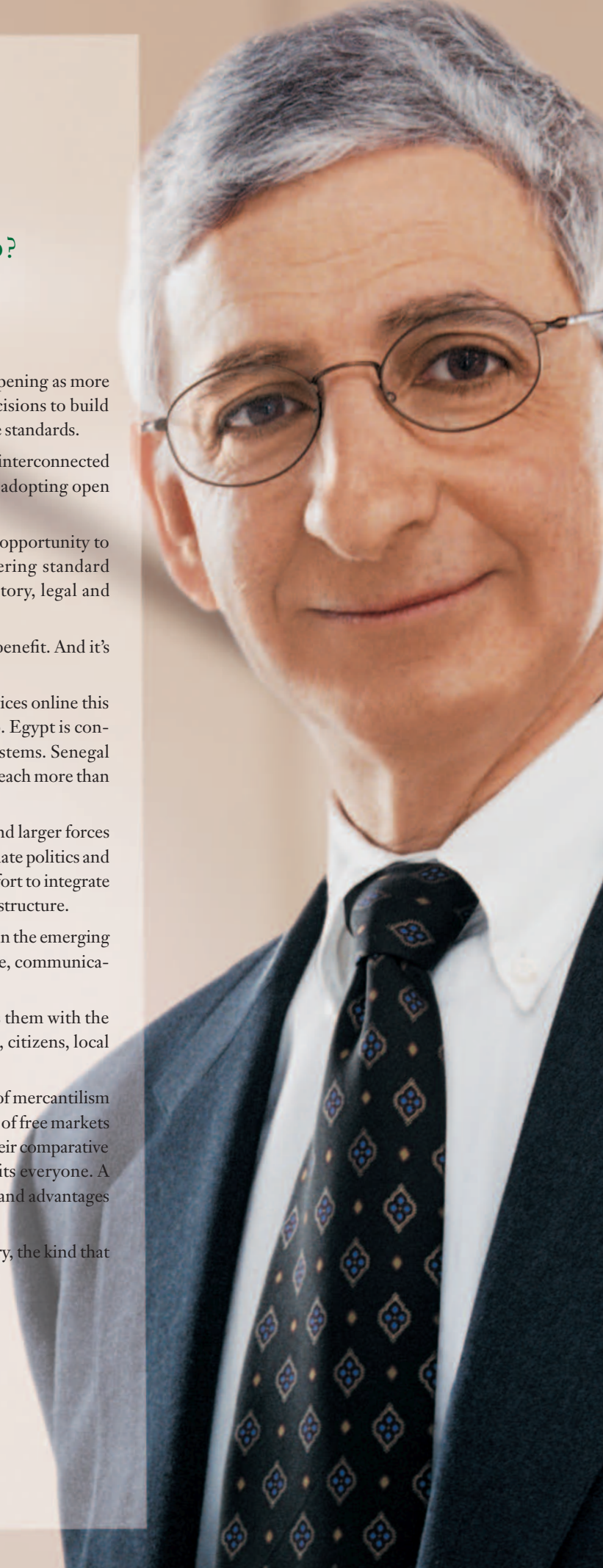
IBM extends its product environmental requirements to its supply chain through an engineering specification for materials, parts and products used for IBM hardware applications. This specification covers substances prohibited from use, documentation of product content, battery labeling, plastics coding and other requirements. Compliance to this specification is required to help IBM products meet applicable legal and client requirements. This specification may be found at www.ibm.com/ibm/environment/products/especs.shtml.

ENVIRONMENTAL REQUIREMENTS FOR PRODUCT PACKAGING

IBM's packaging guidelines, developed in 1990 and periodically updated, prohibit the use of ozone-depleting chemicals, heavy metals, polybrominated biphenyls and polybrominated biphenyl oxides. They also provide direction on minimizing toxic elements in packaging, identifying methods and designs to reduce packaging volume, and promoting the use of materials that are reusable, recyclable or contain recycled content.

GO OPEN OR STAY CLOSED?

BY IRVING WLADAWSKY-BERGER
Vice President, Technology and Strategy



THERE'S SOMETHING tremendously positive and hopeful happening as more and more governments — local, state and federal — make decisions to build their national computing infrastructures around open software standards.

In effect, they are casting a vote for freedom — embracing the interconnected nature of the world and joining the networked revolution by adopting open computing standards like Java, Linux and Web services.

Why does that matter? The answer goes beyond the obvious opportunity to achieve traditional definitions of "e-government" — delivering standard services to underserved constituencies, or providing regulatory, legal and policy-making oversight more efficiently and more broadly.

That's important. It's efficient government at work. Citizens benefit. And it's happening all over the world.

Brazil's government will have all over-the-counter federal services online this year, and is connecting 16,000 rural communities to the Web. Egypt is connecting 3,000 post offices, and is setting up postal banking systems. Senegal has instituted a three-year "digital inclusion" project that will reach more than 7,000 villages.

As valuable as this kind of effort is, I believe larger objectives and larger forces are at work. Just as the principle of openness has come to dominate politics and economics, openness is now beginning to inform the world's effort to integrate information technologies into a new economic and social infrastructure.

Governments are seeing, and seizing, the chance to participate in the emerging planetary infrastructure — the place where the economy, trade, communications and culture increasingly live and are being transformed.

To do that, they need a national infrastructure that integrates them with the world — not to mention all their national agencies, processes, citizens, local businesses and systems.

