INSEAD

The HP-Compaq Merger:
A Battle for the Heart and Soul of a Company

Two Stanford University graduates, David (Dave) Packard and William (Bill) R. Hewlett, founded Hewlett-Packard Company in 1939 in this Palo Alto, California, garage. The structure is a California State Historical Landmark.

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Dear Shareowners,

"Forty-five years ago, a remarkable meeting took place in Sonoma, California, among Bill Hewlett, Dave Packard, and a handful of HP executives.

The people who gathered at the aptly named Mission Inn came together to define a set of values and principles that would help shape a new kind of company, one that would be known for its character as well as its creativity, for its people as well as its products. They crafted six primary objectives, later expanded to seven.

Unique to their time, these principles came to be the underpinning of what is now known as the HP Way. As Bill and Dave understood, the real genius of the HP Way is that it's a legacy built on innovation, bold enough to embrace change and flexible enough to absorb it. The spirit of those original seven principles continues to guide us to this day.

They have helped guide the Hewlett-Packard Company through war and recession, through mergers and acquisitions, through corporate reinvention and industry revolution. But rarely have they been called upon to guide us through all of these things in a single year. …"

(letter from Carleton Fiorina, CEO and Chairman of HP, in HP's Annual Report)

2001 was the year of war, recession, acquisition and reinvention to which Carly Fiorina referred in her letter. It was the year of the HP-Compaq merger—and it was either the best of times for HP, or it was the worst of times, depending on whom you asked. In any case, quite aside from the debate surrounding the merits of the merger, it was also one of the first major skirmishes in a revolution in corporate governance. It certainly was a year for the history books…

The New HP

On September 4, 2001, Carly Fiorina of HP and Michael Capellas, CEO of Compaq, announced that they were negotiating a merger between HP and Compaq. The new company would be called HP, and Fiorina would be the CEO and chairman. They promised that the $25 billion deal was strategically rational and would result in a new organization large and diversified enough to rival both IBM and Dell.

HP was a Silicon Valley original, founded by William Hewlett and David Packard in 1939. It had a long and impressive history of innovation, but was hit in the late 1990s by intense competition among PC manufacturers and by a general economic downturn. Fiorina, who joined HP in 1999 as its first outside CEO, had a mandate from HP's board of directors to shake the company up and transform it into an Internet powerhouse.

The Texas-based Compaq had started as notes on a paper placemat in a Houston pie shop in 1982. The company was enormously successful in the 1980s as a maker of IBM-compatible PCs and laptops. By the late 1990s, however, Compaq was struggling in a mature market with stronger competitors. In addition, its acquisition of DEC in 1998—designed to transform Compaq into a one-stop shop for clients looking for computer hardware and software backed by a global service organization—had proved to be more difficult than expected, and Compaq had not yet reaped much benefit from it. Michael Capellas's predecessor, Eckhard Pfeiffer, was pushed out by Compaq's board in 1999, partly because board members were convinced that he had bungled the integration of DEC. Capellas was a relative unknown, a Compaq insider who was one of the few willing to consider the job. One of his first moves as the new CEO was to cut thousands of jobs and announce restructuring charges of $700 to $900 million. He did manage to pull Compaq back from the brink in 2000, but the increasingly difficult economic climate in 2001 left Capellas open to considering the idea of a merger.

When Fiorina came calling in mid-2001, Capellas let himself be convinced. The two CEOs saw a merger as the best strategy for both companies. Together, they would have a more balanced business portfolio with improved profitability in services and enterprise and access businesses, and a better position in servers and storage. They would have a large market share in enterprise computing and PCs and would double HP's service and support capacity. They believed that combining the two companies would increase operating margins and save $2.5 billion by 2004, adding from $5 to $9 to HP's share price. The new HP would have projected annual revenues of around $87 billion and profits of around $3.9 billion. It would employ 145,000 (before anticipated layoffs of 15,000 people—layoffs some critics claimed would account for 75% of the $2.5 billion cost savings). And although high-tech marriages (including Compaq's semi-digested acquisition of DEC) had had some recent bad press, the boards of Compaq and HP were confident that the two companies were complementary.

A Shotgun Wedding

When Wall Street opened on the day after the merger was announced, HP shareholders began to dump their stock. By the end of the day, HP's share price had dropped 25%, reducing the value of the deal by $6 billion. Compaq's stock tumbled as well, dropping 16% in two days. Over the next few weeks, the reactions from a wide range of observers continued to be mostly negative. Some critics expressed concerns about the difficulty of combining employees from three very different corporate cultures—HP's Silicon Valley old-timers, Compaq's aggressive Texas upstarts, and DEC's Ivy League eggheads. Others, seeing the proposed merger as a risky gamble to save two companies with too much invested in commodity-like PCs, expressed their reservations in terms such as "… a shotgun wedding," "two drunks holding each other up," "… a sudden embrace that smacks of deathbed desperation." The merger was described in one analysis as "two new CEOs ignoring history while simultaneously seeking to out-Dell Dell and out-IBM IBM."[1] One large investor compared the merger to tying two stones together, then throwing them in a river to see if they would float. Many HP and Compaq business clients were at best lukewarm, fearing, as one CIO (chief information

