313-079-8

To buy or not to buy: The acquisition of Compaq by HP seen 10 years later – TEACHING NOTE

This case was written not to illustrate effective or ineffective management but rather as a basis for class discussion.

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This case was written not to illustrate effective or ineffective management but rather as a basis for class discussion.

Preamble

The case has been tested at a higher education institution, on a master's degree course about strategy and competitiveness, in two parts. Part 1 addressed merger and acquisition issues. Part 2, on the other hand, addressed corporate governance issues. Part 1 was given in class over a 120 minute period and the students' feedback was positive. Material to read about the HP-Compaq merger, in *The Economist*, was made known to the students who were told to bring the articles to class to read in three stages, in order to keep student curiosity levels high. Part 2 also involved material from *The Economist*, again to read in class, with questions and discussion lasting approximately 90 minutes. In sum, a lecturer might organize classroom time (with master's in management / MBA students, or executives taking a post-graduate course on strategy and competitiveness) as follows, in table 1:

Table 1 – Suggestions concerning how a lecturer should organize the case in class

Lectures in class	**Part 1 - Merger and acquisition issues**	**Part 2 - Corporate governance issues**
Lecture 1 – 120 to 150 minutes (depending on discussion involvement and other theoretical aspects brought up)	Three articles by *The Economist* were made known to students and these were read in class in order to motivate class discussion	Inform students that the next lecture will be about corporate governance issues
Lecture 2 – 90 to 120 minutes (depending on discussion involvement and other theoretical aspects brought up)	Summarize what happened in the previous lecture concerning mergers and acquisitions	Another article in *The Economist* was made known to students, again to be read and thus motivate class discussion

Part 1 – Setting the scene

The material in *The Economist* read by students in class was as follows:

Stage 1 – An article written before the merger took place: *The Economist* - 18th March, 2002 – Main issue for discussion – Will the merger take place?:

> "*The HP and Compaq drama - Hewlett-Packard's shareholders are about to vote on the biggest merger in the computer business. The battle over teaming up with Compaq has been fierce and sometimes acrimonious, but it has brought a welcome breath of fresh air to corporate America*"
>
> (http://www.economist.com/node/1035824, accessed on 6th November, 2012);

Stage 2 – An article written six months after the merger occurred: *The Economist* - 20th March, 2002 – Main issue for discussion – What has happended to the 'new HP'?:

> "*The HP and Compaq drama – Hewlett-Packard's boss has declared a slim victory in the shareholders' vote to team up with Compaq. But the battle over the biggest merger in the computer business is not over yet*"
>
> (http://www.economist.com/node/1044918, accessed on 6th November, 2012);

Stage 3 – An article written close to ten years after the merger took place: *The Economist* - 1st October, 2011 – Main issue for discussion – Was the merger a success?:

> "*The trouble with superheroes - HP has appointed yet another superstar boss from outside. Bad move*"
>
> (http://www.economist.com/node/21530953; accessed on 6th November, 2012);

After reading these main articles, one at a time, questions were put on the board for the students to resolve, also in stages, thus letting the case unfold as in a story. Students could also access the articles in class on their PCs (at the university in question, we have classrooms with a wireless Internet connection) as the articles were available on *The Economist*'s web site free of charge.

Questions and answers, according to the articles in *The Economist*, and concerning the HP – Compaq merger, follow below:

(Note that students were also encouraged to search for other articles on the web site of *The Economist* to answer the questions posed).

Stage 1 – pre-merger:

1. Did HP buy Compaq?
   Answer: Yes.
2. Why did HP want to buy Compaq?
   Answer: According to Ms Fiorina "The computer industry is consolidating and corporate customers want to deal with fewer, larger suppliers who can offer

them a package of computer equipment, software and services." (*The Economist*, 18th March, 2002). Above all, the 'new HP' "would be able to challenge IBM throughout the industry" (*The Economist*, 18th March, 2002). Hitt et al. (2003) also refer to the cost-cutting expectation, at the level of at least $2.5 billion, as referred to below, also (question 10). Integrating HP and Compaq into only one company would create economies of scale as some of the markets in which they compete are the same (Hitt et al., 2003).