This isn't unlike what happened when the major practitioners of mercantilism were forced to acknowledge that Adam Smith and the devotees of free markets were right: An open system — in which all participants exploit their comparative advantage — stimulates commerce and innovation and benefits everyone. A closed, exclusive system limits productivity, stifles innovation and advantages only the few.

Openness may be one of those fundamental dynamics of history, the kind that sooner or later sweeps away all barriers.

In the end, openness may be destiny.

Key elements of the guidelines are included in engineering specifications, which extend their reach to the supply chain and other suppliers. IBM requirements go beyond legal mandates for packaging to ban polyvinyl chloride (PVC) and "free flow cushioning." Packaging suppliers also must eliminate the use of permanently commingled but dissimilar materials except in cases where they are part of reusable packaging designs or are technically required for product quality (example: static shielding bags). IBM also requires that wood-based packaging be sourced from forests managed in an ecologically sound and sustainable manner.

Recent accomplishments include:

- Eliminating chemicals that would make wooden packaging unsuitable for recycling or energy recovery, even though such chemicals are legally permitted.
- Assisting with the development of a pallet marking program for international commerce that prevents pest migration via wooden packaging materials.
- Replacing wood pallets with "slipsheets" for shipment of computer shells from China to Japan, which addresses pest migration and reduces shipping volumes.
- Replacing expanded foam cushions for some PC options with several all-paper-based packaging designs on which patents are pending.
- Using "foamless" cushions made from 100 percent recycled HDPE plastic — many of which can be reused — for disk drive shipments on some routings.
- Quadrupling the effective reuse percentage on packages for our largest mainframe servers.

IBM is working with contract manufacturers and other supply chain partners to expand the usage of environmentally preferable packaging solutions.

PRODUCT SAFETY

Our product safety requirements are included in various steps of the product design, development, manufacture and test process, and include the supply chain. Required reviews by IBM Product Safety Review Boards help product and project managers comply with applicable standards and national regulations, and obtain third party certifications where required.

Programs for continual improvement include client assessments of a product's safety, which are fed back into the evaluation and planning cycle. This process is augmented by incident management tools that provide effective capture and management of any product-safety-related incident.

Energy Conservation

IBM's corporate policy on environmental affairs calls for the company to use energy responsibly throughout its business, including conserving energy, improving energy efficiency and giving preference to renewable over non-renewable energy sources when feasible.

311 MILLION KILOWATT HOURS:
electricity saved in 2002

CORPORATE ENERGY CONSERVATION GOAL

IBM's energy goal is to save the equivalent of 4 percent of IBM's actual annual electricity and fuel use by improving energy efficiency and giving credit to renewable energy use. Only savings from identified energy conservation projects count toward this goal. Reductions in energy consumption from consolidations, downsizings, the sale of operations or cost avoidance actions are not included in the energy conservation goal.

In 2002, IBM's energy conservation efforts reduced electricity use by more than 311 million kilowatt hours, and fuel use by the equivalent of about 2.73 million gallons of oil. This performance exceeded the 4 percent corporate energy conservation goal, conserving energy equivalent to approximately 6.1 percent of total energy use.

These results avoided the worldwide emissions of approximately 173,500 tons of carbon dioxide and other combustion-related gases, at a cost savings of $17.3 million.

Since 1990, IBM has conserved a cumulative 12.79 billion kilowatt hours of electricity and, as a result, has avoided the emissions of more than 7.7 million tons of carbon dioxide. The total percent reduction in global emissions of CO_2 attributable solely to IBM's energy conservation actions since 1990 is 33 percent.

IBM ELECTRICITY USE AND CO_2 EMISSION DATA

YEAR	Electric Use *Million kWhrs*	CO_2 (est) *Tons (000)*
98	5,898	4,085
99	5,800	3,951
00	5,325	3,412
01	5,228	3,247
02	**5,031**	**2,902**

These figures include estimates for portions of IBM's office space that are leased. CO_2 emissions are calculated for all energy use, including electricity, fuel oil and natural gas.

IBM ENERGY CONSERVATION AND AVOIDED CO_2 EMISSIONS

YEAR	Cumulative Electric Savings *Million kWhrs*	Cumulative Avoided CO_2 (est) *Tons (000)*
98	633	301
99	842	409
00	965	464
01	1,211	568
02	**1,339**	**600**

These annual figures represent results from each year's new conservation programs, plus results from programs of previous years (which are discounted by 25 percent per year). Savings prior to 1997 are not included.

Climate Change

IBM believes the most constructive approach it can take to address the complex issue of climate change is to apply its technical and engineering expertise to reduce emissions associated with its own operations, and to create products that are increasingly energy efficient.

IBM operations do not release significant quantities of so-called greenhouse gases, so the company's greatest potential impact is an indirect one, through the release of carbon dioxide by the utility companies providing the electricity used by IBM. This drives the company's focus on energy conservation.

IBM does directly release some perfluorocompounds (PFCs) from its semiconductor manufacturing operations. Although they are in relatively small amounts (in carbon equivalents, when compared to indirect carbon dioxide emissions), in 1998 IBM became the first semiconductor manufacturer to set a numeric emissions reduction target for PFCs.

That goal was to reduce PFC emissions from semiconductor manufacturing by 40 percent worldwide by year-end 2002, indexed to production against a base year of 1995. IBM beat that goal, achieving the targeted reduction in August 2002.