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[1]   D. Yoffie and M. Kwak, (2001). "Manager's Journal: HP and Compaq Should Return to their Roots." *Wall Street Journal*, New York, December 17, A18.

officer) said, "disruption of customer focus during merger machinations."[2] One admittedly biased observer, Michael Dell, gleefully approved of the uproar:

> "I don't know what happens if they don't merge, but it certainly creates even more confusion and uncertainty. Gotta love that!"[3]

Family Still Matters

It was not long after the September 4th announcement that the Hewlett and Packard families (in their role as successors to the original founders William Hewlett and David Packard, neither of whom was still living) began to make public their concerns about the merger. David Woodley Packard (whom detractors described as an "emotional philanthropist"), the son of founder David Packard, said he was very concerned about the vast number of layoffs that the merger would cause. The other second-generation heir to speak out publicly against the merger was 57-year-old Walter Hewlett, one of founder William Packard's five children (and his oldest son). Walter was a reserved intellectual, soft-spoken and private, who had never tried to outshine his famous father.

Walter had always been very close to his father, who took the young Walter to the office regularly. Both William Hewlett and David Packard were known as generous men who had lived modestly in spite of their wealth. They had instilled their values in their children, and had pushed each youngster to excel. After graduating from Harvard with a degree in physics, Walter went on to earn advanced degrees in music, operations research and engineering. He was also an outdoorsman, running the Boston Marathon as a young man and participating in grueling mountain-bike races in his 50s. Much of Walter's time as an adult was devoted to carrying on his parents' commitment to philanthropy and education. Like his father, Walter had fairly simple tastes. For example, he drove a Ford minivan—although he never sold the 1965 Volvo that his father had given him for his 21st birthday.

Walter Hewlett had led a life out of the public eye before the merger was announced. He was the chairman of the Hewlett family charitable foundation and was elected to the Board of Overseers of Harvard University in 1997. He participated in the formation of Vermont Telephone Company and was currently its chairman. He founded the Center for Computer Assisted Research in the Humanities in 1984 and still served as its director. He had also been a member of the board of Hewlett-Packard since 1987.

Throughout the summer of 2001, when the HP board was debating whether or not to go ahead with the merger, Walter Hewlett had apparently respected his obligation as a board member not to discuss the merger with outsiders, including family members. Therefore, the Hewlett and Packard families read the first official announcement of the deal in the newspaper on September 4th, along with the rest of the world. The president of the Packard Foundation said that the foundation had not received specific details about the merger until ten days after it was announced, when Fiorina first presented it to their board. An HP spokeswoman said that the board was disturbed by the families' complaint that they had not been consulted or kept

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[2]   B. Evans, (2001). "HP + Compaq = ?" *Information Week*, 866, December 3, 78.

[3]   A. Park, (2001). "A Stunning reversal for HP's marriage plans." *Business Week*, 3758, November 19, 42.

informed: "We didn't want to single the families out. We have treated both families the way we treat other shareholders." (Indeed, in the past the Packard Foundation had specifically asked HP to treat them this way.)

Then, on November 7th, came a bombshell. Walter Hewlett filed a proxy statement with the American Securities and Exchange Commission (SEC), outlining his opposition to HP's plans. The move laid the groundwork for a proxy fight. Hewlett's filing said that he would be joined by his sisters, Eleanor Hewlett Gimon and Mary Hewlett Jaffe, the William R. Hewlett Revocable Trust and one of its trustees, Edwin van Bronkhorst, who had previously been chief financial officer of Hewlett-Packard. The board of the David and Lucile Packard Foundation did not immediately say whether they would support Walter Hewlett, but this was the first official sign of dissent from the families, and it took HP by surprise.

In his SEC filing and statements to the press, Walter Hewlett said that, although he had finally voted with the rest of the board to approve the transaction in September, he (as an HP board member) had informed the board of his doubts about the rationale behind the merger as they deliberated the merits of the move over the summer. Now, in November, he announced publicly that he believed Fiorina was mistaken about the economies of scale to be gained. As he saw it, HP would be handing over one-third of the equity in its high-profit printing and imaging business in exchange for a share in Compaq's low-margin PC business—not such a great deal in a shrinking PC market. He also saw the merger as a dangerous distraction for HP managers. In short, he said,

"We profoundly disagree with management's assertion that HP needs to make this large and very risky acquisition. To undertake the proposed merger is to make a big, long-term, bet-the-company move."[4]

It soon became obvious that, in spite of his board vote, Walter would be the family spokesman and leader for the heirs' anti-merger campaign. (Months later, he would remark, "This is not what I normally do.… [I]t's been hard work and I've had to recalibrate myself. It's been a bit like stepping into an alternative universe."[5])

Carly Fiorina had been aware that Hewlett was personally opposed to the deal, but she had not expected him to launch a full-scale attempt to win others over to his side. After Walter Hewlett filed his proxy statement with the SEC, she commented that family shareholders have a powerful incentive to "preserve wealth rather than to create it." She also criticized Hewlett, saying,

"There is a big difference between an individual managing his own personal assets and the assets of the foundation, and a board member going out and

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4   Quotes from Walter Hewlett in this paper for which no citation is given appeared in several sources: his website, press releases, and letters to shareholders.