3. How much did Compaq cost?
   Answer: $19 billion (*The Economist*, 14th November, 2002).
4. How many investors did HP have at the time of the vote concerning the acquisition?
   Answer: 900,000 investors (*The Economist*, 18th March, 2002).
5. How many HP shares were in the market at the time of the vote concerning the acquisition?
   Answer: Nearly 2 billion shares (*The Economist*, 18th March, 2002).
6. What does history tell us about big mergers in the computer business?
   Answer: "Big mergers in the computer business rarely work. The 1998 merger of Compaq with Digital Equipment Corporation is widely judged not to have been a success" (*The Economist*, 18th March, 2002).
7. Who at HP was in charge of the integration with Compaq?
   Answer: "A 600-strong integration office… set up to plot the future of the two companies" (*The Economist*, 18th March, 2002).
8. What should board members be responsible for?
   Answer: The battle for and against the merger "produced a healthy level of debate" (*The Economist*, 18th March, 2002). Board members should stand up and ask "tough questions" (*The Economist*, 18th March, 2002) about what is going on. "Plenty of other businesses would be all the better if investors and board members also had to think harder, instead of simply signing off every management decision" (*The Economist*, 18th March, 2002).

Stage 2 – six months after the merger:

9. What happened to Michael Capellas in 2002?
   Answer: On November 11th 2002 Compaq's former CEO, after being named 2nd in charge at the 'new HP', resigned taking a $14.4 million severance package (*The Economist*, 14th November, 2002).
10. What is WorldCom?
    Answer: "A bankrupt telecoms firm" (*The Economist*, 14th November, 2002) which Michael Capellas was expected to lead after leaving the 'new HP'.
11. What happened to HP shares 6 months after the merger?
    Answer: "HP's shares fell by 11%" (*The Economist*, 14th November, 2002) when Capellas left HP taking with him important operational skills possibly essential for the complex merger to be successful.
12. How much cost cutting was sought after by HP with the acquisition?
    Answer: Cut "$500 million in the second half of fiscal 2002" and "$2.5 billion the folowing year" (*The Economist*, 14th November, 2002).
13. How much downsizing was sought after by HP with the acquisition?

Answer: 10,000 workers by the end of 2002 and a further 6,800 workers later on [in 2003].

14. What happened to HP revenues after the merger?
    Answer: 2002: "In HP's third quarter, ending in July, revenues were down by more than 11%, mainly because of poor results in the PC business" (*The Economist*, 14th November, 2002). Rival Dell was now №1 (*The Economist*, 14th November, 2002).
15. What effect did Wal-Mart have on HP and why?
    Answer: HP's share price was affected "by speculation that Wal-Mart, the World's largest retailer, is planning a range of own-brand PCs" (*The Economist*, 14th November, 2002).

Stage 3 – almost a decade after the merger:

16. What is a superhero and in what context was this term used in the HP case?
    Answer: "A great manager [who] can make all the difference to an ailing firm" (*The Economist*, 1st October, 2011).
17. Who is Tom Perkins?
    Answer: A former employee of HP in the 1960s and former HP board member seen to be "one of Silicon Valley's most successful investors" (*The Economist*, 1st October, 2011).
18. How many CEOs did HP have since 1999 and into 2011?
    Answer: HP "has lost six chief executives since 1999" (*The Economist*, 1st October, 2011).
19. What happened to Carly Fiorina in 2005 and why?
    Answer: Carly Fiorina exited the company in 2005 "after HP's share price halved" (*The Economist*, 1st October, 2011).
20. How old was rival IBM in 2011?
    Answer: 100 years old.
21. Where is HP located?
    Answer: Silicon Valley, California, USA.
22. Who is Jack Welch and what reference is made to him?
    Answer: Jack Welch is the former CEO of General Electric where he boosted this company's "market capitalisation by 4,500% at a time when its old rival, Westinghouse, was desintegrating" (*The Economist*, 1st October, 2011).
23. In the 1970s how many CEOs were hired from outside the company to fill vacancies in the case of the Forbe's 1,000?
    Answer: 15% (*The Economist*, 1st October, 2011).
24. In the 2000s how many CEOs were hired from outside the company to fill vacancies in the case of the Forbe's 1,000?
    Answer: 33% (*The Economist*, 1st October, 2011).
25. Who is Jim Collins and what reference was made to him in the HP case?
    Answer: The author of 'Good to Great' who "insists that great companies almost always recruit CEOs from within" (*The Economist*, 1st October, 2011).
26. What is corporate culture and why is it so important?
    Answer: It is diffiult to "transform a corporate culture single-handed" (*The Economist*, 1st October, 2011). When two companies merge a complex period

follows whereby the two companies have to change in order to accommodate each other's ways of functioning.

27. What was the HP corporate culture known as being?
Answer: "The HP way" which was all about "relentless innovation and solid management principles" (*The Economist*, 1st October, 2011).
28. Who is Ms Meg Whitman?
Answer: The new "superstar" CEO of HP in 2011 (*The Economist*, 1st October, 2011) and on into 2012.