We continue voluntary efforts to further reduce PFC emissions. In 2000, IBM's Microelectronics Division, together with other U.S. semiconductor manufacturers, signed a new Memorandum of Understanding with the U.S. EPA, continuing a voluntary agreement that began in 1996 and committing the companies to reduce PFC emissions from semiconductor manufacturing by an absolute 10 percent between the base year 1995 and 2010.

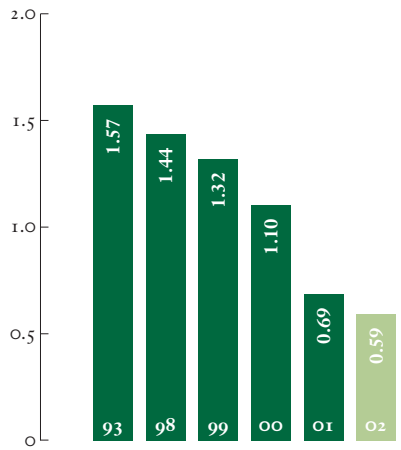
Since 1990, IBM's energy conservation efforts have avoided more than **7.7 MILLION TONS** of carbon dioxide emissions

In 2002, IBM joined the U.S. EPA's Climate Leaders program, which challenges businesses to set aggressive, corporatewide greenhouse gas emissions reduction goals that exceed business-as-usual performance in any company's industry sector. As part of its participation in Climate Leaders, IBM will pursue two emissions reduction goals that cover virtually all direct and indirect IBM greenhouse gas emissions:

- Achieve an absolute 10 percent reduction in PFC emissions from IBM's semiconductor manufacturing processes by 2005, using 2000 as the base year.
- Achieve average annual CO_2 emissions reductions equivalent to 4 percent of the emissions associated with IBM's annual fuel and electricity use over the six-year period from 2000 through 2005. IBM intends to achieve these reductions through further energy conservation actions.

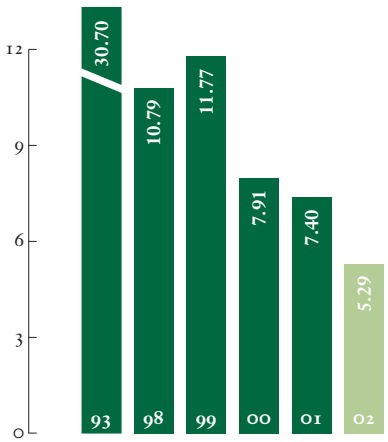
IBM TOTAL RELEASES TO ENVIRONMENT AND WASTES TRANSFERRED OFF-SITE FOR TREATMENT AND DISPOSAL WORLDWIDE

(as defined by U.S. SARA section 313)
(metric tons x 1,000)



IBM TOTAL CHEMICAL QUANTITIES* WORLDWIDE

(as defined by U.S. SARA Section 313 and PPA)
(metric tons x 1,000)



** Includes recycling, treatment, energy recovery, releases and off-site transfers*

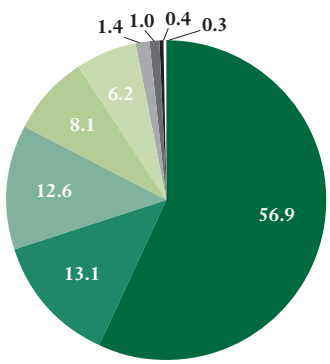
IBM TOTAL CHEMICAL QUANTITIES WORLDWIDE

2002 Reportable Quantities
(as defined by U.S. SARA Section 313 and PPA)

Chemical	Metric Tons
Copper Compounds	1,847
n-methyl-2-pyrrolidone	795
Xylene	700
Nitrate Compounds	664
Ethylene Glycol	238
All Others	1,041
Total	5,285

IBM TOTAL CHEMICAL QUANTITIES WORLDWIDE

2002 Total Reportable Quantities — 5,285 metric tons
(as defined by U.S. SARA Section 313 and PPA)

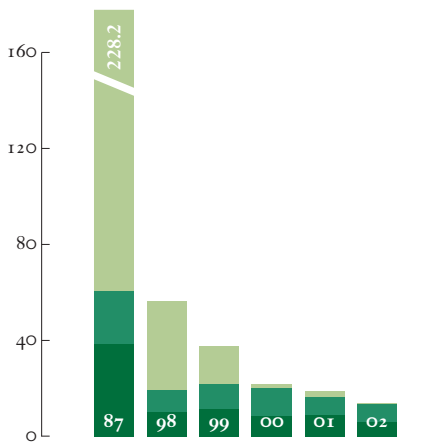


Percent reported in each category

- *Off-site recycling*
- *On-site treatment*
- *Off-site energy recovery*
- *Release to water*
- *On-site recycling*
- *Publicly owned treatment works*
- *Release to air*
- *Off-site treatment*
- *Off-site disposal*

IBM HAZARDOUS WASTE QUANTITIES WORLDWIDE

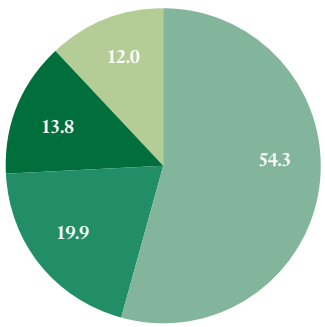
(metric tons x 1,000)