5   P.-W. Tam, (2002). "Walter Hewlett's Counterplan." *Wall Street Journal*, New York, February 11, B1.

actively soliciting against a board's decision. And I don't know how to explain Walter's behavior."[6]

Some heavyweight CEOs shared her view: Jack Welch, then CEO of General Electric, said that it was "unpardonable" for a member of a board of directors to approve a merger and then head the opposition.

In any case, HP appeared to be in too deep to back out of the negotiations. There was a mutual $675 million breakup fee included in the terms of the agreement, to be paid by either HP or Compaq if one of them broke off the deal—unless, of course, the merger was not approved by shareholders of either company. In addition, if the merger did not take place, the two companies would become rivals again after having shared a great deal of proprietary information. Critics also pointed out that the two CEOs personally would lose huge bonuses if the deal broke down. (Fiorina's compensation package was estimated to be in the region of $70 million over the next two years.) Finally, if the merger failed to gain approval, Fiorina would almost certainly be forced to resign.

A Battle by Proxy

By December 2001, a full proxy battle raged. The Hewlett and Packard families and their foundations announced that they would vote their shares with Walter Hewlett, against the merger, thereby solidifying the family front (and their block of 18% of HP shares). With this news, HP's share price rose 17%. In mid-December, Richard Hackborn, a top HP executive and board member who was also a member of the Hewlett Foundation board of directors, announced that he was resigning from the Hewlett Foundation board. Hackborn was a 33-year HP veteran who had created HP's printing and imaging products—ironically, the highly profitable business that Hewlett thought should be the cornerstone of HP. Not only did Hackborn think that the merger was a good idea; he felt that the families were opposing it without adequate groundwork: "I have seen no plan from the heirs. Their opposition does not address any of the issues.… Standing still does not serve share owners or employees." Touché.

Hewlett riposted: on December 27 he filed another proxy statement with the Securities and Exchange Commission, urging shareholders to vote against the merger. He made his side of the story public, saying that he had first learned about the proposed deal in May 2001 (although others say that Fiorina and Capellas first met in June). He said that as talks continued over the summer months, he had expressed strong reservations but had been told three days before the board's final vote that the merger would go ahead even if he voted no, although the price might have to be renegotiated. (HP's lawyer asserts that he was told no such thing.) Hewlett bowed to pressure, believing that he could later vote his own shares against the deal: he reported that on the day of the board vote, September 3, he voted in favor of the merger but warned the board that he would later most likely cast his own and his foundation's shares against it.

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[6] P. Burrows and K. Rebello, "Q&A: Firorina: The Deal is the Right Thing for Shareholders, BusinessWeek, 3763, December 24, 68.

The HP board immediately and strongly denied Hewlett's version of events, saying that not only was he *not* coerced into approving the board vote, but he had missed several critical board discussions about the merger in July—one because he was bike-racing and another because he was playing his cello in a concert at the Bohemian Grove, a "gentlemen's retreat" north of San Francisco.

February 2002 was equally eventful. In the first week, the European Commission approved the merger. While Fiorina saw this barely contested approval as the removal of an important obstacle, Hewlett argued that it only proved *his* point, saying,

> "We understand that HP's rivals raised almost no objections to the proposed merger, helping it to gain Commission approval. We are not surprised. We believe Dell, Sun and IBM must be delighted at the prospect of a merger that would so greatly distract and damage two of their rivals."[7]

On February 11, Hewlett finally addressed Richard Hackborn's criticism that the Hewlett and Packard heirs had no alternate plan, by putting forth a three-point proposal. Hewlett recommended, first, that HP invest in and expand its printer and imaging (digital cameras) unit. This strategy had merit: by getting into the exploding market for digital cameras early, HP would set itself up to reap profits through its printers down the line. He also hinted that an eventual spin-off of the printing and imaging business might be worth considering. Second, he recommended that HP optimize its software and consulting businesses by acquiring smaller companies (a strategy that the HP founders had used to grow HP in the past). Finally, he argued that the company should restructure and rationalize its PC business, possibly by closing some plants. He said,

> "Strapping together boxes [PCs] and selling them is not an area where HP is doing well. Why get further into that business?"[8]

An HP spokeswoman quickly shot the plan down:

> "Once again, Hewlett offers platitudes, not a plan. He offers no specifics. All he offers is targeted acquisitions of unidentified companies in who-knows-what businesses."[9]

Clearly, Fiorina and the HP board had underestimated the importance of winning the Hewletts and Packards over early in the negotiations, instead concentrating their efforts on their large institutional and retail shareholders. The fight carried on, bare-knuckled, with front-page headlines, advertisements from both sides with pro- or anti-merger messages, letters to the 900,000 shareholders, and even his-and-hers dueling websites: "vote*nohpcompaq*.com" and "votethe*hpway*.com." Each side sent out 7 to 10 separate shareholder mailings over the final four weeks of the campaign. Deal-related costs, including advertising and marketing directed

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[7]   Hewlett's press releases, website, and letters to shareholders.

