HP AND COMPAQ COMBINED: IN SEARCH OF SCALE AND SCOPE

I’m going to overgun this thing.1
—Carleton “Carly” S. Fiorina, Chairman and CEO, Hewlett-Packard

INTRODUCTION

A merger as big and bold as Hewlett-Packard’s $19 billion acquisition of Compaq Computer in 2002 had never taken place before in the technology industry. HP’s CEO, Carly Fiorina, called it an “historic” event.2 To many critics, however, the merger seemed doomed to fail. Whatever their opinion of the strategic rationale, many observers thought that HP would not be able to successfully integrate its former rival. An embattled competitor described it as a “slow motion collision of two garbage trucks.”3 Even HP’s head of human resources compared mergers in general to icebergs where the real work takes place below the surface.4 The merger would produce one very large iceberg; perhaps big enough to sink competitors, or break up under the stress of internal and external forces. Nevertheless, Fiorina believed it was the right move for HP, and a key element in her strategic objective to make HP, in her words, “the leading technology company in the world.”

Winning shareholder approval for the merger proved to be a tough fight for Fiorina and her senior executive team. Compaq’s shareholders were willing enough to swap their stock for HP shares, but HP’s shareholders proved harder to convince. Announced on Labor Day 2001, it was clear from the outset that the deal would lead to the elimination of at least 15,000 jobs. That was one of the reasons that Walter Hewlett, HP board member and son of the company’s co-founder

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1 All quotes from Carleton S. “Carly” Fiorina are from the authors’ interview on September 26, 2003 unless otherwise cited. Subsequent quotes from this interview will not be cited.
William R. Hewlett, led a proxy battle to oppose the merger. The fight became costly and bitter. In March 2002, the vote came down to a thin 3 percent majority for the merger, with recrimination on both sides. Soon after, regulators in the United States and European Community also gave their approvals to the merger and HP cleared its last external obstacle.

In early May 2002, the acquisition integration could at last officially start. Behind the scenes, before winning shareholder and regulator approval, but careful to stay within the limits of the law, HP and Compaq had already launched a massive integration planning effort. Operating in so-called “clean rooms,” apart from the thousands of employees working for HP and Compaq, a relatively small and diverse group of HP and Compaq executives had been doing the planning needed to launch the execution of the integration immediately after obtaining legal clearance.

More mergers fail than succeed, and technology mergers in particular are notoriously hard to pull off. However, just two years after HP announced its intention to acquire Compaq, the company met or exceeded its ambitious integration targets. Within the first nine months of the merger, HP reported savings of nearly $3 billion from layoffs (12,000 out of 155,000 employees), reduction in overlapping product lines, facilities closures and consolidation of its supply chains. The savings exceeded HP’s announced goal of cutting $2.4 billion of expenses within 18 months of the merger.

This case describes the strategic analysis that went into identifying Compaq as an acquisition target to help HP achieve its objective of becoming the leading technology company in the world, the planning and execution of the merger, and the actual processes created to achieve the strategic, administrative, and cultural integration of the two companies.

1999–2001: EXPLORING STRATEGIC ALTERNATIVES

A Failed Strategic Acquisition Attempt

Searching for a new, more services-oriented corporate strategy, Fiorina announced in September 2000 an $18 billion bid for the consulting arm of PriceWaterhouse Coopers (PwC). At that time, HP’s Services Group accounted for about 1 percent of the market for IT services. The market was huge, estimated to exceed $660 billion in 2000, and fragmented; Compaq also had an estimated 1 percent of the market and IBM was the industry leader with 5 percent. The deal would have transferred PwC’s 31,000-strong army of information system consultants to HP’s small IT services group. HP’s goal was to garner a higher percentage of its revenue from high margin services. Services were becoming increasingly important sources of revenue for other technology companies. For example, by 2001, IBM obtained one-third of its revenue from its Global Services arm. In 1998, HP’s once arch-competitor Compaq bought Digital Equipment

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5 The Trustees of the William R. Hewlett Revocable Trust, a group that controlled a large block of HP shares and opposed the merger, cited research from Sanford C. Bernstein in October 1999, which found that a survey of over 7,000 merger and acquisition transactions between 1992 and 1999 revealed that acquirers underperformed by 5 percent per annum in the three years after the transaction and 11 percent in the first two years. The research also found that technology transactions generally fared worse, stock deals were more destructive to returns than cash deals and that the larger the deal, the greater the odds of failure. Source: “Report to the Trustees of the William R. Hewlett Revocable Trust on the Proposed Merger of Hewlett-Packard and Compaq,” undated but made public at the time of the proxy fight.

6 One year ahead of FY 2004, HP had already achieved $3.5 billion in cost savings.
(DEC) for its services business, saying, “We put tremendous value on the customer relationships Digital has cultivated over the past 40 years. We are committed to supporting these key customer relationships by investing in Digital’s strategic assets, particularly its worldwide service organization...”7 But the deal proved costly for Compaq. The company lost more money in the three years following the merger than in its entire previous history: more than $2 billion by the end of 2000. Compaq also lost its position as America’s leading PC maker, having been passed by both Dell and HP in the retail market. Compaq’s president and CEO, Eckhard Pfeiffer who engineered the deal, was fired within a year of the purchase.8

If this experience did not scare off Fiorina, it probably gave HP’s investors pause. Perhaps fearful of the challenges in merging the two companies, but also corresponding with disappointing financial performance, investors stripped 36 percent off HP’s share price in the two months from the time the deal with PwC was announced until it was abandoned in November 2000. The all-equity deal became much more expensive in view of HP’s reduced share value. In addition, there were fears over the increased consultant turnover at PwC during the time the acquisition was in play. Explaining her decision to drop the deal, Fiorina said, “Given the current market environment, we are no longer confident that we can satisfy our value creation and employee retention objectives—and I am unwilling to subject the HP organization to the continuing distraction of pursuing this acquisition any further. We remain committed to aggressively growing our consulting capabilities, organically and possibly by acquisition, and are open to other business arrangements to achieve our goals.”9 Still, Fiorina was determined to grow HP’s presence in the lucrative services industry.

In May 2001, HP and Accenture (formerly known as Anderson Consulting), announced an alliance to provide IT outsourcing services to enterprises. The companies would focus on migrating legacy mainframe applications to next generation architectures and platforms. The alliance combined Accenture’s industry, management, and technology expertise with HP’s technology, innovation, and operational services. The companies could offer enterprises the ability to design, build, run, and operate applications across a spectrum of outsourced IT lifecycle and infrastructure solutions.

In September 2002, the technology and services giant IBM spent $3.5 billion to purchase the PwC group that Fiorina had left on the shelf. In late 2003, this did not seem to concern Fiorina. She said HP could have purchased PwC for $3.2 billion two weeks before IBM finally bought them for $3.5 billion. Her decision not to acquire the group did not mean she was backing away from services. In fact, she believed services had become even more important since the economic downturn, with customers demanding more from their technology suppliers and unwilling to make tradeoffs. In September 2003, recalling her experience with the proposed PwC merger, Fiorina discussed her rationale for letting the deal drop. She said:

> The deal at the price that was on the table at that point clearly was not going to work. But, you have to remember in December 2000 there were a couple of things going on that had since changed. We, along with other technology

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companies, didn’t see the downturn coming as fast as it came. So, at that point in time, December 2000, for example most of the conventional wisdom was that the Unix market was going to grow at 15 percent.

And so we got very heavily engaged with that company [PwC] to understand what they were thinking, what they were doing, what their cost models were like. You know, we found out, for example, that even in the heady days of summer of 2000 they were barely scraping by with a utilization rate at or near breakeven.

What does that say when times get tough? We think the high-priced consultant model is a value proposition of the past and will not translate well into the future.

Preparing for the Compaq Acquisition

These lessons, along with the changing forces acting on the entire technology industry, shaped Fiorina’s perception of what was needed and what was possible for HP. Fiorina said that ever since her arrival at HP, she and the board spent most of their time together considering the strategic choices for the company:

We examined strategic choices across a number of different vectors. So that by the time we actually landed on the Compaq acquisition, we had, as a board, examined several different alternatives. I say it that way because some of the companies we considered, which never became publicly known, were along different vectors. Broadly speaking, we examined companies along four different vectors:

- Continuation along our current path
- Services infrastructure
- Imaging infrastructure
- Scope- and scale-intensive options

We obviously ended up on a scope- and scale-intensive play, but we looked very hard at various alternatives along the lines of status quo-intensive, services-intensive, and imaging-intensive acquisitions. Included in the imaging intensive vector was spinning out the imaging business, but that certainly wasn’t the only option we looked at.

In considering actions along the services-intensive vector, we concluded that making some of the obvious acquisitions in the services-intensive space was buying a backward-looking value proposition and cost model. I have been asked numerous times and have answered publicly that I would not and will not buy EDS believe they have a backward business model, a backward-looking value proposition. It is a backward value proposition in the sense that we don’t think it is any longer about throwing people at technology to make it less complex. We think it is about using technology to make technology less complex. And therefore, we think it’s a huge deal that our managed services business is attached
to a technology business. In fact, we think about managed services as a
technology business, not a people business.