- *Closed-loop on-site recycling (annual throughput)*
- *Off-site recycling*
- *Treatment, incineration, landfill*

IBM HAZARDOUS WASTE MANAGEMENT WORLDWIDE

2002 quantities—13,671 metric tons



Percent reported in each category

- *Recycling*
- *Landfill*
- *Aqueous and other treatment*
- *Incineration*

Hazardous waste generation indexed to output

DECLINED

14.2% IN 2002

Releases

IBM's manufacturing and development operations rely on the use of some chemicals on the U.S. Toxic Release Inventory (TRI) list. Over the past 10 years, IBM has reduced its total TRI chemical quantities worldwide 82.8 percent as shown on page 63. Given the reductions that already have been achieved, and the resulting decrease in opportunities for further reductions, IBM's objective in this area is one of continual improvement in minimizing its global TRI chemical quantities, including its releases and transfers off-site for treatment and disposal.

INTERNATIONAL PERFORMANCE MEASURES

Under the U.S. Superfund Amendments and Reauthorization Act (SARA) of 1986 and the U.S. Pollution Prevention Act (PPA) of 1990, companies are required to file an annual inventory of routine releases and off-site transfers in addition to recycling, treatment and energy recovery activities for more than 600 chemicals. IBM uses this U.S. metric to track these activities globally. In 2002, IBM sites worldwide used 22 of these chemicals in quantities greater than the reporting threshold of 4,536 metric tons (10,000 pounds).

IBM's **TOTAL CHEMICAL QUANTITIES WORLDWIDE,** as defined by U.S. SARA and PPA, **DECREASED 28.6%** from 2001

As shown in the charts on page 63, in 2002 the total releases to the environment and waste transferred off-site for treatment and disposal from IBM's worldwide operations decreased 14 percent from the previous year, to 590 metric tons.

IBM realized a 28.6 percent decrease from 2001 of the total quantities covered by both SARA and PPA worldwide to a total of 5,285 metric tons. Much of the decrease came through source reduction, though changes in production also played a part.

Pollution Prevention and Waste Management

Since 1971, IBM's objective has been to identify and eliminate potential pollution before it becomes a problem, often by reducing the generation of hazardous waste at its source. Where possible, IBM has redesigned processes to eliminate chemical use or substitute environmentally preferable chemicals. For the waste that is generated, IBM focuses on preventing pollution through a comprehensive, proactive waste management program.

POLLUTION PREVENTION THROUGH SOURCE REDUCTION

In 2002, IBM's hazardous waste generation indexed to output was reduced 14.2 percent. This means that source reduction efforts reduced the generation of hazardous waste by 1,268 metric tons. This measurement covers 90 percent of IBM's manufacturing and hardware development-related hazardous waste, which came from nine sites.

WASTE MANAGEMENT

IBM manages the waste that it generates (both hazardous and nonhazardous) according to a waste hierarchy that requires, in order of preference:

- reduction
- reuse
- recycling
- chemical or physical treatment
- disposal (as a last resort)

HAZARDOUS WASTE

From 2001 to 2002, IBM's total hazardous waste decreased by 5,444 metric tons or 28.5 percent, primarily the result of pollution prevention efforts. In 2002, IBM recycled approximately 54.3 percent of its hazardous waste.

As is shown by the chart on the previous page, over the past five years IBM's total hazardous waste decreased by 75.7 percent, and was decreased by 94 percent since 1987.

IBM's total hazardous waste calculation includes waste from both nonmanufacturing and manufacturing operations. Waste from manufacturing operations includes waste recycled in closed-loop systems in which process chemicals are recovered for subsequent reuse, rather than disposing of the waste and using new chemical supplies.

NONHAZARDOUS WASTE

IBM's nonhazardous waste recycling is divided into Category 1 and Category 2 waste, with recycling goals of 67 percent and 35 percent, respectively.

Category 1 waste consists of the more recyclable waste: cardboard, paper, metal, plastic, wood, glass, computer equipment, construction debris and ordinary trash.

Category 2 waste includes all nonhazardous waste not defined as Category 1 waste. Examples of Category 2 waste are batteries, deionized water plant resin and nonhazardous chemicals.

IBM TOTAL NONHAZARDOUS WASTE GENERATED AND RECYCLED WORLDWIDE

(metric tons x 1,000)

	98	99	00	01	**02**
Total Recycled	136	142	142	127	**120**
Total Generated	185	190	185	167	**154**
Percent Recycled	74%	75%	77%	76%	**78%**

Last year, both of these goals were surpassed with recycling rates of 81 percent and 61 percent, respectively. Sixty-eight percent of IBM's locations met their recycling goal for Category 1 waste, and 62 percent met their goal for Category 2 waste. Over the past several years, some of IBM's global sites with mature waste management programs have been able to recycle virtually all nonhazardous waste generated. In addition, as a result of conservation efforts, the total quantity of nonhazardous waste generated in 2002, including both waste categories, declined 7.8 percent.

Conserving Water

Water conservation projects frequently involve the recycling of ultrapure water used in electronics manufacturing. They may also include such initiatives as manufacturing process innovations to reduce water use and water reuse projects such as the substitution of treated water for well water or city water in certain applications.