[8]   C. Taylor, (2002). "HP's Fierce Face-Off." *Time*, March 4, 46-48.

[9]   Quoted in several sources.

toward influencing shareholders' votes, reached an estimated $232 million for HP, Compaq and Hewlett combined. *Business Week* satirized,

> "Really Carly ... Miss Nuptials always urges families to respect a bride's choices, but announcing that you were 'not surprised' when the founding families of HP came out against this hookup was a blast of snippishness unbecoming a well-compensated CEO. After all, we have come to that part of the ceremony when people with a few billion dollars on the line don't have to hold their peace."[10]

In mid-February, HP announced better-than-expected revenues for the previous quarter. Although Walter Hewlett said this news proved that HP could do well on its own, the favorable report seemed to finally turn the tide of public opinion toward approval of the merger. On March 5th, the proxy advisory firm Institutional Shareholder Services (ISS) announced that they supported the HP board's strategy and plans for implementation, and they recommended that the merger take place. ISS, who normally advises clients on corporate governance issues, did not control any shares, but their clients held 23% of HP shares, making their recommendation a weighty one in the proxy battle. This appeared to be a final blow to Walter Hewlett.

Then, in a nearly last-minute surprise development, several heavyweight HP shareholders announced that they would vote *against* the merger—and some of them were ISS clients. Banc of America, one of HP's top five shareholders (with 2.8% of the total), said that they would vote no. The New York State Common Retirement System Fund and Wells Fargo, a US banking group, also disapproved. CalPERS, a huge California state pension fund, and the Canadian Ontario Teachers' Pension Plan—both ISS clients—also joined the "no" group. CalPERS emphasized that their decision was based simply on what would be best for their portfolio.

It became fairly clear that these shareholders, the majority of whom were holders of retirement and pension funds, had investment goals similar to those of the Hewletts and Packards and their foundations. People began to wonder: Had Fiorina and the HP board analyzed shareholders' investment strategies early in the planning stage? If the HP board had made the deal more palatable to Walter Hewlett, would the outcome have been different?

HP Shareholders – January 2001[11]

Institutional investors	57%
Retail or individual investors	25%
The David and Lucile Packard Foundation	10%
Families of William Hewlett and David Packard	8%
Management and company insiders	<1%

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10   J. Hamilton, (2001). "Happily Ever After?" *Business Week*, 3760, December 3, 32.

11   Adapted from Copeland, L., 2(2001), *Computerworld*, December 17, 35;51 p 1.

The Die is Cast

The date and place for the ultimate confrontation were finally set: all 900,000 shareholders (controlling approximately 1.9 billion shares) were called upon to vote March 19, 2002, in person in Cupertino, California, or by proxy. There was a great deal at stake. The *Financial Times* reported: "It appears to be a battle for control of the company, pitting management against descendants of HP's co-founders."[12] Thomas Perkins, a Compaq board member, observed that Walter Hewlett and Fiorina were proxies in a battle for the heart and soul of HP.

As the proxy battle waged on, many people had the same fundamental question: Why did HP let this battle happen in the first place? In an interview Fiorina said,

> "Walter's behavior publicly has been a complete surprise. I think it is an insult to this board."[13]

Many people didn't buy that argument. One academic said, "You have to question her business judgment. Either [the board] failed to persuade him, or they ignored him. Either way, it's bad."[14] Another business school professor said, "Win or lose, she loses … unless there's a god of perfect women."[15]

People also wondered how Fiorina could have underestimated the influence of the Hewlett and Packard families, both within HP and in the community. Fiorina probably drove past Stanford University every day, seeing there a tangible reminder not only of HP's early history—as the place where William Hewlett and David Packard met and formed their lifelong partnership—but also of the families' philanthropy. Likewise, the Monterey Bay Aquarium—a prime tourist destination and a world-renowned center for marine research—had been built with funds from the Packard Foundation and was directed by Julie Packard, one of David Packard's daughters. James Hewlett, Walter's younger brother, was an active volunteer worker in the Silicon Valley. Susan Packard Orr was the founder of a software development firm that worked with nonprofit organizations and was the head of the huge David and Lucile Packard Foundation. Why hadn't Fiorina—with her much-touted people skills—done more to win this powerful and extremely well respected family and their foundations to her cause?

The March 19th shareholders' vote turned out to be so close that the official result would not be known until weeks later, although it was clear who the sentimental favorite was: Walter Hewlett got a standing ovation from a crowd waving green fluorescent glow sticks; Fiorina was booed. (Compaq shareholders, on the other hand, decisively voted "yes" at their meeting the following day.) Even before the final HP count was announced, some people were threatening lawsuits, claiming that dirty politics had swayed the vote. For example, many of

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[12] S. Morrison, (2001). *The Financial Times*, Section: Companies and Finance International, November 13, 37.

[13] M. Blake, (2001). "Q&A Fiorina: the deal is "the right thing for shareholders"." *Business Week*, 3763, December 24, 68.