So to me, what customers are saying is we need everything that we used to be
willing to make tradeoffs about. All these things that they used to be willing to
trade off, they are not willing to trade them off anymore. We’ve got to have all of
that. And part of that is driven by the fact that every physical process will
become a digital process. Everything is networked and connected. Every
physical process will not only become a digital process, but will also become a
mobile process and a virtual process. Everything has got to be connected. That
raises the bar so high that only companies with huge scope and scale and the
ability to sustain meaningful innovation while also reducing total cost of
ownership to customers will be able to compete. You’ve got to be able to deliver
high-tech and low-cost, total customer experience. That’s a tall bar and we need
scope and scale and huge capabilities to deliver that. So that’s what drove us [to
acquire Compaq].

2001-2002: HP AND COMPAQ DECIDE TO MERGE

Compaq called HP

Ostensibly, Compaq’s CEO, Michael Capellas, called HP’s CEO, Carly Fiorina, to discuss a
joint research and development (R&D) deal, but the conversation turned to acquisition. It was a
call that Fiorina said she was prepared for and awaiting. Fiorina said:

The reason people sometimes think Compaq came along is because of the way the
intensive discussion started, when Michael Capellas made a phone call saying
‘let’s collaborate on R&D.’ We [Fiorina and HP’s board] predicted the phone call
would happen. We wanted the phone call to happen and it was important to the
negotiating process that they call us. But 12 months before that phone call, it was
clear it was going to happen and the issue was then what do we want our answer
to be 12 months from now? I almost predicted to the month when that phone call
would happen: it was clear, given Compaq’s strategic challenges.

Compaq had to make the call because you could look at [the strategy they
espoused] and compare it to what they had in terms of capabilities to pull it off.
They saw the market the same way we did, but you could look at how much strain
their business model was under, and you could see they didn’t have the scope and
scale to achieve their vision. Their business model was challenged in places
where ours was strong and our business model was challenged in places where
theirs was strong. But, they were under more strain than we were. So, it was
easy to predict they were going to make the first call.

A big reason Compaq had been troubled was its failure to do much with their acquisition of DEC
in 1998. Another reason was its reliance on the PC market, where it struggled against fellow
Texas rival, Dell Computer, and its low-cost, build-to-order model with direct distribution. At
the time of the merger announcement, HP’s operating margin on PCs was estimated at breakeven at best. Compaq made an estimated 1.5 percent in PCs while Dell, with its relentless focus on cost containment, managed to earn an estimated margin of 7 percent in PCs. In 2001, PCs accounted for about 44 percent of Compaq’s revenue, while enterprise systems comprised 32 percent and services made up 24 percent.

Even before Fiorina and Capellas started discussing a merger, Compaq had been trying to increase its presence in the services market. Over 55 percent of Compaq’s 68,000 employees worked in its services division. The company aimed to derive 30 percent of its total revenue from services. To achieve this growth, Compaq budgeted $500 million for acquisitions of small and mid-sized service companies.

Some analysts were concerned about the nature of Compaq’s current services business. One estimated that between 25 and 30 percent of Compaq’s services business was derived from supporting older and declining Tandem and Alpha products. The highest fees and margins were earned in the consulting and outsourcing segments of the service industry. However, much of HP and Compaq services had been focused on providing product support, which was a lower-margin business. (See Exhibit 1 for current selected HP financial information, and selected financial and market data for HP and Compaq prior to the time of the merger.)

From the Compaq Side

The call must have gone well, because soon Fiorina and Capellas were meeting face-to-face to discuss a merger. Initially, the group discussing the merger was limited to four executives: Fiorina, Capellas, HP’s Duane Zitzner, who at the time headed the company’s PC business, and Shane Robison, then Compaq’s senior vice president and chief technology officer of Strategy and Technology.

Robison discussed the reasons Compaq had been willing to surrender its independence: “Market share and scale matters; and size matters; it’s basically a portfolio play. As we looked at the two companies, we found that while we appeared to be competing, our strengths and our weaknesses were perfectly complementary. So it made a really nice merger strategy.”

A merger with HP was not the only option Compaq considered. Robison led Compaq’s review of other strategic possibilities, but his analysis, like Fiorina’s, pointed to a HP-Compaq merger. Robison recalled: “We considered pretty much everything. I had a process I was running as part of corporate strategy to analyze all combinations of different partnerships. There were very few that had a strategic, cultural, product, and customer fit like this one. When you get through with the analysis, it’s almost a no-brainer.”

Capellas’ phone call to Fiorina came at the end of a tumultuous period for Compaq. The company never recovered from its purchase and failed integration of DEC in 1998. Compaq had been riding high when it bought the minicomputer pioneer for $9 billion. In 1998, Compaq was

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12 All quotes from Shane Robison are from the authors’ interview on September 18, 2003. Subsequent quotes from this interview will not be cited.
growing at a heady 30 percent per year, twice the industry average and was the world’s largest maker of personal computers (PCs), ahead of IBM, Dell and HP. Just a year prior, Compaq had purchased Tandem, a maker of robust “fault-tolerant” servers that companies used to run critical applications, such as NASDAQ’s trading operations and airline booking services. However, by 2000, the merger had gone so badly that, as stated above, Eckhard Pfeiffer, Compaq’s CEO who engineered the deal, had been fired, the company’s share price lost about half of its value (this during the boom time for technology stocks), and the company itself lost $2 billion. Compaq’s board, failing to find an outsider willing to lead the company, promoted Compaq’s then COO, Michael Capellas, to the position of CEO.

The acquisition had been an attempt to move Compaq into new growth areas such as services and high-end enterprise servers. At the time of its acquisition by Compaq, DEC’s services business had been number three in the industry. Twice before, in 1995 and again in 1996, Compaq tried to acquire just the services portion of Digital, but was rebuffed when a price could not be agreed. By 1998, DEC had been performing so badly that Compaq was able to buy the whole company. That meant that Compaq acquired DEC’s high-performance, 64-bit processor called Alpha, its group of services customers, and a line of products that were largely complementary to Compaq’s.

By most accounts, Compaq botched the DEC merger integration. Compaq had been slow to blend DEC into its portfolio, perhaps distracted by the turmoil in its core PC business that emerged at the time. Compaq was losing money and slipping behind IBM, Dell and HP in PC sales. According to The Economist, Compaq hired three consultancies to advise it on integration strategy and set up more than 200 internal committees to discuss DEC’s integration, but made little real progress.13

Compaq was not able to successfully deploy DEC’s service arm. DEC’s customers were reputed to be loyal to the company, but Compaq rebranded all products and services under its own name, which carried little cachet with DEC’s customers. Cultural differences between Compaq and DEC persisted after the merger.

In making a bet on scope and scale, Fiorina wagered a huge amount of HP’s resources and the shareholders’ value on her vision for the future of the technology industry, and the ability of companies to provide differentiated technology solutions to a wide variety of needs. Fiorina said, “Technology now is so critical to business success, it is so central to solving fundamental problems like healthcare—it’s so much a part of the fabric of life—that customers are no longer going to be willing to make the kinds of compromises and tradeoffs that they used to make.” By combining HP with Compaq, Fiorina planned to offer, under one roof, the solutions to meet the growing technology needs of customers.

### Strategic Logic of the Merger: The View of an Internal Skeptic

HP’s longtime CFO and 34-year company veteran, Robert R. Wayman, was an important early skeptic of the merger who became convinced it was the right move for HP. Wayman said:

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As CFO, I think one of my jobs is to be skeptical of major uses of capital, particularly mergers and acquisitions because they are so challenging and difficult. I usually just say ‘prove it to me.’ I get paid to make sure that the typical excitement of the business folks, once they get into something, doesn’t ignore the real economics, because they may have a problem to solve, or because they may want to be a bigger presence in the marketplace. Those are all real, legitimate issues, but they are not reasons to spend money on a bad purchase. This was a little different in that it came from the two CEOs. So it was very friendly, or potentially friendly from the beginning, on a higher level. But still, my initial reaction was, we’ll look at this for two to three weeks and bye-bye, move right on.14

As he looked further into the proposed merger, Wayman saw more and more that he liked. According to Wayman, the deal was a “consolidation merger, so cost synergies are potentially significant.” Because HP was already in the businesses it would acquire from Compaq, Wayman felt that HP was in a good position to evaluate the risks as opposed to “extension” mergers where companies acquire unfamiliar lines of business, enter new geographies.