WATER SAVINGS GOAL

Past data from IBM manufacturing, development and research facilities worldwide indicated that IBM's Microelectronics Division used approximately 70 percent of the total water consumed at these locations. As a result, in 2000 the division established an annual water savings goal of 2 percent of total water usage, based on the water usage of the previous year and measured as an average over a rolling five-year period. Water savings credited toward the goal always include water use reduction. Also included are water reuse and water recycling savings when those results are greater than the previous year.

In 2002, the division achieved a 7.5 percent savings rate against its goal of 2 percent, translating to a savings of more than 1,000 thousand cubic meters (TCM) of water. The water savings rate is based on savings from water reduction activities only. An additional 1,650 TCM of water was reused and recycled at Microelectronics Division facilities. Over the past three years, the IBM Microelectronics Division has achieved an average annual water savings of 5.2 percent.

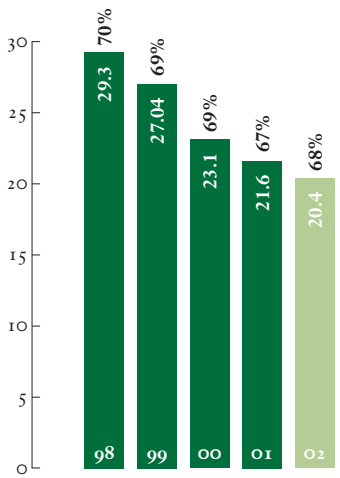
Examples of water savings projects and activities include 550 TCM from using treated wastewater for cooling tower supply water in East Fishkill, N.Y.; 76 TCM from reduced manufacturing water use in Yasu, Japan; and 79 TCM from the reuse of wastewater generated during the production of ultrapure water in Burlington, Vt.

IBM's Microelectronics Division achieved a **7.5 PERCENT WATER SAVINGS RATE** in 2002 — against its goal of 2 percent

Although not subject to the 2 percent water savings goal, other IBM divisions also continued their water conservation initiatives in 2002. Treated wastewater was reused for cooling tower supply water, reducing the demand for city or well water at several IBM locations, including Mainz, Germany; San Jose, Calif.; and Yorktown Heights, N.Y. At IBM Guadalajara, Mexico, all treated wastewater is used for irrigation at the facility. Treated groundwater from groundwater remediation projects is used for irrigation in San Jose, Calif., and Austin, Texas.

IBM WATER CONSERVATION
PLANTS AND LABS WORLDWIDE

(water consumption in thousand cubic meters x 1,000 and percent manufacturing use)



Audits and Compliance

IBM measures its environmental and health and safety performance against both external and internal requirements. Each manufacturing and hardware development and research site completes a standard annual self-assessment, and some operations and functions are assessed even more frequently.

In addition, five to seven sites are audited to environmental, health and safety requirements by IBM's Corporate Internal Audit staff each year. Audit results are communicated to top management. Follow-up, accountability and actions are all clearly delineated.

In addition, as part of IBM's single, global registration to ISO 14001, approximately 15 sites are audited each year by an independent ISO 14001 registrar. All major manufacturing and development sites are audited, by either the corporate audit team or the external ISO 14001 registrar, at least once every two years.

ACCIDENTAL SPILLS AND RELEASES

IBM sites around the world use the company's Environmental Incident Reporting System (EIRS) to report environmental incidents and accidental releases to IBM management. Every event meeting IBM's environmental incident reporting criteria, which equal or surpass legal reporting requirements, must be reported through EIRS. Each IBM location must also have a documented incident prevention program (including provisions for preventing environmental incidents or their recurrence) and reporting procedures.

In 2002, a total of 67 accidental releases were reported through EIRS. Eight releases went to secondary containment and did not actually involve any release to the environment, leaving 59 actual releases to the environment. Fifty-one of these releases included 13 refrigerants; 14 petroleum products such as fuel, hydraulic oil or motor oil; 13 diluted or treated wastewater or cooling tower water; and 11 releases of untreated industrial or sanitary wastewater.

The remaining eight releases included eight gallons of antifreeze, 0.5 pounds of gas from a lab test vial, one gallon of chemical stripper, air emissions from open paint cans, 885 pounds of CF_4, five gallons fiberglass resin, one minor vapor release from a lime storage facility, and 24 pounds of sodium hypochlorite.

Corrective action was taken for releases that could be contained and did not immediately dissipate. Those that could not be contained and remediated were either instantaneous air emissions or discharges to water conveyances. The releases to water were minor and had minimal impact on the environment. The releases to air immediately dissipated. None was of a duration or concentration to cause long-term environmental impact.

FINES AND PENALTIES

In 2002, IBM paid one $840 fine for some construction debris and nonhazardous office waste containing IBM's name that was found in an industrial park far from IBM's location in Monterrey, Mexico. Over the past five years, IBM has paid 12 environmental fines for a total amount of $14,796.

FINES AND PENALTIES WORLDWIDE

	98	99	00	01	**02**
Number	4	5	1	1	**1**
Fine *($ in thousands)*	$2.8	$9.3	$1.9	$0.01	**$0.8**

Among the resources IBM has developed to help safeguard client and employee privacy:

"Privacy in a Connected World," an executive-level white paper that explains this complex issue.

IBM Privacy Services that include a Privacy Workshop and a Privacy Strategy and Implementation Service that is based on IBM's Enterprise Privacy Architecture.

