

## hewlett-packard's \$19B acquisition of compaq

SUCCESSFULLY INTEGRATING THE WORLD'S LARGEST TECHNOLOGY MERGER AGAINST THE ODDS

Throughout the fourth quarter of 2001, the "New Economy" driven by dot.com and established technology companies was unraveling. Corporate customers stopped buying software, data networks, servers and other hardware. The blind spending of the late 90's came to a screeching halt as CIOs and their staffs reigned in non-essential spending.

### HEWLETT-PACKARD SITUATION

Amidst this backdrop, Hewlett-Packard, the second largest computer company behind IBM with revenues of \$45 billion, saw its share price plummet from a split-adjusted \$68 a share in mid-2000 to \$30 by the end of 2001. Beleaguered by a slew of challenges – the technology slump, poor financial performance, a dismally executed round of layoffs in a bid to cut costs by \$500 million a year, management bureaucracy, and a company culture that entitled every employee to second-guess decisions – Carly Fiorina, the HP board, and their advisors considered their options. Of four distinct strategic possibilities, HP became convinced that a portfolio-based consolidation strategy yielding market leadership in all industries in which it competed was the way to go.

### COMPAQ COMPUTER CORPORATION SITUATION

At the time, Compaq was the third largest computer company, behind IBM and HP, with revenue of \$42 billion in fiscal 2001. A dominant manufacturer of personal computers, Compaq had acquired Tandem Computers and Digital Equipment in the late 90's in a bid to more successfully compete with IBM. Integration efforts for both acquisitions were failing to achieve targets, and as the dot.com bubble burst, share price plummeted to \$20, nearly 60% below its all-time high. Michael Capellas and the Compaq board quietly analyzed partnership options, and of all the pairings examined, an HP-Compaq alliance seemed most promising. Licensing technology from HP was viewed as a starting point for discussions.

### THE LARGEST TECHNOLOGY MERGER IN HISTORY

As talks between senior executives of the two companies progressed, the logic of a business merger became clear. On September 4th, 2001, the largest technology merger ever proposed was announced. High technology is a 'winner-takes-all' industry. Carly, Michael, and their boards were betting that the merged company would be the world's dominant IT company, leading in all segments in which it competed. Simply becoming a larger version of the two struggling, sickly organizations was not an option.



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### Robert Burgelman

Edmund W. Littlefield Professor of Management at the Stanford Graduate School of Business, quoted in Business Wire July 16, 2007

## CHALLENGE

**Build and implement an integration plan to merge the two technology giants – while convincing shareholders not to kill the deal – and deliver business results after the vote.**

### NEGATIVE STAKEHOLDER REACTION TO THE DEAL

Soon after the merger announcement, analysts, partners, customers, executives and even board members went on record against the proposed merger. Employees feared the end of the “HP Way” and massive layoffs. Investors, board members and many company executives worried that the merger would dilute the value of HP’s world-class printing and imaging business, increasing exposure to low-margin, commodity PCs. Few stakeholders felt HP had the competence to plan and implement a near-seamless integration across all business operations and product lines that would be necessary to successfully consolidate the two giants.

“In 2001, when Hewlett-Packard’s then-CEO Carly Fiorina announced that the technology giant proposed to merge with Compaq Computer Corporation, she set off a firestorm of controversy. Michael Dell, CEO of rival Dell Computer, famously called it ‘the dumbest deal of the decade,’ and Walter Hewlett, the son of the company’s founders, mounted an aggressive proxy fight to prevent the corporate marriage from being consummated.”<sup>1</sup>

Robert Wayman, HP’s CFO, was similarly skeptical:

“I assumed we’d study it for two weeks and move on....In this industry, there’s virtually no history of a good consolidating merger.”<sup>2</sup>

### WALL STREET PUNISHES SHARE PRICES

Wall Street was similarly unimpressed. On the day of the announcement, HP’s stock plunged 19% to \$18.87 a share. Compaq’s dropped by 10%. Large institutional shareholders began dumping the stock in huge blocks. By month’s end, Walter Hewlett’s public denouncement of the deal, Wall Street’s negativity, continued lethargy in the tech markets, and the September 11th terrorist events conspired to drive HP’s stock to nearly \$12.50 per share.