An important feature of the consolidation merger was that HP believed the relative positions of the companies’ lines of business were complementary. Wayman said, “Compaq was strong in industry standard servers and HP was weak there; HP was strong in Unix servers and Compaq was weak there and so on. And where we had overlap such as in managed services, our combined size and scale increased our possibilities in the market.” This convinced Wayman to look deeper at the proposed merits of the deal. Wayman said:

> Once I understood what we had to work with, I saw how this could make sense. So then you get into some of the more challenging parts of the analysis: How does the merger position you strategically going forward, as opposed to just the here and now? Strategically, if you looked at what this meant to HP, it brought some real positives to either bolstering our strategic position where we were, or adding to our strategic position in areas in which we wished to have strength. Two of the latter categories are industry standard servers and storage. We were number four in servers, and so [Compaq’s assets here offered] a clear positive strategic positioning in our ability to bring to customers a full portfolio of our products. The same is true in storage. Compaq had an industry leading position.

> In areas that we had already said we were heading, such as managed services or outsourcing, the merger doubled our size and that makes a big difference in terms of your credibility and resource levels. That plus, frankly, some of EDS’s troubles have just dramatically changed our position in the managed services market, which is something we wanted to accomplish.

> The next element I considered was the management team: The ability to integrate at the human level, culture, board dynamics, and governance. Can you bring the

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14 All quotes from Robert P. Wayman are from the authors’ interview on September 8, 2003, unless otherwise cited. Subsequent quotes from this interview will not be cited.
boards together in a friendly way, can you bring the CEOs together in a friendly way? Any of these things could still have killed the deal. But we got through all of those and then you get down to the final issue here of what do you pay—which to a finance guy is critically important.

A Bruising Proxy Battle

The conventional wisdom before the HP-Compaq deal was that large mergers of technology companies do not work. Indeed the chairman of Compaq, Ben Rosen, said about AT&T’s acquisition of NCR in 1991: “The main beneficiaries of mergers in the computer industry have been competitors, because companies become so focused on organizational matters that they lose sight of their customers.”\(^\text{15}\) That acquisition, like so many others in technology, turned out poorly and destroyed billions of dollars of value for AT&T shareholders. Before HP could embark on its vision to gain scope and scale by acquiring Compaq, it had to convince its shareholders to support the deal. This was made difficult, and the merger was very nearly scuttled by the proxy fight waged by Walter Hewlett, an HP board member and son of co-founder William Hewlett. Walter Hewlett and the trusts of the families of both founders (which controlled large blocks of HP shares) were against the merger and spent heavily to try and persuade other shareholders to vote against it. (See Exhibit 2 for selected data that was cited by Hewlett in opposition to the merger and by HP in support of the merger.)

Walter Hewlett and the others opposing the merger boiled down their position to four major points:\(^\text{16}\)

1. Resulting business portfolio is worse than the existing HP portfolio:
   a. Larger PC position will increase risk and cash drain.
   b. Contrary to earlier professed strategy of migrating to higher margin, less commodity-like businesses.
   c. Diluted interest in Imaging and Printing.

2. Acquisition will not solve HP’s strategic problems:
   a. PC economics remain unattractive.
   b. Combined entity remains “stuck in the middle” in servers – behind Dell at the low end and Sun and IBM at the high end.
   c. Services weighted heavily to lower margin support, not outsourcing and consulting.
   d. HP+CPQ ≠ IBM.

3. Integration risk is substantial:
   a. No precedent for success in big technology transactions.
   b. Most acquisitions fail.
   c. Integration difficulties are obvious.
   d. Revenue risks offset cost synergies.
   e. Very difficult to mesh cultures.

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4. Financial impact on HP shareholders is unattractive:
   a. Relative contribution of earnings favors Compaq.
   b. Weaker credit.
   c. Increased equity risk and cost of capital.

Fiorina and her executive team countered Hewlett’s objections every step of the way. Her team rebutted Hewlett with five key points:

1. Information technology industry continues to undergo rapid change and HP must continue to address challenges of new environment.
2. Compaq merger is uniquely compelling strategic alternative—no other option offers such comprehensive benefits and opportunities.
3. Combination addresses industry dynamics and customer requirements, creates stronger company and is financially compelling.
4. Management is experienced and focused on execution, and integration planning is ahead of schedule.
5. Walter Hewlett filings [such as the points Hewlett made above] are based on a static and narrow view of HP and the industry, selectively ignore synergies, offer no alternatives and rely on faulty financial assumptions and analyses.

Other critics, besides Hewlett, pointed out that neither HP nor Compaq had any experience integrating large mergers. The biggest merger accomplished in the past by either company had been Compaq’s acquisition of DEC in 1998 for $8.5 billion. At the time, DEC had $13 billion in annual revenues, 53 percent of Compaq’s annual revenue. DEC had been a leader in minicomputers, producing the very successful VAX/VMS line. However PCs and networking supplanted minicomputers by the time Compaq acquired the company, and its most valuable pieces had been its installed base of customers, its service arm and its Alpha chip. Compaq did not do much with Alpha over the years and faced rising pressure from industry standard competitors. Similarly it was unable to convert much of DEC’s installed base to Compaq products. As mentioned above, the merger had been widely viewed as a failure and cost the job of Compaq’s CEO at the time. While HP did not have the same troubled history with acquisitions, its record was not terrific. It acquired RISC workstation maker Apollo in 1989 only to see its share of the market immediately decline against Sun Microsystems and others. In 1997, HP acquired VeriFone, a maker of electronic point-of-sale payment terminals, but sold off the company in 1999.

While fighting the proxy battle for shareholder approval of its merger with Compaq, HP management issued several projections of anticipated growth for the various segments of the resulting combined company. These forecasts projected revenue growth and operating margins in key businesses (Exhibit 3). These projections could be expected to strongly impact the external view of the validity of the strategic logic driving the acquisition. Attaining them would affect the future share price of the combined companies and the perceived effectiveness of the CEO and the new top management team.

17 Points from “HP Position on Compaq Merger,” p. 4.
In March 2002, a narrow 3 percent majority of HP’s shareholders voted to approve the merger. Compaq’s shareholders were far more enthusiastic, voting 9-to-1 in favor of selling the company to HP. However, the drama did not end with the vote. Hewlett accused HP management of using “HP corporate assets to entice and coerce certain financial institutions [Deutsche Bank] to vote in favor of the proposed merger.” HP denied the allegations and in late April 2002, a judge ruled in favor of the company. Very soon after that judgment, the board decided to not renominate Hewlett; for the first time since its founding, there was no member of the Hewlett or Packard family serving with the company.

**Creating an Integration Process**

In deciding to acquire Compaq, HP would create a company with $80 billion in revenue, with over 155,000 employees with a presence in 178 countries. The company had few successful mergers to emulate, either in their own separate histories or in the technology industry in general. HP and Compaq would have to create their own processes, procedures and culture to meet their ambitious targets.

From her earlier efforts to radically change HP’s structure in 1999-2000, Fiorina had learned the importance of managing change with “massive inspection and discipline,” and she was determined to heed these lessons: “When we approached the Compaq integration, which was a massive change, I used the phrase over and over again: ‘We will over-gun this, not under-gun it.’ When in doubt I will over-gun it, because we’ve got to do it right. So we put massive discipline and inspection around it.”

**Due Diligence: Assessing the Cultural Differences**

Fiorina’s ability to convince internal skeptics, such as her CFO, was helped by the thoroughness of her approach. Dan Plunkett, an experienced external consultant and longtime personal advisor of Fiorina observed: “Carly is very systematic. She is a very planning leader, both on a large scale and on the tactical level. We got involved directly with the due diligence of understanding the two cultures, the two sets of leadership, how they would fit together and what would be needed to make these teams work effectively as one team.” Plunkett said:

> HP saw itself, and the evidence supported that view, as a culture of consideration, thoughtfulness, and planning—a more careful culture. Compaq saw itself more as a culture of “ready, shoot, aim.” They were much quicker to act. They debated less, discussed less, and considered less before they took action. And HP saw itself as quite different from that.

> There were some other quite interesting findings. For instance, there was a perception that Compaq held their people more accountable than HP. [But] as we looked into the two cultures, the Compaq people admitted that they certainly had room to grow in that area, and that HP was not quite as bad as people perceived it as far as delivery and sense of accountability, responsibility.

> And I think that was largely due to the progress that HP had made in the couple of years before the Compaq acquisition came about. It was a culture that had become
much more accountability-oriented, much more aggressive, much more willing to take risks, at least among the leadership of the organization, and much more in touch with the customer and the competition. Compaq was perceived as much more customer and competitor focused than HP. In fact, the HP that bought Compaq no longer fit the old perception—it was much closer to Compaq in that regard.18

Plunkett also observed that top management used the challenges the acquisition faced, including the proxy fight, as a kind of rallying call. He said that because they had an “outside enemy to fight” the two teams started very early on to work together as one team.

**Appointing the Integration Leaders**

In August 2001, a month before the acquisition was announced, Fiorina and Capellas each selected an executive from their respective companies to co-lead the integration effort. Fiorina chose Harry “Webb” McKinney, a longtime HP veteran who ran worldwide sales and marketing for enterprise accounts. Capellas selected Jeff Clarke, at that time Compaq’s chief financial officer.