Tivoli Privacy Solutions, an access control solution developed for e-businesses needing to effectively implement privacy policies while helping protect the client's personally identifiable information.

Enterprise Privacy Architecture to provide an object-oriented methodology to implement an organization's privacy policy.

IBM Privacy Institute, an organization within IBM Research that promotes the advancement of privacy and data protection technology for e-business.

A MATTER OF TRUST

BY HARRIET PEARSON

Vice President, Human Resources, IBM Systems Group, and Chief Privacy Officer

THE INTERNET and other technologies didn't create the issue of personal privacy protection. Our human desire for privacy is as old as the emergence of society.

However, there's no doubt that today, the Net is where the open, global, liberating virtues of a networked world collide with more ancient concerns, and force a re-examination of the balance between individual privacy and the competing social interests — ranging from law enforcement to consumers' desires for all kinds of more personalized products and services.

If you believe, as I do, that privacy is basically the ability of individuals to determine how information about them is communicated to others, then it's obvious that the issue transcends information technology, and encompasses the full range of government regulation, local customs, and personal choices and actions.

For example, technology might allow an insurance company to search millions of pieces of data to find out more about me. But I expect the company's own standards of behavior, the regulations under which it operates, and the norms of the society in which I live to put a brake on inappropriate and harmful use of information about me. That's more than an entirely reasonable expectation. It's the bedrock of trust on which human-to-human and human-to-business relationships are premised.

Without question, there is a role for government on this issue, and it will vary by region of the world. Privacy protection, by definition, also entails significant individual responsibility and action. And the role of industry is unambiguous: Even in nations with strong data protection regulation, the private sector has the largest responsibility to develop workable processes to manage and secure data.

As one of the world's leading information technology companies, we believe we have a preeminent responsibility — on both the technical and policy fronts — to contribute to the evolution (if not creation) of thoughtful frameworks for privacy and data protection.

IBM recognized, even in the Internet's infancy, that privacy would play a pivotal role in the development of the networked world. In fact, three decades before that, we were among the first companies with a global privacy policy, focused on employee information.

We are still evolving our policies today, because the underlying issues are very much alive. Guiding us is the belief that the heart of this intensely human and complex question is trust. Earned trust. We develop our policy initiatives — and the solutions that help our business and government clients protect customer or citizen information — with that in mind.

IBM IMPLEMENTED ONE OF THE FIRST GLOBAL PRIVACY POLICIES FOR THE WEB, AND APPOINTED ONE OF THE INDUSTRY'S FIRST CORPORATE CHIEF PRIVACY OFFICERS

IBM INVENTED (AND DONATED TO THE WORLD WIDE WEB CONSORTIUM) AN XML-BASED PROGRAMMING LANGUAGE CALLED ENTERPRISE PRIVACY AUTHORIZATION LANGUAGE (EPAL) THAT ALLOWS COMPANIES TO TRANSLATE CLEARLY STATED PRIVACY POLICIES INTO TERMS A COMPUTER CAN READ AND ACT UPON

When Remediation Is Needed

Because pollution prevention technologies have changed so much since the 1950s, some measures that had been considered state-of-the-art then are now either ineffective or outmoded. IBM's response has been to recognize the need for corrective action wherever necessary, and to act responsibly and swiftly.

For example, IBM has vigorously remediated groundwater contamination ever since a problem was discovered in 1977 at its site in Dayton, N.J. Because of that discovery, IBM voluntarily began monitoring groundwater at its manufacturing and development locations around the world.

Worldwide, IBM has approximately 2,740 monitoring and 135 extraction wells. In 2002, approximately 15,200 pounds of solvents from past contamination were extracted while remediating, controlling and containing groundwater at 10 currently operating sites and nine former sites in three countries. At four of those sites, an additional 620 pounds of solvents were removed by soil vapor extraction or other methods.

As part of its groundwater monitoring program,
IBM has approximately
2,740 MONITORING WELLS
to measure water quality
at its plants and labs worldwide

As a result of the U.S. Superfund law, IBM is also involved in cleanup operations at some non-IBM sites in the United States to which wastes had been sent for disposal in the past. The Superfund law creates a retroactive responsibility for certain past actions even though they may have been technically and legally acceptable at the time, and requires that companies whose waste was sent to such sites share in the cleanup costs.

As of year-end 2002, IBM had received notification (through federal, state or private party) of its potential liability at 102 sites. Of these, 53 are on the U.S. National Priority List. Of those 102 sites, IBM believes it has or may have some involvement — resolved, ongoing or under investigation — at 71. The company believes that it has no responsibility at the others.

A Superfund site at which IBM is actively involved is one where the company began remedial activities in 2001. The site, known as the Shenandoah Road Groundwater Contamination Superfund Site in New York, was operated by a vendor with whom IBM did business about 30 years ago. The vendor's operations apparently caused soil and groundwater contamination that was discovered in 2000. The vendor is no longer in business and in May 2001 IBM voluntarily signed an agreement with the U.S. EPA to excavate and remove the contaminated soil. IBM has also provided water filtration systems for local homeowners with wells whose water may have been impacted. IBM is currently working on developing an alternative water source as a long-term reliable drinking water supply and is studying possible groundwater remediation solutions.

Groundwater vapor intrusion can occur when, under certain conditions, chemical vapors from groundwater rise and possibly enter buildings. Government agencies, scientists and professional engineers are studying this phenomenon to better understand it.