### THE NEED FOR ROBUST INTEGRATION PLANNING

The challenge was daunting: robustly plan short-term and long-term integration, convincing shareholders that both operational and strategic value could be achieved. Unlike most deals, pre-close planning would enable or kill the deal as proxy voting to authorize the deal would be tight. Institutional Shareholder Services (ISS), advising numerous institutional shareholders on how to vote their shares on the merger, put integration planning under a microscope:

“...a company’s integration efforts can impact the strategic/financial determination (of whether shareholder value will be increased). Strong integration planning can minimize the risks associated with failure, and thereby shift the balance in favor of a deal.”<sup>3</sup>

## SOLUTION

**Manage a rigorous pre-close process to drive value on Day 1 and beyond.**

### CLEAN ROOM FORMED

When the merger between HP and Compaq was announced, Fiorina and Capellas tapped Webb McKinney of HP and Jeff Clarke of Compaq to form and run the merger integration team, reporting to a small steering committee which was a subset of the company’s new Executive Committee. The steering team included Susan Bowick (EVP HR), Bob Wayman (CFO), Bob Napier (CIO), Fiorina, Capellas, McKinney and Clarke. Together, they created a small integration office known as the clean room where planning the details of the merger could begin without violating antitrust laws. Webb McKinney and Jeff Clarke appointed John Bender, who was Executive Director, Merger Integration Office at the time, to run the clean room with 3 other executives. The integration team was responsible for developing a short-term Day 1 launch and long-term master plan to be implemented once the deal closed. The scope of the plan was massive—every aspect of the new company (NewCo) needed to be designed: product lines, go-to-market capabilities, organization structure, Human Resources, IT systems, branding, culture, and others. Specialty teams were set up to address merger-specific requirements such as synergy-savings, legal deliverables, and communications. What initially began as a 50-person team grew to 500 individuals within a few weeks. At the launch of the new company, nearly 2,500 employees had contributed to an estimated one million person-hours of planning, and more than 10,000 separate decisions had been managed and tracked.

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**Robert Burgelman**

Edmund W. Littlefield Professor of Management at the Stanford Graduate School of Business, quoted in *Business Wire* July 16, 2007

## PREPARATION – KEY TO SUCCESS

Job one for the clean team: doing its homework. Both companies had mediocre merger and acquisition track records, yet they were undertaking the largest technology consolidation in history. HP and Compaq had to develop processes that would work immediately. The team began comprehensively benchmarking other large deals. NationsBank and Bank of America were studied for branding know-how. The Citibank-Solomon Smith Barney merger was studied for employee retention. Exxon-Mobile and Chevron-Texaco for global-scale issues; Cisco for cultural integration – more than 30 mergers and academic studies in all. Additionally, the clean team learned from the mistakes of Tandem, Digital Equipment Corp., Verifone, Apollo, and the Agilent divestiture. From this benchmarking work, the team identified ten “Critical Success Factors” for successful integration. These became the foundation for the clean team’s integration philosophy and guiding principles, team structure, planning framework, and weekly decision-making processes.

The integration team’s guiding principles were:

- Start with the customer experience, retain the highest level of customer satisfaction
- Name executive leaders early and link tightly into planning
- Ensure that structure follows strategy
- Make decisions quickly and make them stick
- Adopt and go
- Clarify roles and ensure shared accountability
- Create dedicated integration teams
- Address cultural similarities and differences
- Rigorously measure, manage and communicate integration progress, wins, issues and opportunities

## MINIMIZING INTEGRATION RISK

In addition to these principles, the integration team strove to control integration risk, tie compensation to integration results, and measure success through the eyes of our customer, partner, employee, and shareowner constituents. These efforts enabled the growing clean team to move forward quickly, independently, and in an aligned fashion.

All planning activities were completed and influenced by NewCo’s

- Strategy: channels, product portfolio, strategic priorities
- Structure and Process: organization structure, decision-making, IT systems and information flows
- People and Culture: retention of top talent, one common culture, roles and responsibilities
- Metrics and Measures: customer satisfaction, financial, employee satisfaction, operational excellence, reward and recognition systems.

## FOCUSED PLANNING FOR BOTH DAY 1 AND YEAR 1 INTEGRATION

To maintain focus and ensure clarity of integration planning roles, the clean team members were assigned to support Day 1 launch activities as well as longer-term integration milestones. Day 1 activities were focused on getting NewCo up and running. Priorities included enabling customers to interact with HP as one company, marketing products and services seamlessly, operating the workforce as a single company, and providing 24x7 “war room support” for employees and operations. In parallel, a “Launch + 18 Months plan” was also constructed to drive massive synergy savings and value capture, particularly in the areas of procurement, supply chain, IT integration, headcount reduction, and facility closures. Bender led a small team of executives representing each business and functional group, called the PMI team, to develop this plan. The longer-term opportunities became HP’s integration plan of record. Post-launch, this plan was managed through a rigorous process – continually aligning activities with value capture, restructuring, and financial planning targets. The central integration team helped drive results across team boundaries, with a cross-organization perspective. Developing the long-term plan was extremely challenging, particularly given HP’s new matrix organization. Bender, now a founding Partner and Managing Director at Bender Consulting, noted:

“Not all of our existing programs (from the two pre-merger companies) aligned with our desired end state. We had to make some very difficult decisions very quickly, but they were informed decisions. Transformational change is very difficult, and the management of change is an integral part of the consolidation process. We gained some great insight and skills about how to manage change during our consolidation and rationalization.”<sup>4</sup>

## MANAGING A RIGOROUS PLANNING PROCESS

The clean team developed a weekly cadence to drive quick decision-making and prevent teams from stalling due to disagreement. Weekly meetings among business, functional areas, and program-specific teams occurred on Mondays. Bender facilitated Wednesday meetings chaired by McKinney and Clarke to discuss recommendations, decisions, and issues needing steering committee approval or input. Steering committee meetings with Capellas, Fiorina, McKinney, Clarke and other senior executives culminated the weekly process on Thursdays. The clean team used best practice integration tools throughout the pre- and post-close planning process.

Key among these included:

- Using an *Adopt & Go* management style to choose the best of what either Compaq or HP had to offer
- Designing and conducting decision-acceleration sessions to drive quick, stakeholder-supported decisions on the most contentious issues
- Delaying region and country integration to minimize customer disruption until after the merger close
- Deploying *Fast Start* and *Fast Value* sessions to ensure operational excellence and create a new culture

## RESULTS

### Best-in-class Day 1 new-company launch and Year 1 short-term integration. Long-term value of the merger intent realized.

Hewlett-Packard's thorough integration planning set the stage for a successful shareholder vote and best-in-class Day 1 new-company launch and Year 1 short-term integration.

#### THOROUGH PLANNING SECURES THE SHAREHOLDER VOTE

Even before the new HP was launched, it was clear that integration team plans were thorough and robust. This had a large influence on how institutional investors carrying huge blocks of HP and Compaq stock voted. In its guidance to large investors, ISS commented:

"From a procedural standpoint...it appears that management has done everything it can to maximize the chance that integration will be a success."<sup>5</sup>

#### BEST-IN-CLASS DAY 1

On Day 1, the effectiveness of integration planning was even more apparent: the company was ready to operate as a new entity and had met the expectations of customers, shareholders, employees and partners. The top four levels of leadership – representing more than 800 leaders including region and country managers – were named. Product roadmaps and transitions were available for customer review. Customer and partner outreach plans were activated, with the top 25 retail accounts contacted by senior leaders within 24 hours – and more than 1,100 contacted within days. 20,000 presales and sales call center agents and 8,000 customer support users leveraged their training and fielded questions and requests. The online store, hp.com, was open for business, each of the company's more than 150,000 employees had access to a new intranet portal, and all company networks were combined at strategic locations.

#### EXCEEDING YEAR 1 EXPECTATIONS

Robust integration planning – coupled with consistent monitoring of implementation metrics by the Executive Committee – facilitated faster synergy savings and value capture. Market-share losses were narrower than expected, and the short-term synergy target of \$2.4B was exceeded by more than \$1B in the first 12 months. More than 95% of key milestones were accomplished on-time. Additional organizational design and selection processes were completed efficiently to minimize employee uncertainty and put new teams in place quickly.

Robert Burgelman, the Edmund W. Littlefield Professor of Management at the Stanford Graduate School of Business, stated:

"One of the best things that HP did early on was to engage in rigorous integration planning...the integration planning process was so successful that on the day the merger was approved, the new company was ready to go... establishing the logic for the integration and setting the performance goals were right on target. The pre-clearance integration planning was first-rate."<sup>6</sup>

## HP/COMPAQ INTEGRATION SUCCESS

Hewlett-Packard's thorough integration planning set the stage for a successful shareholder vote and best-in-class Day 1 new-company launch and Year 1 short-term integration.