McKinney and Clarke in turn assembled a 30-person integration team and set out to create and execute a plan to blend a single company out of two longtime rivals. The two worked together so closely that HP and Compaq employees referred to the executives collectively as “Weff.” Ann Baskins, senior vice president and general counsel, pointed out that for antitrust reasons, companies are allowed to plan for the integration, but cannot integrate until they have clearance. She said that, consequently, Fiorina early on decided to leave the legal function out of the integration planning. She wanted to make sure that the legal teams of each company would continue to represent only their company during the time that the merger was waiting to get clearance. But each legal team served up a lawyer to act as counsel to their respective member of the “Weff” team.

Jeff Clarke, who became HP’s executive vice president, Global Operations, himself a former employee of Compaq-acquiree Digital Computer Corporation (DEC), was in a good position to compare this merger with other similar technology mergers. Clarke said consolidation drove the HP-Compaq merger and pointed to similar mergers in the past: “If you looked at what [former IBM chairman and CEO] Louis Gerstner had done at IBM, it was clearly significant at consolidation. In fact at Digital, significant consolidation had made us again an interesting property to Compaq, and most recently Capellas and I at Compaq had done significant restructuring to make Compaq an interesting entity to other players.”19

Clarke recalled what he learned from his experience as a DEC employee at the time that company was acquired by Compaq: “Going back a little bit, I found myself at the Digital level embracing the new Compaq culture very quickly and obviously rising to a strong position in that company and I intended to do the same at HP. I intended to dive right into the new management

18 All quotes from Dan Plunkett are from the authors’ interview on September 8, 2003. Subsequent quotes from this interview will not be cited.
19 All quotes from Jeff Clarke are from the authors’ interview on September 18, 2003. Subsequent quotes from this interview will not be cited.
Looking back from the perspective of the summer of 2003, Webb McKinney discussed the elements of the deal that aided its success. McKinney said:

The companies had essentially the same strategies. As the teams got together and discussed this, they said, boy, this is a perfect fit from a current product point of view and also the same basic strategy to move to industry standards and open systems and the belief that the services part of the business was very strategic and that customers were looking for more total solutions. And it seemed like every place we looked, we saw these really nice fits and then, on top of that, you have the overall efficiencies. You only need one CEO, you only need one country manager in France, and so on. And that’s really what built the logic behind the merger and it was part of what we repeatedly attempted to communicate during what turned into the proxy fight.

It certainly was our belief that mergers of consolidation tend to be more successful than expansion for the simple reason that the management teams actually understand the businesses they’re in. It was really interesting to sit around the table and do the planning with people who had been in the same industry that you’ve been in for all those years. You’ve been competing against them. The decisions were so easy. We would sit and say well, how many ways have you tried it and how many ways have we tried it, okay, what was the good news and the bad news? We knew the territory and so it really facilitated the decision-making. We were knowledgeable and had all been around long enough to try things various ways and understood the tradeoffs.20

Jeff Clarke pointed to a unique feature of the HP-Compaq merger that he felt was critical to the integration: commitment from the top of the organization, i.e. Fiorina, to dedicate powerful executives to the task of integration and empowering those executives, i.e. McKinney and Clarke, to get the job done. Clarke said:

Carly was very intimately involved from the start. And it started at the very front with her decision on who would run the merger. She chose two of the most empowered people in the respective companies—people who already had extensive relationships with the boards and the management teams, and who got things done on a day-to-day basis. Webb McKinney ran the HP sales force, and when you’re running a sales force, you’re talking to the CEO on a regular basis because you need the CEO to get decisions. You’re the most important person delivering the [quarterly results], you’re cross-functional and you’re getting things done formally and informally. The same thing was true in my role as the CFO at Compaq. My job was to execute restructuring and execute the financial performance of the company. I had to communicate regularly with the board as

20 All quotes from Harry “Webb” McKinney are from the authors’ interview on August 20, 2003. Subsequent quotes from this interview will not be cited.
well as with the management team. Most merger integrations are run by an executive who was in between jobs, or an ex-consultant with great strategic and planning skills, or up-and-coming executives who had yet to prove themselves. Rarely would you pull people out of such important roles as the CFO and the head of sales and ask them to do something of this nature.

Clarke pointed to another interesting feature of HP’s planning that he felt was important to the success of the merger: “adoption.” In an effort to short circuit likely us-versus-them mentality among senior managers, Fiorina had each senior executive adopt a counterpart from the other company, a buddy system—sometimes referred to as a “Noah’s Ark” staffing plan. Clarke recalled: “[HP’s head of Human Resources] Susan Bowick and I chose to adopt each other as we were really driving most of the hard-nosed restructuring going on and I think it was quite helpful for the integration process to see Susan and me publicly patting each other’s back, publicly supporting each other and working well together privately.”

The Working of the Clean Teams

Within weeks of the merger's announcement, Clarke and McKinney’s team had grown to 500 members; by March 2002, it numbered more than 900. The group eventually grew to 2,500 members. Because this group was dedicated full-time to the merger integration and hence “uncontaminated” by the day-to-day concerns of running businesses, it became known as the “Clean Team,” as managers were pulled from their jobs to work exclusively on the integration, meeting in “Clean Rooms” in isolation from their former colleagues. The Clean Team encompassed employees from each line of business and function from both HP and Compaq.

Adopt-and-Go. The Clean Team would do the research necessary to make recommendations about which products to keep and which to eliminate. These were determined in a “Product Roadmap,” a master plan of which overlapping product lines from HP or Compaq would be kept and which would be dropped. It was a huge task, but one they were expected to perform expeditiously. Clarke explained:

Adopt-and-Go, to put it simply, is a theory which we put in practice and I believe it’s unique among mergers, that holds that clarity of decision, implementability of decision, and decisiveness or fortitude in that decision are more important than a perfect decision.

The Clean Team objectively evaluated the asset, whether it was a product line or an internal system such as a general ledger, and kept whichever company’s version was deemed better and threw out the other one. In most mergers you would study each for the best practices. For example, you would try to combine the best aspects offered by the respective assets of both companies and try to create a new, better version of whatever you had.

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We refused to do it that way. Instead, we chose the better of what was currently used by HP and Compaq, made that the winner as fast as we could, and moved on to the next decision. The people whose jobs were eliminated when their products were dropped knew that they could look for other jobs in the company. This Adopt-and-Go process stopped the politicking, it allowed for speed of execution and that was the pivotal part of our ability to accelerate the savings. Because in this industry there is no time for studying these things and re-engineering 10,000 processes in a market that is moving at this rate. We had to move towards executing and Adopt-and-Go gave great clarity to the field.

Adopt-and-Go improved the focus of 99 percent of the combined HP-Compaq employees who worked outside of the Clean Teams. They knew that there would be no debate over the clean room decisions. Their job was to execute the clean room decisions. And that allowed us to get enormous speed in the first six months, which obviously led to good financial performance. People weren’t debating, they weren’t politicking; they were executing, because they had plans in front of them of what to do.

That was a key part of the secret sauce.

Launch-and-Learn. Susan D. Bowick, HP’s executive vice president of Human Resources and Workforce Development, and a 25-year veteran of HP pointed out that “A big part of the Tandem/Digital and HP cultures was you don’t take a step until you’re 100 percent sure that you know what’s going to happen.” But HP was not going to have the luxury of taking time to get everybody to such high levels of certainty around the many decisions that would have to be made. So, to complement the Adopt-and-Go approach the teams also developed a Launch-and-Learn mentality, a way of taking action that was “fast and good enough.”

Launch the Moose. Bowick also spoke about some of the more delicate and complex challenges involved in getting teams drawn from employees from two very different companies to work together to do a hard job. Along with approaches such as Adopt-and-Go and Launch-and-Learn, she discussed another hallmark of the HP-Compaq integration called “Launch the Moose” to help the company deal better with conflict. She explained:

> It only took us probably two meetings until we started having problems around differences of opinion over how to approach conflict. We had to get the clean room team unstuck fast, and move on as one team. But I would say we didn’t waste more than two or three weeks before we had a culture discussion with the Clean Team and developed a plan we called “Launch the Moose” in which differences were put on the table and we decided how were we going to deal with them. This really helped us move.