Above all the case gives a good idea of what being the CEO of a large organization entails. The quest is for increased sales / market share, profitability, as well as for cost reduction – which should lead to an increased share price. Being a CEO is obviously not about coming in early and just doing e-mails without talking to anyone all day but rather is about justifying your salary which will require ambition and resourcefulness. In the case of a major merger this may mean hiring "expensive lobbying outfits and public-relations firms" to hammer "big and small investors with a torrent of information" (*The Economist*, 18th March, 2002). It may mean using "full-page advertisements to appeal to HP investors" (*The Economist*, 18th March, 2002). Being a CEO is "a job that requires being tough and even ruthless" (*The Economist*, 19th August, 2004) though also being charming, attractive, and stylish will help, as was the case of Carly Fiorina (*The Economist*, 19th August, 2004). Note that chairman compensation can be as high as $40 million in one year (salary plus bonuses plus stock option), as was the case for Walt Disney chairman, Michael Eisner, in a strong year for Disney (Hitt et al., 2003, p.307).

A major discussion revolved around the following, which applies to both the HP-Compaq merger as well as to the Compaq-DEC merger:

> "From the smallest businesses to the World's largest corporate titans, the search for synergy often leads people to seek new markets and new partners. The vast majority of these efforts are driven by business factors, but according to numerous experts, they succeed or fail more often because of cultural factors than for any other reason" (Stachowicz-Stanusch, 2009, p.64).

According to Stachowicz-Stanusch (2009) small as well as large companies seek new partners, above all, in order to create synergies. More often than not, however, these synergies are not realized. As concerns the HP-Compaq merger: *"Of course the merger was a success. Neither company could have lost that much money on its own."* (Steve Case, Former Chairman of the Board AOL/Time Warner, quoted by Stachowicz-Stanusch, 2009). Many lessons can be learned from the HP-Compaq merger. One such lesson could be that "infrastruture, head count, or market share" (Stachowicz-Stanusch, 2009) should not dictate whether a merger is attractive – a financial balance sheet is not all that matters – the people involved, especially senior executives but also middle managers and operatives, and whether they have the resolve to make things 'stick' and truly merge into one strong culture, is all the more important.

A series of questions were posed for discussion:

1. Why didn't the merger between Compaq and DEC work out and what could HP have learned from it in order to make the 'new HP' a success?
   The question is formulated for students to explore the intricacies of corporate management decisions.
2. What should be done before all mergers?
   The Due Diligence process is a very important one in all mergers. In general all strategy and finance books strongly recommend it as a precondition for a successful merger and/or acquisition. It would be interesting if students could perform a due diligence concerning Compac, prior to the HP acquisition, in 2002.
   For all mergers a due diligence should be performed, typically involving (Bouchard and Pellet, 2002; Stachowicz-Stanusch, 2009):
   a. Historical activity (considering five previous years of activity, if available).
   b. Ownership and structure of entity.
   c. Management team.
   d. Products and services, including market share by category.
   e. Assets and liabilities.
   f. Information systems and technology.
   g. Organizational culture.
3. Should a due diligence focus only on 'hard' data? What about 'softer' issues, such as 'organizational culture'?
   One of the main problems in the aftermath of mergers is the difficulty in dealing with two different, sometimes opposing cultures and organizational values. This question intends not only to deal with the hard issues of the due diligence process, but also to pave the way for the softer ones.
4. What should a cultural due diligence focus on?
   The cultural due diligence involves the following issues (Bouchard and Pellet, 2002; Carleton and Lineberry, 2004; Stachowicz-Stanusch, 2009):
   a. Leadership and management practices, styles, and relationships;
   b. Governing principles;
   c. Formal procedures;
   d. Informal practices;
   e. Employee satisfaction;
   f. Customer satisfaction;
   g. Key business drivers;
   h. Organizational characteristics;
   i. Perceptions and expectations;
   j. How the work gets done in the organization.

   It would be interesting if students could perform a cultural due diligence concerning Compac, prior to the HP acquisition, in 2002.

Part 2 – Corporate Governance issues

With the HP-Compaq case the issue of board membership can be discussed, in view of HP's developments. What should board members be prepared to do if they do not agree with senior management decisions?

A series of questions can be posed concerning Corporate Governance Issues:

1. As a board member just prior to the HP-Compaq merger, would you have had the courage to have questioned the CEO's strategic decision to go ahead with the merger?
   Apparently, the literature claims that it is advisable that board members need to get on well, to enable rapid and superior collaborative decision making concerning future firm strategy (Hitt et al., 2003). The issue is that as a board member one should ask tough questions in order to ensure the "right" strategic direction, which might be a conflicting one relatively to the vision of other members of the board of directors. Mergers and acquisitions entail a huge debate over the long and short-term perspectives and concerning strategic direction.
2. How many and what sort of people would you have serving on the Board of Directors at HP?
   Although it is always possible to have a broad perspective with insiders, outsiders, academics, venture capitalists, consultants, etc. there is no clear cut solution to know beforehand what sort of people must be part of the board of directors. The main purpose is to address the advantages and disadvantages of diversity over homogeneity.
3. Do board members need to get on well?
   See questions 1 and 2 for a complementary discussion.