Following draft guidance issued by the U.S. EPA in December 2001, IBM identified its former facility at Endicott, N.Y., as a facility where this situation might occur. Upon further analysis, it was determined that low levels of some vapors from contaminated groundwater to which IBM contributed might be entering some homes and buildings off of IBM's former plant site.

The level of vapors was very low, and there are no national standards defining permissible amounts of these vapors in nonindustrial indoor air. IBM has been offering and installing ventilation systems for the structures meeting the criteria the New York State Department of Environmental Conservation established for this project.

When a cleanup program becomes likely, and its costs can be reasonably estimated, IBM accrues remediation costs for all known environmental liabilities. Estimated environmental costs connected with postclosure activities (such as removing and restoring chemical storage facilities) are accrued when the decision is made to close down a facility. As of December 31, 2002, the accrued amount was $247 million. Accrued amounts do not cover any site in a preliminary stage of investigation, when neither the extent of the cleanup nor the company's percentage of responsibility has been established.

Recognition Programs

In 1991, IBM established two internal programs to encourage and recognize environmental leadership.

The Corporate Environmental Affairs Excellence Award confers awards of up to $50,000 on individuals and teams of employees for innovative achievements contributing to IBM's environmental, energy and safety objectives. In 2002, four awards were presented to 22 employees from three countries.

The innovations recognized included new processes and technologies for pollution prevention, a new environmental information management tool, and an initiative that enabled IBM to obtain a significant amount of competitively priced green power in the U.K.

Since the inception of IBM's Environmental Recognition Programs
64 AWARDS have been granted to **358 EMPLOYEES** for an amount totaling more than **$2.4 MILLION**

The IBM Chairman's Environmental Affairs Award was established to encourage leadership and recognize achievement and progress in environmental affairs on the part of manufacturing sites and organizations. Recipients are selected based upon the leadership, comprehensiveness, progress and results of their environmental, energy and safety programs within the framework of IBM's corporate policy on environmental affairs.

In 2002, IBM East Fishkill received the award in the competition among Manufacturing/Fabricator sites. IBM Brazil received the award in the competition among Sales & Distribution, Software and Services organizations.

More information on the recipients of these awards and their achievements may be found at www.ibm.com/ibm/environment/news.

A SAMPLING OF RECOGNITION

In 2003, IBM Japan took the top AAA rating in the Deloitte Touche Tohmatsu Environmental Corporate Rankings in Japan. IBM Japan also took first place in environmental activities and corporate ethics in a ranking compiled by Sustainability Management Rating Institute (SMRI) and sponsored by the Environmental Management Association with the backing of the Ministry of Economy, Trade and Industry and EPA Japan.

Number 1 in the U.K.'s Business in the Environment's 7th Index of Corporate Environmental Engagements in 2003. This was the second consecutive year in which IBM shared the top rating and was the only company to retain its position from the prior year.

IBM Canada's Bromont site won the 2002 CCME award for pollution prevention. The submission to the Canadian Council of Ministers of the Environment, Pollution Prevention Award won the large-business category.

IBM Burlington was recognized with three 2002 Governor's awards for environmental excellence and pollution prevention. They included two Environmental Excellence in Pollution Prevention awards and the Environmental Excellence in Environmental Stewardship and Resource Protection award.

IBM Zurich's new headquarters building received the Minergie Certificate of the Swiss Environmental and Energy Agency in 2002. The Minergie label is awarded for buildings that meet the very stringent energy conservation requirements of this government agency. IBM's building is the largest building in Switzerland to receive the label.

IBM Guadalajara received the 2003 Tlaloc Award for environmentally conscious water usage from the Guadalajara division of the Environmental Committee of the American Chamber of Commerce of Mexico and the Federal Enforcement Agency for Environmental Matters.

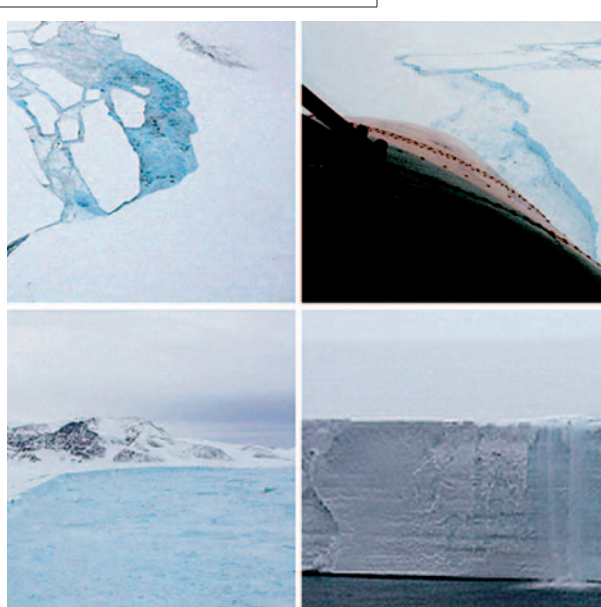
At one end of the spectrum, massive computing power, simulation capabilities and software advancements unlock new understanding of some of the world's most demanding problems. *At the other end*, the vast human capital of IBM unlocks the potential of future generations. In both cases, new understanding creates insight, which spawns solutions, which change our world.