Watch out for Icebergs. Bowick pointed out that as with icebergs, where so much of their (potentially dangerous) mass is beneath the surface of the water, hidden from view, many of the

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22 All quotes from Susan Bowick are from the authors’ interview on August 29, 2003, unless otherwise cited. Subsequent quotes from this interview will not be cited.
problems that could sink a merger were not visible from the surface where issues like financials and strategy and product decisions attracted so much public attention. For Bowick, issues such as leadership, governance, retention, and communications, to name a few, were not highly visible to outside observers, but had to be handled well if the merger were to succeed. *(Exhibit 4)* Bowick said:

> You have to deal with the social engineering. Some of us have spent 30 to 40 percent of our time acting as an ambassador, interacting with people with very strong opinions. We were shifting the power structure under them, which had them in backup modes. I would say Jeff, Webb and I were the three that really became ambassadors to work the issues within the power structure. Both companies were still running independently [during the integration period], but we had defined the endpoint for the governance structure of the combined company. People were experiencing loss and resisting it, which can lead to undermining and second-guessing the changes. We had a lot of that; it is typical human dynamics. Some of those troubles are a normal part of two companies becoming one company. But we also had to actively get those moose on the table and work them. This was something Carly was very good at doing.

To help speed the cultural integration of the two companies, HP included a Cultural Integration Team (CIT) within the overall Clean Team. The CIT launched “Fast Start,” a program of merger integration workshops led by facilitators and held at the level of individual employee teams, designed to help employees get to know each other, understand and align themselves with the company’s strategy and identify and deal with “hot spots”—likely sources of contention that employees would face as HP got down to the job of integrating Compaq and HP together. Every HP employee was required to attend a Fast Start workshop. One product of the Fast Start effort was the “Fast Value” program, one-to two-day focused sessions designed to help employees learn to work horizontally across the post-merger HP.23

**Naming the team.** The difficult job of selecting which executives from HP or Compaq would assume the top jobs at the combined company fell to the integration team. They accomplished the task and announced the names before the merger became official. In April 2002, a month before the merger took effect, HP released the names of the 150 senior managers who would lead the combined organization around the world—assuming the merger became official. These were the senior managers who would fill key positions in HP’s four business groups and the company’s global corporate functions. Along with quick decisions about who would occupy important positions at the merged company, pre-merger HP and pre-merger Compaq also offered retention bonuses to selected employees in order to help the integration effort. Pre-merger HP’s retention bonuses extended from executive officers to managers and some rank-and-file employees. In all, pre-merger HP and pre-merger Compaq awarded retention bonuses to about 8,200 employees, with executives accounting for only 10 percent of this total. Around 95 percent of the employees offered retention bonuses stayed.24

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23 Source: “Off and Running,” HP internal communication posted on October 18, 2002.
24 Source: HP.
In late November 2003, Susan Bowick announced that she would retire from HP at the end of the year. Her position was filled by Marcela Perez de Alonso, Executive Vice President, Human Resources. Prior to coming to HP, Perez de Alonso had been a long-time executive at Citigroup, where she held senior-level roles in both operations and human resources.

Meeting with the Steering Committee

While the Clean Team operated in metaphorically clean rooms apart from the day-to-day distractions of operating a company, they were closely linked to the Steering Committee. Fiorina had limited the Steering Committee to a small group of senior executives who could rapidly make decisions and have those decisions be completely unquestioned during execution. The committee consisted of Carly Fiorina, Webb McKinney, Jeff Clarke, Susan Bowick, Bob Wayman, and Bob Napier, the chief information officer.25 (Exhibit 5)

Clarke described the day-to-day process the Clean Team used and its interactions with the Steering Committee:

> Each Monday, the teams would go through a very rigorous process with the merger integration program office, (reporting to Webb and me). We would track the status of each project. We used the color codes red, green, yellow, just like a stoplight. Items on track were marked with yellow, items that were finished or well ahead of plan were marked green, and items that were falling behind or otherwise failing were marked red. Since we had to track over 10,000 Adopt-and-Go decisions, the simplicity and rigor of that red, green, yellow tracking process was critical.

> On Tuesdays, teams prepared for an all-day Wednesday integration meeting that Webb and I chaired. During these meetings, teams made recommendations about integration decisions. Webb and I would consider the recommendations and often sent them back to the teams for more work. Members of the teams would sometimes debate and come to a consensus recommendation, or a consensus position of agreeing to disagree. Webb and I then made the Adopt-and-Go decision.

> On Thursdays, Carly held her half-day Steering Committee meeting. Webb and I were on the agendas for these meetings; we would present or bring others in to present and make recommendations about important status items of the merger and different decisions, such as the merger product roadmaps, management decisions, restructuring plans, consolidation plans, etc.

Profile of an Integration Challenge: IT

A critical area to get right from day one, especially for a computer technology company, was that of IT integration issues. Cobblers’ children may have the worst shoes, but there is no way that

HP could afford to bungle this aspect of its integration. Within the Clean Team, two managers, one from Compaq and the other from HP, led this work. From the HP side, Pete Karolczak, former CIO of HP’s Consumer Business, managed IT integration. Karolczak spoke of the importance of IT to companies today: “IT has become so much part of the fabric of a company, it is not a tool, it is as heavy as the supply chain, as physical as the sites in which we sit.”

The efforts to integrate HP’s and Compaq’s IT assets, including critical networking and Web functions touched on all aspects of the companies. A close examination of this integration shows a microcosm of the entire integration challenge. Karolczak explained how they tackled the IT integration.

Within the clean room, we had the challenge to put ourselves in the place of a customer, put ourselves in the place of an employee, a sales rep, put ourselves in the place of someone in the operations somewhere in, say, China looking forward to day one. What are you going to want to do? You are going to want to collaborate, you’re going to want to start talking to other employees. If you’re a manager, you’re going to want to walk into every building independent of the pre-merger heritage and be immediately recognized and productive when you plug in.

As a customer you’re going to expect to go to compaq.com and see hp.com. As an analyst, you’re going to expect to see an integrated set of books. As an employee you’re going to expect to see an integrated HR or view to the customer.

In a merger, networking is also your biggest anchor. When you think about IT, the easiest way to look at it, and one of the first things we did in terms of the integration, was divide it into domains. You can manage domains. So the most obvious split is you divide infrastructure from applications. Take product orders for example. You start moving back to how every single order, be it an electronic order, a physical order, or an Internet order is handled in process. How every single order is fulfilled across every product category in every country in which we do business, to retail channels, commercial channels, and to direct partners. How every single part is bought and how every single customer and product and financial asset is actually managed in the company.

In the application space, you have such tremendous complexity. Very highly integrated value chain across both companies; from the traditional supply chain to your management, what we would call your quote to cash or customer to cash ecosystem, your financial backbones. Add to this all of your decision support systems and everything else that supports it.

When you get to infrastructure, it gets extremely interesting because it is every PC, every server, every data center, every piece of wire under every building, every phone, every phone number. It is every voice mailbox. It is every address and e-mail, every e-mail box. It starts to become quite significant.

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26 All quotes from Peter Karolczak are from the authors’ interview on October 1, 2003. Subsequent quotes from this interview will not be cited.
The team had to look beyond integration issues to consider what made sense for customers. For example, Karolczak discussed decisions made around the Compaq customer Web site.

If customers and even employees went to compaq.com and it stayed compaq.com, perhaps they wouldn’t have expected otherwise, but they would have been disappointed. So we knew we had to do some connection. On the other hand, again, the subtlety of day one management was that if you were a 20-year Compaq customer and you suddenly went to compaq.com and you didn’t recognize anything that would be a dissatisfier. So total integration was actually not the objective. Near integration was the objective; a presence and consistency, a sign that said ‘we are one.’

Other challenges were more tangible. Karolczak explained:

Customers would like to shop at hp.com and have at least some connection into the corresponding Compaq online stores. For instance, many customers would probably literally within the first week expect us to send one bill and have us deal with the complexity of having the remittance go to the right place. So you have to start doing a lot to meet the needs of that customer.

The world was watching. We had to challenge ourselves in terms of we weren’t going for a B+. One of the toughest decisions you make as a manager is what are the marching orders you give to your people. I was present and involved during the Agilent split. We had a very aggressive day one spin-off date and the marching orders for me were very explicit: Good enough is good enough. Explicit direction helps people. For this merger, our marching orders were get an A+, no mistakes. If you can’t guarantee me an A+, drop out of the class. Either pull out yourself and/or tell me the scope needs to be smaller, but that which you sign up for can have no errors. We did not sign up for things that were impossible to get an A+ and it was hard enough to do that which we did sign up for.

For employee issues, I divided my list into two areas; things that absolutely needed to be done in order to enable fundamental productivity and cultural issues. Those were easy to define. You needed to at least interconnect the networks. So that application teams could start sharing files, so that finance teams could start collaborating on planning, so on and so forth. You also need to at least enable an interconnection of the e-mail backbone, so people can start collaborating. All e-mail came from HP on day one. Just doing that could have been sufficient. But it is not as productive as, for instance, completely integrating the enterprise directory so that when I look for names I see now the entire combined population. Which we did.

We also considered the cultural implications of our choices and actions. The vast majority of our employees were either afraid or just nervous about the merger. So many of them knew that this was probably a very important thing to do with the
company. From a personal perspective, only the naive are completely unafraid. It is intimidating. They know that it’s going to be hard. It’s very straining. You have a new manager, potentially. Perhaps you’ll be the only HP person in a sea of Compaq or vice versa. Employees in both companies were very nervous, even though I think the majority was absolutely in favor of biting the bullet and making it happen.