The acquisition of Autonomy Corporation plc – An endnote to the HP case

Finally, an article by *The Economist* (20th November, 2012) was made known to students for them to read, concerning HP developments after the acquisition of Autonomy Corporation plc:

> "*HP and Autonomy – Conflicting accounts*"
>
> (http://www.economist.com/blogs/schumpeter/2012/11/hp-and-autonomy, accessed on 23rd November, 2012)

The following questions arise from reading the article and from discussing its contents with students; answers to the questions are included below:

1. What is Autonomy?
   Answer: A British software company that specializes in analysing 'unstructured' data (*The Economist*, 20th November, 2012). "The management of unstructured data is a very large problem. According to projections from Gartner, white-collar workers will spend anywhere from 30 to 40 percent of their time this year managing documents, up from 20 percent of their time in 1997. Similarly, Merrill Lynch estimates that more than 85 percent of all business information exists as unstructured data – commonly appearing in e-mails, memos, notes from call centers and support operations, news, user groups, chats, reports, letters, surveys, white papers, marketing material, research, presentations and Web pages" (Blumberg and Atre, 2003).
2. What is the relationship between HP and Autonomy?

Answer: HP acquired Autonomy, in 2011, for $10.3 billion (*The Economist*, 20th November, 2012).

3. Was HP 'duped' or did it manage Autonomy badly following the acquisition?
   Answer: Both sides have different opinions on this issue – Autonomy and HP (*The Economist*, 20th November, 2012).
4. What does 'duped' mean?
   Answer: 'Duped' means "to trick or cheat somebody" (Oxford Advanced Learner's Dictionary online). E.g. serious accounting improprieties, misrepresentation, and disclosure failures (*The Economist*, 20th November, 2012).
5. Who is Mike Lynch?
   Answer: Mike Lynch is the founder and former chief executive of Autonomy, forced out in late May 2012 (*The Economist*, 20th November, 2012).
6. What are accounting sleuths and what do they do?
   Answer: This is a reference to the detective work done by accountants – sleuths "carry out a search or investigation in the manner of a detective" (Oxford Dictionaries online).
7. What is a due diligence?
   Answer: For all mergers a due diligence should be performed, typically involving:
   a. "Historical activity (prior five years' worth, if available).
   b. Ownership and structure of entity.
   c. Management team.
   d. Products and services, including market share by category.
   e. Assets and liabilities.
   f. Information systems and technology.
   g. Organizational culture."

   (Bouchard and Pellet, 2002, p. 168, as quoted in Stachowicz-Stanusch, 2009)

8. Who can do a due diligence?
   Answer: Accountants such as KPMG; bankers such as Barclays and Perella Weinberg (*The Economist*, 20th November, 2012).
9. Who was Autonomy's auditor? What do auditors do?
   Answer: Autonomy's auditor was Deloitte. Auditors analyse how companies work and sign their accounts (*The Economist*, 20th November, 2012).
10. What does 'plan to spin off the company's PC division' mean?
    Answer: It means to plan to sell the division. Investopedia explains 'Spinoff':
    "Businesses wishing to 'streamline' their operations often sell less productive, or unrelated subsidiary businesses as spinoffs. The spun-off companies are expected to be worth more as independent entities than as parts of a larger business." (http://www.investopedia.com/terms/s/spinoff.asp#axzz2DKJNEvjl, accessed on 26th November, 2012).
11. What has happened to the HP share price since Meg Whitman took over as CEO?
    Answer: "The company's share price has fallen by almost half since she took over" (*The Economist*, 20th November, 2012).
12. What market-related results has HP presented in 2012?

> Answer: "In the fourth quarter it reported year-on-year declines in revenues from PCs, printers, services, servers – just about everything, in fact, except software, where revenues was up by 14%" (*The Economist*, 20th November, 2012).

The HP case has involved high profile acquisitions such as of Compaq (2002) and of Autonomy (2011). While CEOs can become celebrities (Rego et al., 2012) and receive very high salaries, bonuses and stock options, the global financial crisis has brought with it various cases of CEOs having fallen from grace. We hope with our case to have contributed in whatever small way to the understanding of what being a CEO entails so that current and future chief executives may thus contribute to overcoming "the crisis of confidence in corporations" (Rego et al., 2012, p.viii).

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