[14] P. Burrows and A. Park, (2001). "Carly's Last Stand." *Business Week*, 3763, December 24, 62-70.

[15] In a private interview.

the 6,000 HP executives eligible for the combined $337 million retention bonus package for successful completion of the merger undoubtedly chose to take the easy money. (One HP executive said that he voted for the merger even though he wasn't convinced it was a good idea: "I know it's pathetic, but the old HP is gone. I'm giving up on the stock and taking the cash. The bribe worked."[16])

After what must have been a heart-stopping delay for Fiorina, a last-minute change of heart to a "yes" vote by Deutsche Bank for 17 million of the more than 25 million HP shares it held came through during the shareholders' meeting. HP's corporate lawyer had been waiting backstage for Deutsche Bank's vote. As soon as he heard it, he radioed HP's general counsel, Ann Baskins, who was seated onstage near Fiorina. Ann Baskins handed Fiorina a note with the good news—but they both knew the game was not over yet.

Indeed it was not. Within days of the shareholder vote, rumors surfaced that Deutsche Bank's vote switch had come only four days after the bank had arranged a $4 billion line of credit for HP. There was even a smoking gun: in a voicemail to chief financial officer Bob Wayman about Deutsche Bank and another big American bank, Fiorina said that HP would have to do something "extraordinary for those two to bring them over the line." Although HP denied any impropriety, Walter Hewlett immediately filed a lawsuit, which would delay the official results even further. As a result, Walter Hewlett was not re-nominated to the HP board of directors, meaning that for the first time in HP history, the families were not represented on the board. (Hewlett's lawsuit was dismissed in April 2002, exonerating HP.)

Decidedly, from beginning to end—from mudslinging to back-office deals—the financial world had never seen a merger battle like this one before. Whatever the outcome of the vote, the proxy battle was a watershed. It had brought issues of corporate governance to the fore—issues that would likely have repercussions on similar decisions in other companies. For HP it was the decisive battle in a cold war that had been waged within the organization, albeit less visibly, during the previous year between the old HP hands on one side and Fiorina on the other. As people reflected on the proxy battle, many realized that to fully understand what had happened, it would be necessarily to look back to the egalitarian, decentralized culture created and nurtured at HP for forty years by the founders, William Hewlett and David Packard. As the world tuned in to the HP soap opera, people were asking themselves: *What would Bill and Dave say about this?*

(Bill Hewlett (*left*) and Dave Packard take a moment to look at products manufactured by Hewlett-Packard Company in January 1963.)

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16   P. Burrows, (2002). "Doubts about HP-Compaq's Financial Goal," *BusinessWeek Online*, March 18.

What if we had stopped here?

[hp audio oscillator 200A, our first product. At $54.40 each, several were sold.]

(Image is an example of pro-merger ads used by HP. It was taken from a postcard inviting shareholders to visit the VotetheHPway.com website.)

William Hewlett and David Packard

William Hewlett and David Packard can be described without exaggeration as American icons. The company they created has long been a symbol worldwide of organizational best practices, both technological and human. The meeting of two engineering students at Stanford, and the birth of their company under the guidance of their professor and mentor Fred Terman, has become a legend. The California ethos of the company's early days—based on respect and responsibility for individuals, love of nature, and the belief that there are practically no limits to what one can invent—is credited as being the foundation of the famous HP Way. The story really begins much earlier, however, with the values and experiences that

not only shaped the young Bill Hewlett and Dave Packard but also continued to influence their heirs as HP moved into the 21st century. HP was founded on family values and run according to those same values for sixty years.

Dave and Bill

David Packard was born in 1913 in Pueblo, Colorado, a tough mountain mining town. His home town had the frontier mentality of the miners and cowboys who had shaped the western United States.

As a boy, young Packard had many interests beyond the outdoors: chemistry, electronics, team sports and music. While his father had a strong influence on him, the youngster also enjoyed other significant mentoring relationships. Packard learned to fish with one friend's family, played music with another friend, and was coached by a track and field champion who worked in his father's law office. Packard's management style, with its commitment to teamwork and mentoring, was influenced by these relationships.

As a student at Stanford University, he met a young radio engineering professor, Fred Terman, who would become a lifelong mentor to both Packard and Hewlett and is credited with being the "father" of Silicon Valley. It was through Packard's interest in electronics that the young student developed a friendship with classmate Bill Hewlett.

William Hewlett, who was also born in 1913, was a 4th-generation Californian. Hewlett's early interests, like Packard's, were in science and electronics. During their junior year at Stanford, Hewlett and Packard, on a field trip to visit a hydroelectric plant, took time out to go fishing. Their mutual love of the outdoors and respect for each other became the foundation of their friendship.

After graduation from Stanford, Packard took a job with General Electric on the East Coast as a manager in a research laboratory that made mercury-vapor control tubes. The process used in the lab was very uncertain, and the failure rate was high. Packard soon realized that although his employees *wanted* to do the job right, they weren't getting enough guidance to do so. There were written instructions for procedures, but employees were expected to simply follow these on their own. Packard became involved in the work in a much more hands-on way, and results improved. His insight about the importance of the human factor in manufacturing quality would later become part of his practice of "management by walking around."