We studied a lot of mergers, again from a cultural, as well as from a productivity perspective, and one of the things that we saw in pre-merger Compaq from both the Digital and Tandem acquisitions were what I fondly call “gang colors” or “badges of honor.” Six years after an acquisition, people still proudly displayed their old heritage badge. So we made badges and signage a priority. We made other statements too, such as total alignment on e-mail addresses, full alignment on the enterprise directory so you could now search for everybody. A lot of the feedback we got from employees was very positive on things like that. These things do not fundamentally affect productivity, but they are as important as actual operational functions.

Effectiveness of the Integration Effort

An accomplishment that HP executives are particularly proud of is the fact that the company was ready to operate as one from the first day the merger took effect. Product lines were selected or dumped, corporate systems were operational, signs were changed, e-mail was set up, badges were issued, all of the things, big and small, that had to change were accomplished by day one. The only exceptions were tasks that could not, under local statutes, be changed so quickly, such as job cuts in countries that required long lead times to employment reductions.

Looking Back in 2004

The company’s top and senior executives seemed to feel that the organizational integration of HP and Compaq had been a success. Chris Morgan, vice president and in charge of worldwide marketing for the Imaging and Printing Group, said:

When the merger happened, we were very quickly able to integrate the Compaq assets in the consumer space. For example, there were the new distribution channels, like Radio Shack, where Compaq had a very strong presence. Within a few weeks after the merger date we were already operational with all the accounts. All our retailers and consumer partners knew the new HP structure, they knew the product roadmap. So we were able to pretty quickly get the consumer strategy operationalized and integrated. And that helped an awful lot because it minimized disruptions, and if you look at the business results, the consumer business has stayed strong.

General Counsel Ann Baskins described a personal experience indicating the success of the integration effort:
There was a meeting in February (2003) in London with some 12 to 14 lawyers—pretty senior attorneys—country counsel, regional counsel, and two of my deputy GCs, and we were going over an organizational issue. A very intense meeting, but a very good one because people didn’t pull punches. They were putting all the issues on the table and discussed (for instance) what would work in Germany that might not work in Holland. At one point … what really occurred to me was that the “merger” was over. Because you could not tell who was pre-merger from this or that company. It was a whole group of people trying to do the right thing for HP—trying to make sure that the local issues that they were facing were on the table, and it just had nothing to do with where you came from.

Voice of the Workforce

In the spring of 2003, HP conducted a survey of its entire workforce. More than 93,500 employees, 68 percent of the total responded. The survey gave employees a chance to tell HP’s leaders how well they, the employees, thought the company had been doing along thirteen dimensions. The company got unmistakable feedback from its workforce. Workers thought that HP was above the industry norm in seven categories, at industry norm in two categories and below industry norm in four categories. (Exhibit 6) HP’s leaders were encouraged by the results of the survey. Susan Bowick said in an interview, “It was a really pleasant surprise. We had no idea what we were going to hear back, and it’s fairly risky to tell everybody that you’re going to get to weigh in on how we did and what else we need work on.”

In a follow up survey conducted in March 2004, even more employees, this time 77 percent, responded. According to Fiorina, the 2004 survey revealed that “most employees now understand the companywide strategy and can support HP’s image in the marketplace—our focus on this area in the past year resulted in large improvements.” On the other hand, Fiorina said, “there are areas that require our focused attention” including “empowerment of managers and employees” and “simplification of systems and processes.”

The External View: Customer Perspectives

Doug Moore, senior VP of Operations and former senior merchandiser, responsible for buying printers and scanners, for Circuit City, a consumer electronics retailer with over $10 billion in annual sales, described his experience with HP over the years:

My sense is that the merger complemented the companies. Compaq had the ability to make decisions on the fly, while HP was good at planning. They seem to have retained the best of both cultures, while making the change seamless to us customers.

We experienced the merger through the eyes of a small number of HP and Compaq people we worked with on a day-to-day basis. There were times when

27 Source of Bowick quote is an internal HP communication.
these people were uncertain about the outcomes of the merger, how it would affect their respective jobs, but they were always positive about the merger.

The merger affected us directly. Still, by 2002, there has been little change in the nature of the debate and wrestling that takes place with the merged HP and Circuit City.

One important early victory for the new HP was its 10-year, $3 billion contract to provide IT services to the global consumer products company, Procter & Gamble (P&G). P&G looked closely at partnering with several different companies, including EDS and IBM, but selected HP. Linda Clement-Holmes, General Manager, Global Business Services, IT Infrastructure and Governance for P&G said the company evaluated candidates on the basis of capability/quality, cost and culture. With the capabilities of EDS and IBM well known, it seemed that the deciding factors in this decision came down to cost and culture. Clement-Holmes said, “We were comfortable doing business with HP. They appear on many of the same lists as we do, in terms of being among the best companies to work for. Since we were transferring 2,000 IT employees to them and since we had to work with them for the next 10 years, that was important to us.”

Clement-Holmes likened the relationship to a marriage. She said P&G and HP were now “back from the honeymoon and settling in to living with each other. As in a marriage, from time to time, we find out things about the other that come from living together, things that are the equivalent of one spouse squeezing the toothpaste from the center of the tube.” Clement-Holmes ran an organization at P&G that worked to resolve any such issues that arose. Each member of this organization had a counterpart at HP. For example, Clement-Holmes worked closely with Dave Middleton, the global P&G account representative at HP as well as with Dan Talbott, the HP sales executive who ran the negotiation with P&G. Within the first year of the contract, most issues were resolved before they reached these three. Any issues these three could not resolve went to the president of P&G Global Business Services and Ann Livermore, head of HP Services. Only a few have been elevated to this level. In March 2004, HP and P&G announced that they were expanding the contract to include P&G’s global account payable operations.

HP received very high scores from customers for responsiveness during the merger integration and in the time that followed. Something even less tangible than responsiveness, but perhaps even more important for HP was inventiveness. By most accounts, HP had long been a technology leader, on the forefront of technology with its R&D. Did this capacity survive the merger? Some customers believed that if anything, HP was even more innovative and better at getting its innovations to market. However, other customers thought that HP’s legacy of breakthrough innovation had been de-emphasized after the merger.

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31 For more on this issue, see Robert A. Burgelman and Philip E. Meza, “The New New HP (A): Leading Strategic Integration,” SM-125A, Stanford Graduate School of Business.
LASTING ORGANIZATIONAL CHANGE CAPABILITIES

With the integration well under way, Clarke and McKinney went in different directions. Clarke went on to oversee HP’s global supply chains. McKinney was tasked with finding and driving new capabilities that stemmed from the integration and resulting organization. One lasting capability the company developed was change management.

For much of his last year with HP, McKinney was in charge of the Program Management Office (PMO), a small group of executives helping to drive changes associated with the merger. The PMO reported directly to the Steering Committee. Said McKinney: “We certainly learned that there is a big difference between just sort of sending a note out saying we’ve decided to do this and having dedicated teams really focused on making sure the change is managed well.”

McKinney next led the strategic change and global excellence office. The team focused on developing and disseminating operational excellence particularly in the areas of global citizenship, organizational effectiveness, emerging market strategies and internal communications at HP around the world.

This new capability was not planned in the clean room, or the executive suite, but rather emerged in the wake of the integration effort. McKinney recalled:

Initially, we just pulled this team together in order to plan and drive this integration. Our aim was just to get it done. But our success made us realize that we had figured out how to change across a large complex company. We got about six or nine months into this and Carly and I had a discussion and she said, you know, I think we’re on to something here, let’s keep driving forward. We realized that we needed to keep this capability because the merger is not the end of the journey, it’s only the beginning of the latest chapter.

McKinney ran a staff of fewer than 10 employees whose role it was to examine and improve organizational effectiveness across the entire expanded company. The team worked with both group managers and functional managers in the field. McKinney explained:

We have worldwide governance around finance, HR and IT, so we have to make sure this whole model is working out. And right from the beginning, even back in the planning phases, I’ve tried to focus mainly on the intersections between the organizations. Most of what my team is doing now is not completing a merger, but driving on new corporate-wide initiatives. And we clearly are still doing some system work and some organizational tuning and that sort of thing, but the vast majority of what the team is working on now is how do we continue to drive forward to achieve potential.

32 In November 2003, HP announced the sudden resignation of Clarke, effective immediately. HP declined to discuss details, but said Clarke’s resignation was “mutually agreed to and appropriate.” Press reports said that Clarke left because he had wanted the CFO position, quoting Clarke as saying, “That was the job I wanted and that position was unavailable.” Source: Scott Morrison, “Hewlett-Packard Executive Makes a Sudden Departure,” Financial Times, November 26, 2003, p. 17.
This task required a unique set of skills. McKinney was a respected and longtime veteran of HP, but in his new role he would have to work with other executives to help them fix or otherwise alter processes and programs that they might not want changed. McKinney discussed the leadership challenge his new role presented:

> It’s been somewhat humbling, I have to tell you, because I’ve spent my whole career as a line manager in the company; but now there aren’t many people I can tell what to do. I can always just say do it because Carly said so, but you know how well that works. So you can’t use position power. I mean it’s there because people know I report to Carly, but it’s fundamentally all about influencing and in many ways it’s a harder leadership role than getting a bunch of people together who work for you and have to listen to you.