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More than six years after the merger closed on May 3, 2002, "Dell Computer...has seen its stock price drop 20%. The S&P 500 has risen 28% and IBM 42%. Meanwhile, the once-maligned Hewlett-Packard has seen its stock price soar 163%!"<sup>8</sup> Today, Hewlett-Packard has surpassed Dell to become the world's largest PC maker in terms of units sold.<sup>9</sup>

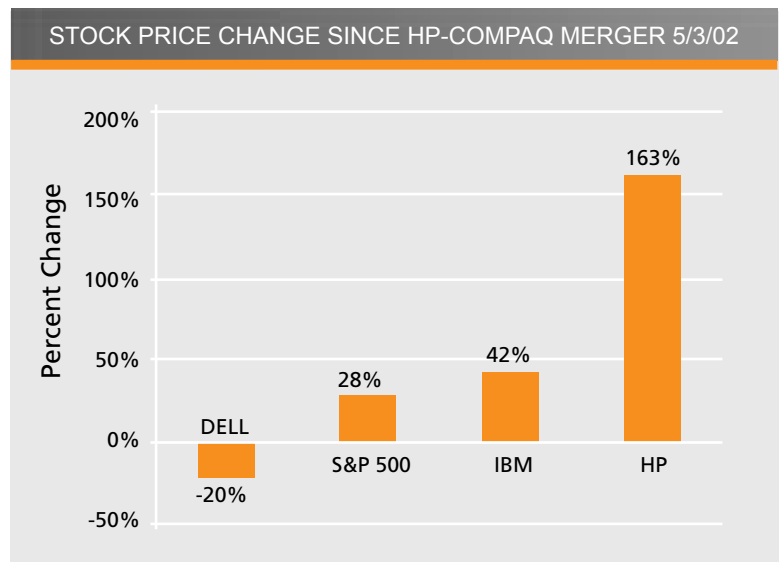
## LONG-TERM INTEGRATION MILESTONES SLIP

While short-term integration planning and execution has been widely lauded by academics and industry analysts, it was not until recently that HP has begun to reap the full benefits of the merger. After 12 months of post-close integration, the Executive Committee, key leaders, and employees were burned out on integration. Fiorina wanted to re-focus conversations with the press, analysts, and key shareholders on something other than the merger. A decision was made to close down the integration team, and many of the longer-term, more strategic integration goals including IT infrastructure, operational effectiveness, culture, and other elements of long-term synergy savings began to slip. HP's pre-close assumptions about growth in the IT market proved to be overly optimistic. Continued weakness meant operational expenditures were out of line with revenue, leading to the need for further cost reductions and layoffs – a difficult task for a battle-weary leadership team. Customers were anxious about HP's strategy, which had taken a back seat for quarters while the company focused inwardly on integration. Ultimately, the board's impatience led to the appointment of Mark Hurd, former CEO of NEC, to replace Fiorina.

## NEW CEO DELIVERS LONG-TERM VALUE OF THE MERGER

The current thinking at HP is that Hurd, his trusted leaders, and their near-maniacal focus on operational excellence and “the numbers” provided HP with the management skills and focus needed to successfully realize the strategy Fiorina designed. Today the merger is lauded as a “sensational combination, whether measured by market share, market leadership or increased shareholder value.”<sup>7</sup> The following chart<sup>8</sup> is indicative. Almost six years after the merger closed on May 3, 2002, “Dell Computer...has seen its stock price drop 20%. The S&P 500 has risen 28% and IBM 42%. Meanwhile, the once-maligned Hewlett-Packard has seen its stock price soar 163%!”<sup>8</sup>

Today, Hewlett-Packard has surpassed Dell to become the world's largest PC maker in terms of units sold.<sup>9</sup> With its acquisition of EDS, extending capabilities beyond the Compaq deal, HP is expected to be an even more dominant player in managed services and consulting, competing head-to-head with IBM.



For additional specifics about the **Hewlett-Packard \$19B Acquisition of Compaq** project brief, please contact Bender Consulting at [info@bendercon.com](mailto:info@bendercon.com).

CITATIONS: 1 Business Wire, July 16, 2007; 2 CFO Magazine, September 1, 2003; 3 CNET News, March 5, 2002, from the Article “HP-Compaq: Excerpts from ISS report”; 4 From the Article, “IT consolidation: How two companies merged into one great enterprise,” © 2004 Hewlett-Packard Development Company, L.P.; 5 CNET News, March 5, 2002, from the Article “HP-Compaq: Excerpts from ISS report”; 6 Business Wire, July 16, 2007; 7 The Huffington Post, April 9, 2008, Ben Rosen from the Article “The Merger That Worked: Compaq and Hewlett-Packard”; 8 The Huffington Post, April 9, 2008, Ben Rosen from the Article “The Merger That Worked: Compaq and Hewlett-Packard”; 9 Deal Journal (Wall Street Journal On-Line), August 16, 2007, from the article, “The HP/Compaq Union, From Controversy to Success”.



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