Professor Terman continued to play a helpful role in the lives of Hewlett and Packard: in the summer of 1938 he secured funding for a Stanford Fellowship for Packard so that he could return to the Bay Area. After moving back to Palo Alto, the newly married Packard and his wife rented a small house on Addison Avenue. Bill Hewlett and his new wife moved into a small cottage on the property. Behind the house was a one-car garage that soon became the friends' workshop.

In 1939 they formed their own engineering firm. Hewlett won the coin toss, so his name came first: their new company would be called Hewlett-Packard. Hewlett focused on R&D, and Packard worked on manufacturing and management. The partners begin looking for ways to

develop their concepts into products. Their headquarters were in the little garage at the rental house. Terman (who continued to send ideas and contacts their way) would later say that if the car was parked in the garage, he knew business was slow; if it was parked in the driveway, there was a healthy backlog of work. The first invention to come out of the garage was an audio oscillator (designated *model 200A* so that it would appear to be from an established product line, in the picture above), an instrument for generating the audio frequencies required in communications, physics, medicine and military equipment. (In 1989, the garage on Addison Avenue was designated a California Historical Landmark, "the birthplace of the Silicon Valley").

The HP Way

In the 1940s the company grew from two employees and sales of slightly over $5,000 to 166 employees and sales of $2.2 million. It had moved out of the garage and was earning an enviable reputation among young engineers and scientists. As the organization grew, Bill and Dave began to formalize a unique management style based on their personal philosophy and values. Practices included "management by walking around" and management by objectives (the latter giving employees flexibility to achieve the broader objectives that Bill and Dave had set for the company). Hewlett-Packard also became one of the first companies to have an open-door policy and an open-plan office space to encourage information-sharing and networking. The founders emphasized the importance of creating an egalitarian organization in which everyone was on a first-name basis. William Hewlett set the example by sitting at the middle of the table rather than at the head during business meetings.

Early in 1957 the company held its first off-site senior management meeting. Hewlett and Packard realized that with 1,200 employees, they had to delegate responsibility for running the business. The goal of the off-site meeting was to get their senior management team fully involved in developing the values and corporate objectives that came to be known as "the HP Way." When the company held an IPO later that year, all employees who had been with the company 6 months or more received automatic stock grants and became eligible for the company's stock option program. This financial move reflected the founders' strong belief in the importance of employee support and participation. When Hewlett-Packard moved its headquarters to the Stanford Industrial Park in 1960, it was into a building designed to enhance employee satisfaction and performance—in other words, to support the HP Way. The site, overlooking San Francisco Bay, included outdoor patios, horseshoe pits, volleyball and badminton equipment, and a large cafeteria for all employees. At the annual company barbeque, Bill and Dave flipped the burgers.

The HP Way was also about strategy. Although Bill was considered "the engineer" and Dave "the businessman," they had always agreed on one thing: HP would focus on innovation and organic growth, not economies of scale. HP's ability to morph its core technologies to stay ahead of the wave of technological development in the coming decades was seen as a result of Dave Packard and Bill Hewlett's far-sighted philosophy that their company was "built to last," not to break up and spin off as a market peaked.

The Glory Days

HP was not left on the beach as new waves of technological development washed through Silicon Valley in the 1960s. In 1966 the company entered the computer market with the HP 2116A, which by virtue of its relatively small size eliminated the need for special computer rooms and changed the nature of the computing industry. HP also introduced the world's first desktop scientific calculator and was the first to use the term "personal computer" in an advertising campaign. The company ended the 1960s with sales over $300 million and nearly 16,000 employees.

In the 1970s the innovative, entrepreneurial spirit of the early days was nurtured: HP became an *intra*preneurial organization, with product groups being split off into autonomous units as soon as they became large enough. Bill made sure that people had the tools and the time they needed to be creative. Once when he encountered a storeroom door that was chained and padlocked, he got a bolt cutter and cut the lock off, then left a note that said, "Please don't chain this again—Bill." Bill and Dave also encouraged engineers to work on personal projects (such as building speakers for stereo amplifiers) with company equipment and parts. Bill told his engineers to spend every Friday thinking about new ideas rather than pursuing ongoing projects. Bill and Dave thought that these (and similar) learning experiences could pay off for the company, and they often did.

In 1971 sales took a dramatic downturn and drastic cutbacks were required. Instead of laying off 1,000 people as he had been advised to do, Bill decreed that virtually all employees, including himself, would take Fridays off without pay for the next six months. Many grateful employees worked a full week anyway. Sales picked up as HP introduced more path-breaking products, including the HP 35, the first handheld scientific calculator. The company continued its expansion globally, and by the mid 1970s sales had passed the $1 billion mark. Three years later sales had doubled again.