So, it really comes down to your ability to build trust and confidence and work the issues and be objective. I have to work very hard to be neutral—I mean I obviously have opinions, but I try to work very hard to make sure the right thing is happening for the company and not have it be like a personal agenda. That’s not going to work. So it’s been a genuine learning experience. I continue to learn.

McKinney and his team also took the lead in evaluating pan-HP strategic initiatives for the company, such as the company’s strategy for getting further involved in the challenging but potentially lucrative markets in China. McKinney said: “That market is absolutely critical. We felt we have been too fragmented. We showed up too much as four product groups and not one company. [My team has] somewhat umpired who is leading the China team and Asia/Pacific team, and making sure the right issues get in front of the Executive Council.”

McKinney used the example of China to describe the complicated balance that he maintains with other executives:

> The China manager doesn’t work for me. But I have someone I’ve hired at the VP level who is very experienced in Asia, [and] who is now working with those teams. My greatest fear in taking this job was that it would be hard to get the support I’d need from other executives. I have known some of these executives for a long time, some I haven’t known nearly as long. Obviously, in my kind of role, if you don’t have the support of the people on the team it’s hard to get anything done. But I have to say it’s been fantastic. I’ve found the team is really very appreciative and they see the value-add and it’s working well.

In November 2003, HP announced that McKinney would retire from HP at the end of the year. Upon McKinney’s departure, the change management team was moved under the direction of Shane Robison, the CTO. Robison also managed corporate mergers and acquisition and the overall strategy process, thus aligning strategy and execution (change management).

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33 A group of HP senior executives that works with HP’s chairman and CEO Carly Fiorina to set strategy for the company.
CONCLUSION

In May 2004, two years after the deal was announced, the integration of HP and Compaq had been far more successful than anybody—outside of the Clean Team and HP Executive Council—would have predicted. The strategic way in which the potential benefits of the acquisition were analyzed, the planning and execution of the integration under difficult and uncertain conditions, and the novel approaches developed to integrate two very large organizations with somewhat different cultures held important lessons for those considering similar “bet-the-company” moves. It seemed important to capture these lessons and to identify and build on the new capabilities for managing large change that the acquisition integration had generated, especially since several of the key architects of the integration effort, including Bowick, Clarke and McKinney had departed the company by the end of 2003.

Going forward, however, the success of the merger would not be measured simply by HP and Compaq’s ability to effectively integrate their two organizations, or even to cut operating costs by several billion dollars. Rather the success would depend upon the integrated company’s ability to grow profitably—and do so even faster—in the future. This, in turn, could only happen if the two companies could pursue a more powerful corporate strategy by being better together. With the enormous changes in the information technology and related industries continuing unabated in 2004, HP would unavoidably have to meet that test within the next several years.
**Exhibit 1**

**HP Selected Financial Data**

**1999-2003**

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<th>2001</th>
<th>2000</th>
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<td>72,848</td>
<td>45,226</td>
<td>48,870</td>
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<tr>
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<td>4,540</td>
<td>3,139</td>
<td>1,439</td>
<td>4,025</td>
<td>3,618</td>
</tr>
<tr>
<td><strong>Net earnings</strong></td>
<td>3,557</td>
<td>2,409</td>
<td>630</td>
<td>3,564</td>
<td>3,164</td>
</tr>
</tbody>
</table>

*Note: Combined company results for 2002 and 2003.*

**Segment Information**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>HP Enterprise Storage and Servers</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Net revenue</strong></td>
<td>14,083</td>
<td>15,307</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td><strong>Earnings (loss) from operations</strong></td>
<td>142</td>
<td>(313)</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
</tr>
</tbody>
</table>

| HP Services                          |      |      |      |      |      |
| **Net revenue**                      | 12,367 | 12,368 | NA | NA | NA |
| **Earnings (loss) from operations**  | 1,362 | 1,270 | NA | NA | NA |

| HP Software                          |      |      |      |      |      |
| **Net revenue**                      | 774 | 817 | NA | NA | NA |
| **Earnings (loss) from operations**  | (190) | (349) | NA | NA | NA |

| HP Personal Systems Group            |      |      |      |      |      |
| **Net revenue**                      | 21,210 | 21,960 | NA | NA | NA |
| **Earnings (loss) from operations**  | 22 | (367) | NA | NA | NA |

| HP Imaging and Printing Group        |      |      |      |      |      |
| **Net revenue**                      | 22,623 | 20,447 | 19,447 | 20,468 | 16,050 |
| **Earnings (loss) from operations**  | 3,570 | 3,345 | 1,987 | 2,666 | 2,364 |

| HP Financial Services                |      |      |      |      |      |
| **Net revenue**                      | 1,301 | 2,068 | NA | NA | NA |
| **Earnings (loss) from operations**  | 75 | (128) | NA | NA | NA |

*Note: HP 2000 and 2001 actual reports used.*

HP's segment classification began in 2002, only segment data for Imaging and Printing is consistently available prior to 2002. HP attributed the decline in net revenue and earnings from operations in Imaging and Printing in 2001 to a host of reasons including lower average selling prices and generally difficult market conditions.
Exhibit 1 (continued)
Compaq Selected Financial Data
1998-2001

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>(in $ millions)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>STATEMENT OF INCOME</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenue:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Products</td>
<td>26,726</td>
<td>36,506</td>
<td>31,824</td>
<td>27,372</td>
</tr>
<tr>
<td>Services</td>
<td>6,526</td>
<td>6,716</td>
<td>6,623</td>
<td>3,797</td>
</tr>
<tr>
<td>Total revenue</td>
<td>33,252</td>
<td>43,222</td>
<td>38,447</td>
<td>31,169</td>
</tr>
<tr>
<td>Cost of sales:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Products</td>
<td>21,536</td>
<td>27,624</td>
<td>25,366</td>
<td>21,383</td>
</tr>
<tr>
<td>Services</td>
<td>4,506</td>
<td>4,793</td>
<td>4,635</td>
<td>2,697</td>
</tr>
<tr>
<td>Total cost of sales</td>
<td>26,042</td>
<td>32,417</td>
<td>29,990</td>
<td>24,080</td>
</tr>
<tr>
<td>Selling, general and administrative expense</td>
<td>6,328</td>
<td>6,044</td>
<td>6,341</td>
<td>4,878</td>
</tr>
<tr>
<td>Research and development</td>
<td>1,305</td>
<td>1,469</td>
<td>1,880</td>
<td>1,353</td>
</tr>
<tr>
<td>Restructuring and related activities</td>
<td>742</td>
<td>(166)</td>
<td>666</td>
<td>393</td>
</tr>
<tr>
<td>Merger-related costs</td>
<td>44</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Purchased in-process technology</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>3,186</td>
</tr>
<tr>
<td>Other (income) expense, net</td>
<td>466</td>
<td>1,503</td>
<td>(1,154)</td>
<td>(63)</td>
</tr>
<tr>
<td><strong>Income (loss) before income taxes</strong></td>
<td>(773)</td>
<td>675</td>
<td>534</td>
<td>(2,662)</td>
</tr>
<tr>
<td><strong>Provision (benefit) for income taxes</strong></td>
<td>(210)</td>
<td>280</td>
<td>365</td>
<td>81</td>
</tr>
<tr>
<td><strong>Income (loss) before cumulative effect of accounting change</strong></td>
<td>(563)</td>
<td>595</td>
<td>569</td>
<td>(2,743)</td>
</tr>
<tr>
<td><strong>Cumulative effect of accounting change, net of tax</strong></td>
<td>(222)</td>
<td>(28)</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td><strong>Net income (loss)</strong></td>
<td>(785)</td>
<td>569</td>
<td>569</td>
<td>(2,743)</td>
</tr>
</tbody>
</table>

**Segment Information**

<table>
<thead>
<tr>
<th>(in $ millions)</th>
<th>2001</th>
<th>2000</th>
<th>1999</th>
</tr>
</thead>
<tbody>
<tr>
<td>ENTERPRISE COMPUTING</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenue</td>
<td>10,699</td>
<td>14,253</td>
<td>12,947</td>
</tr>
<tr>
<td>Operating income</td>
<td>163</td>
<td>1,666</td>
<td>674</td>
</tr>
<tr>
<td>ACCESS</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenue</td>
<td>15,193</td>
<td>20,624</td>
<td>18,128</td>
</tr>
<tr>
<td>Operating income (loss)</td>
<td>(587)</td>
<td>145</td>
<td>(437)</td>
</tr>
<tr>
<td>COMPAG GLOBAL SERVICES</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenue</td>
<td>7,789</td>
<td>7,483</td>
<td>7,413</td>
</tr>
<tr>
<td>Operating income</td>
<td>1,062</td>
<td>884</td>
<td>998</td>
</tr>
<tr>
<td>SEGMENT ELIMINATIONS AND OTHER</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenue</td>
<td>(127)</td>
<td>(136)</td>
<td>(41)</td>
</tr>
<tr>
<td>Operating income (loss)</td>
<td>1</td>
<td>(43)</td>
<td>(28)</td>
</tr>
<tr>
<td>CONSOLIDATED SEGMENT TOTALS</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenue</td>
<td>33,564</td>
<td>42,222</td>
<td>38,147</td>
</tr>
<tr>
<td>Operating income</td>
<td>639</td>
<td>2,642</td>
<td>546</td>
</tr>
</tbody>
</table>

Note: Most of the drop in revenue in 2001 was attributable to the Enterprise Computing (e.g. servers, storage etc.) and Access (e.g., notebook and desktop PCs, etc.) segments. Some subsegments suffered double-digit declines in revenue for the year.