HARNESSING THE POWER FOR EARLY DETECTION

IBM is working with universities and government agencies in the United Kingdom and the United States to build sophisticated computing "grids" that will enable early screening and diagnosis of breast cancer. Grids harness the computing power of hundreds or thousands of geographically dispersed systems. The two mammography projects, based at Oxford University and the University of Pennsylvania, will give physicians access to the processing power required for sophisticated analytics of digitized X-ray data — with the goal of improved detection of breast cancer and improved efficacy of treatments.

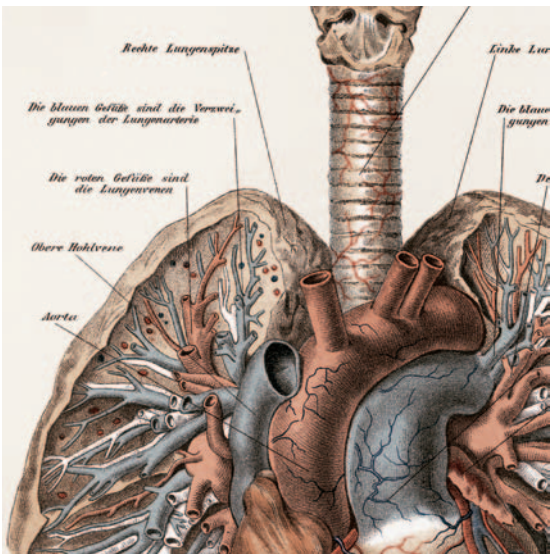
FINDING ANSWERS BLOWING IN THE WIND

IBM and the U.S. Department of Energy's National Nuclear Security Agency will use a supercomputer known as Blue Gene/L to research global climate change and the interaction between atmospheric chemistry and pollution.



STALKING KILLERS

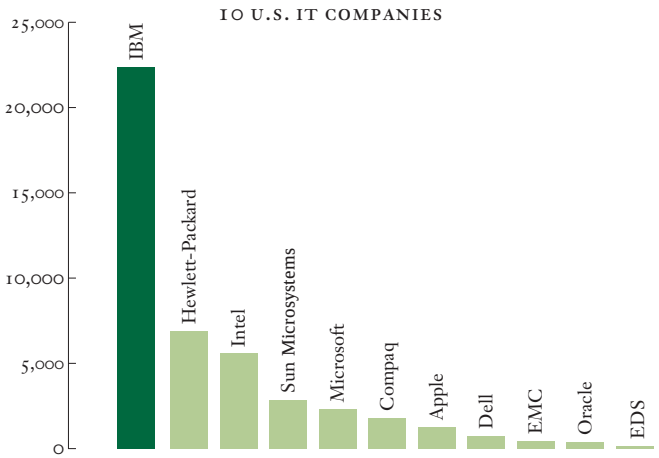
IBM and the iCapture Centre, a UBC-Providence Healthcare Research facility based in Vancouver, are collaborating on research into the link between genetic and environmental influences in heart, lung and blood vessel diseases, which are the leading causes of death in North America.



PRESERVING CULTURAL IDENTITY

A Reinventing Education project is developing the professional skills of more than 2,200 teachers in Brazil and teaching students to use technology to conduct research, document local history and preserve their local culture.

IBM'S 1993–2002 PATENT TOTAL
VS.
10 U.S. IT COMPANIES



IF SMALLPOX RETURNS

IBM, United Devices and Accelrys are supporting a global grid research effort to develop new drugs that for the first time would combat the smallpox virus after infection. The project will provide leading smallpox researchers at Oxford and Essex Universities in the United Kingdom, the University of Western Ontario, and other locations with the computing horsepower needed to identify new drug targets.

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Note: At the end of 2002, IBM had sold to other companies some or all of the manufacturing operations at the following locations: Endicott, N.Y.; Rochester, Minn.; San Jose, Calif.; Guadalajara, Mexico; Mainz, Germany; Beijing, China; Shenzhen, China; Fujisawa, Japan; and Prachinburi, Thailand. The site at Szekesfehervar, Hungary, ceased operations at year-end 2002.

ABOUT THIS REPORT

This report combines and expands upon IBM's previous reporting on corporate philanthropy, diversity, employee well-being and environmental programs. The document describes these and other programs and provides data for 2002. Where appropriate, five years of data have been included to demonstrate trends and provide year-to-year comparisons. Environmental and selected financial data include that for IBM and its controlled subsidiary companies, which in general are majority owned. Other data is that of IBM.

We have included information on the areas of corporate responsibility we believe are the most relevant and meaningful with regard to IBM's global activities. Among the references used in preparing this report are the Global Reporting Initiative (GRI) *Sustainability Reporting Guidelines*, the corporate social responsibility surveys of a number of external organizations, and questions we are often asked by customers and other stakeholders.

We view this report as a valuable tool for maintaining dialogue with a variety of interested parties, including our employees, customers, investors, neighbors and regulators. We also realize we cannot address all the interests of all groups in a single document. For additional information, questions or comments on the report, call (800) IBM-4YOU or, outside the United States, (404) 238-1234.

Additional information about IBM and its business performance may be found in the company's annual report, available on the Internet at www.ibm.com/annualreport/2002/index_home.htm. Copies also may be obtained from EquiServe Trust Company, N.A., PO Box 43072, Providence, Rhode Island 02940-3072; (888) IBM-6700. Investors residing outside the United States, Canada and Puerto Rico should call (781) 575-2727.

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