The Founders Bow Out

By 1978, Bill and Dave had retired from operational management after overseeing the first top-management transition in the company's history. John Young, a long-time HP executive, became CEO, while Hewlett stayed on as chairman. Bill and Dave's old offices became near-shrines: they were left open and untouched, complete with the original linoleum floors and a one dollar bill that Hewlett had left on his desk. (He put it there as proof of the integrity of HP employees, saying, "I could leave it there and it would be there forever." It's *still* there, along with a pile of change that other employees have added over the years.)

Young had taken control of a major computer corporation, and he kept it focused for many years, something that top executives at AT&T, Honeywell, RCA and other competitors were not able to do during that period. The company glided through the early 1980s—with the notable introduction of several new PC models and a desktop printer with Canon inkjet technology—but by the end of the decade, the HP Way philosophy and structure had gotten out of hand. For example, Young discovered that two HP divisions had independently invented microprocessors! Young attempted to establish order, but his efforts apparently added bureaucracy without solving the underlying problems. In addition, after several years of double-digit sales growth, Hewlett-Packard found itself competing directly against IBM and

Digital Equipment in the minicomputer market, Sun Microsystems in engineering workstations and Dell, Apple and Compaq in the PC market.

In 1990 HP faced a serious financial challenge due to these factors. After watching earnings drop 10%, Bill and Dave, who were both nearing 80, roared back and took control of HP once again. (They still owned 25% of the company.) In a summary that, with hindsight, is extremely ironic, one observer said,

> "Hewlett-Packard might well have gone the way of IBM or DEC, but in HP's case powerful shareholders cracked down at the first sign of trouble rather than waiting for it to get out of hand."[17]

Bill and Dave decentralized, moving people away from headquarters to other locations and shifting power back to the operating units. For the first time, they laid off employees—a total of 3,000, but mostly by attrition. They also orchestrated the retirement of John Young, who was 60. Young helped them to handpick Lewis Platt, a thirty-year HP veteran and head of the computer systems group, to become the next CEO.

Lewis Platt, HP's CEO from 1992 to 1999, attempted to reinstate the innovative culture that the early HP had been known for. As a result, there was a pattern of steady growth and profitability for several years, particularly for printer products and high-margin ink cartridges (also based on Canon technology). Unfortunately, there were flaws in the rest of company's product and marketing strategies, and the decade ended much as it had begun.

Despite a lack of important new products to introduce to the market, Platt had continued through the late 1990s to focus on "stretch goals" such as promoting diversity and a more humane balance of work and personal life for employees. One former HP worker said,

> "[IBM CEO] Gerstner wasn't running around talking about work and life balance.
> It was like our own chairman [Platt] didn't realize how tough it was out there."[18]

Decentralization had gone to the other extreme; the company now had 130 independent product groups whose main goal was to meet their own financial targets. The Laser-Jet and ink-jet printer divisions were competing with each other.

This inward focus became a dangerous myopia as HP concentrated on hardware while competitors such as Sun and IBM were reinventing themselves as Internet dot.coms. A consultant who worked with HP at the time said: "They had this 'ready, aim-aim-aim, fire' culture. These days it has to be 'aim, fire, re-aim, re-fire.'"[19] Although the company had developed Internet-compatible technology years ahead of the curve, risk-aversion kept top HP leadership from factoring the growth of the Internet into its technology and marketing decisions. The local wisdom was that if HP ever went into the sushi business, it would advertise the product as "cold, dead fish."

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17   J. Pitta, (1993). "It had to be done and we did it." *Forbes*, 151: 9, April 26, 148-153.

18   P. Burrows and P. Elstrom, (1999). "The Boss." *Business Week*, 3640, August 2, 76-83.

19   Burrows and Elstrom, "The Boss."

HP was once again in trouble. The computer industry was consolidating, with Microsoft, IBM and Dell becoming the dominant players and HP consigned to the also-rans. But David Packard had died in 1996, and William Hewlett was frail; the company couldn't look to them for help this time. Second-generation family members Walter Hewlett, David Woodley Packard, and Susan Packard Orr were members of the HP board of directors, but they all had other professional interests and obligations. Revenue growth had slowed to below 5%. In December 1997 a survey of 300 top employees showed that people saw a need for new thinking and increased customer focus. Platt took drastic action, exploring radical restructuring options. In March 1999, he announced the spinoff of HP's venerable test and measurement units, which became Agilent. (David Packard then resigned from the HP board of directors, since he did not approve of splitting the company.) Platt also asked the HP board of directors to consider hiring a new, Internet-savvy CEO. They took his advice.

Carly Fiorina and the New HP

Enter Carly Fiorina, former president of Lucent's $19 billion global service-provider group. She had earned a reputation as one of the most powerful women in corporate America. In 1996, Fiorina had managed AT&T's successful spinoff of Lucent (at $3 billion, the largest IPO up to that time), and then had launched a $90 million brand-building and product development campaign that transformed Lucent from a manufacturer of phone equipment to an icon of the New Economy.

Fiorina was the daughter of an abstract painter and a California judge. She earned a degree in medieval history and philosophy at Stanford (working as an intern at HP!), then attended law school before changing direction and joining AT&T. She later earned business degrees from the University of Maryland and MIT. She flew up through the ranks at AT&T, earning a reputation for having aggressive marketing skills, a deft human touch, a silver tongue, and most of all an iron will.