Exhibit 1 (continued)
Position of HP and Compaq in Selected Personal Computer Services Markets

<table>
<thead>
<tr>
<th>INFORMATION TECHNOLOGY SERVICES</th>
<th>PERSONAL COMPUTER</th>
<th>SERVERS</th>
<th>PRINTERS</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>RANK</th>
<th>MARKET SHARE</th>
<th>RANK</th>
<th>MARKET SHARE</th>
<th>RANK</th>
<th>MARKET SHARE</th>
<th>RANK</th>
<th>MARKET SHARE</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>I.B.M.</td>
<td>5.0%</td>
<td>1. Dell</td>
<td>14.1%</td>
<td>1. I.B.M.</td>
<td>26.5%</td>
<td>1. Hewlett-Packard</td>
</tr>
<tr>
<td>2.</td>
<td>E.D.S.</td>
<td>2.9</td>
<td>2. Compaq</td>
<td>11.3</td>
<td>2. Sun Microsystems</td>
<td>16.7</td>
<td>2. Epson</td>
</tr>
<tr>
<td>5.</td>
<td>Accenture</td>
<td>1.5</td>
<td>5. NEC</td>
<td>5.0</td>
<td>5. Dell</td>
<td>6.8</td>
<td>5. Lexmark</td>
</tr>
<tr>
<td>6.</td>
<td>Hewlett-Packard</td>
<td>1.1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7.</td>
<td>Compaq</td>
<td>1.0</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

1Full-year market size estimate based on revenue for first half of 2001; market share for first half of 2001
2Full-year market size estimate based on revenue for first quarter of 2001; market share for first quarter of 2001

Source: Gartner Dataquest
Exhibit 2
Estimated Change in Portfolio and Revenue Mix in 2001
Resulting From Merger
(Data cited by Walter Hewlett in opposition to merger)

Notes:
1 Based on Morgan Stanley research dated 10/2/01
2 Banc of America Securities research dated 10/11/01
3 Before potential revenue losses

Source: Report to Trustees of the William R. Hewlett Revocable Trust on the Proposed Merger of Hewlett-Packard and Compaq
**Exhibit 2 (continued)**

**Estimated Effect of Merger on Operating Margins of Combined Company**
(Data cited by HP in support of merger)

<table>
<thead>
<tr>
<th></th>
<th>Enterprise Operating Margins (1,2)</th>
<th>Access Operating Margins (1,2)</th>
<th>Services Operating Margins (1,2)</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2001</td>
<td>-3.2%</td>
<td>-4.2%</td>
<td>4.50%</td>
</tr>
<tr>
<td>HP Standalone</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>FY2003</td>
<td>9.2%</td>
<td>3.0%</td>
<td>13.7%</td>
</tr>
<tr>
<td>New HP (Pro Forma)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Notes:**
1. FY01 EBIT numbers represent HP published segments, adjusted for reclassifications modeled between segments (Business & Home PCs and Workstations to Access from CS/Enterprise, Verifone to other). Segment data is pro forma, excluding acquisition-related charges and assuming profit-sharing and bonuses at modeled levels for FY01 plan. Also excludes eliminations and other.
2. Segment revenues and operating income per management estimates as of 12/5/01 and exclude eliminations/other. Pro forma FY03E financials adjusted for management projected pre-tax synergies of $2.054mm, revenue loss of 5% of overall revenue and 12% contribution margin on lost revenues. For additional detail, please see page 27.

Source: HP management report to trustee / HP Position on Compaq Merger
Exhibit 3
Pre-Merger Projections of Post-Merger Operation Results

Estimated 2004 Revenues Implied by HP Pre-Merger Proxy Material by Segment

<table>
<thead>
<tr>
<th>HP Segment</th>
<th>HP Estimated Market Growth Rate between 2000-2004 (AGR) i</th>
<th>Implied HPQ Projected 2004 Revenue ii ($M)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Enterprise</td>
<td>12%</td>
<td>26,826</td>
</tr>
<tr>
<td>PCs</td>
<td>8%</td>
<td>35,559</td>
</tr>
<tr>
<td>Services</td>
<td>12%</td>
<td>19,546</td>
</tr>
<tr>
<td>Imaging and Printing</td>
<td>10%</td>
<td>25,856</td>
</tr>
</tbody>
</table>

Estimated 2004 Operating Margins Projected by HP Pre-Merger Proxy Material

<table>
<thead>
<tr>
<th>HP Segment</th>
<th>Operating Profit Margin (Pre-merger estimate) iii</th>
</tr>
</thead>
<tbody>
<tr>
<td>Enterprise</td>
<td>9.2%</td>
</tr>
<tr>
<td>PCs</td>
<td>3.0%</td>
</tr>
<tr>
<td>Services</td>
<td>13.7%</td>
</tr>
</tbody>
</table>

Note: HP did not estimate a post-merger operating profit figure for the Imaging and Printing segment.

Estimated 2004 Earnings Projected by HP Pre-Merger Proxy Material

<table>
<thead>
<tr>
<th>HP Segment</th>
<th>2004 Projected Operating Earnings iv ($M)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Enterprise</td>
<td>2,468</td>
</tr>
<tr>
<td>PCs</td>
<td>1,068</td>
</tr>
<tr>
<td>Services</td>
<td>2,678</td>
</tr>
<tr>
<td>Imaging and Printing</td>
<td>2,482</td>
</tr>
</tbody>
</table>

Notes for above:

i Source of HP’s pre-merger growth estimates is “HP Position on Compaq Merger,” HP, December 19, 2001, p. 10. Annualized growth rate is used here.

ii HP projected 2004 earnings are comprised of:

- revenue calculated by applying market growth estimates to 2001 actual earnings.

iii HP Position on Compaq Merger, p.7.

iv At the time pre-merger estimates were made, HP’s Enterprise group included software. The software segment has since been spun out of the Enterprise group. Software is a money-losing segment for HP; in 2004 HP earned $922 million in the segment, but reported a loss from operations of $(145) million in the segment.

v 2004 Projected Operating Earnings Calculation: estimated profit margin X implied HP 2004 projected revenue. For example, HP estimated that the enterprise segment would earn profit margin of 9.2%, and generate revenue (implied 2004 revenue) of $26,826 million, giving projected earnings of $2,468 million.
Exhibit 4
Navigating Icebergs

Source: HP
Exhibit 5
Merger Integration Team Organization Chart

steering committee

post merger integration (PMI) team
PMI team

central program management office (cPMO)
nerve center
fasttrack center

program teams
PMO PMO PMO PMO PMO PMO PMO

project teams

Source: HP
Exhibit 6  
Voice of the Workforce Survey—2003

Four categories of employee responses are significantly below the external benchmark comparison group. Seven categories of employee responses are significantly above the external benchmark comparison group.

<table>
<thead>
<tr>
<th>Degree of importance as it relates to employee commitment</th>
<th>Total HP compared to industry norms</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Critical</td>
<td>Significantly below</td>
<td>Similar</td>
</tr>
<tr>
<td>• Company strategy</td>
<td>• Employee commitment</td>
<td>• Productivity</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Business strategy</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Internal communication</td>
</tr>
<tr>
<td>Strong</td>
<td>• Workload management</td>
<td>• Performance standards</td>
</tr>
<tr>
<td>• Performance strengths</td>
<td></td>
<td>• Strong leadership</td>
</tr>
<tr>
<td>Moderate</td>
<td>• Total Customer Experience</td>
<td>• Fair/ accurate performance feedback</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Team productivity</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Risk taking</td>
</tr>
</tbody>
</table>

Note: 67.5% survey response rate (93,535 employees); less than 1% data error deviation. Total HP results compared against the Information Technology Survey Group or the normative data base provided by Genesee Survey Services, Inc.

Source: HP