After considering 300 potential candidates, on July 19, 1999, the HP board of directors announced that 44-year-old Carly Fiorina would become the company's new CEO. Her appointment was in itself a signal that change was in the wind: she was the first outsider, the first non-engineer, the first woman, and the youngest person to become CEO in HP's history. HP was quite a catch for Carly as well—she was now head of the 14th largest industrial company in the world. Given her record at Lucent, the HP board was convinced that she was their messiah.[20] Board member Jay Keyworth recalled that they asked her to "totally recreate and reinvent HP according to the original HP Way."[21]

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[20] This kind of "consecration" is a classic example of what has been called the *myth of the messiah*: "[People in the organization have] the notion that redemption and salvation will come from an omnipotent source. The person anointed as the messiah walks into an environment overburdened with expectations. He or she is supposed to make right everything that is wrong in the organization. Usually, messiahs are outsiders coming into the family firm to set things right. The messiah can be … a highly praised, recently arrived (non-family) president, for example." M. F. R. Kets de Vries, (1996). *Family Business: Human Dilemmas in the Family Firm*. London: Intl. Thompson Business Press. p. 64.

[21] Economist, (2001). "In the Family's Way." *The Economist*, December 15, 64.

HP employees were equally excited. Fiorina was greeted by standing ovations from HP employees around the world. One manager commented,

> "We were looking for a CEO who would shake up a company that had grown slow and stale. The moral of the story: watch out what you wish for, because you may get it!"[22]

Fiorina's take? HP had become "a gentle bureaucracy of entitlement and consensus." The company was suffering from turf battles and complacency, and the famous HP Way had become a smokescreen for sluggishness and risk aversion. Management needed to clear out "layers of sediment that clogged up the company." Fresh from her experience with Lucent, she made it clear that successful companies have to accelerate change and embrace risk. Her modus operandi: "Preserve the best, reinvent the rest."[23]

As a self-described "brand evangelist," her first move was to come up with a new list of "rules of the garage," invoking the legacy of the HP culture of the early days, with the original garage as an unmistakable metaphor. She also championed a brand-building strategy, starting in November 1999 with the announcement of a $200 million "global brand initiative." She stylized the company's logo—eliminating the name Hewlett-Packard and replacing it with a simpler HP. The purpose of the new logo was to reposition HP as a strong brand uniting diverse product groups. Fiorina went on the road, visiting clients and branch offices, promising that the new HP would offer not only innovative technology, but also better solutions for customers' problems and service requirements. To show that she meant business, in a nationwide ad campaign Fiorina posed next to the iconic one-car garage in Palo Alto, proclaiming that HP was reinventing itself: "HP is a one-car garage in need of paint," she said.

Fiorina's goal was to position HP for the Internet's second wave: e-services. Toward that end, she reduced the number of product groups from 83 to 12, and she divided the organization into six divisions—two front-end for sales (consumer and business) and four back-end for products (computer systems, personal systems [clients], printing and imaging, and services.) The new HP, she promised, would create new e-services and the hardware and software to deliver them. At the end of fiscal 2000, HP had met its revenue growth goal of 15% for the year. Carly—now president, CEO and chairman of HP—was hot, and analysts were bullish on the company again.

Fiorina's next big move came in September 2000, with the announcement that HP was negotiating an acquisition of PricewaterhouseCoopers' (PwC) global management and information technology consulting business. HP simply didn't have the ability in-house to cash in on the lucrative consulting work that implementation of its high-end enterprise applications required. Grafting PwC onto the company would provide a quick fix. Fiorina said, "We believe that the days of talking to one company about business strategy and another company about technology are, frankly, over."[24] Some observers were skeptical, expressing

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22   From private interview.

23   Fiorina's comments appeared in company documents and in press releases.

24   N. Mayes, (2001). "Compaq won't fix HP's services problems," *Global Computing Services*, September 6.

concern that HP might have trouble integrating the 31,000 PricewaterhouseCoopers employees who would come with the deal.

This was a valid concern. Fiorina's rapid and radical restructuring thus far had created disenchantment rather than excitement for many workers, particularly HP department heads and employees who were accustomed to running their outfits as they saw fit. Worse—from their point of view—the restructuring and the concurrent economic downturn now led to inevitable layoffs. More and more employees began to complain that Fiorina had turned her back on the HP Way. One said that she seemed to have come in with the attitude that it was time to "shake up the country club." (Paradoxically, some outside observers said that HP's problems were exacerbated by long-term employees who were lulled by HP's safe, paternalistic ways.) There was concern, given her lack of engineering and technical experience, that Fiorina had not appointed top lieutenants with this type of background to advise her in these areas. Some clients and customers described a climate of confusion and gridlock within the company. One computer reseller said,

> "It's beyond my ability to communicate our frustration. It's painful to watch them screw up million dollar deals."[25]

Given Fiorina's problems with her own employees, it was not at all clear that the integration of the PwC consultants would work. By December 2000, it was clear that the pessimists had been at least half right: Fiorina announced that HP was dropping the PwC acquisition; negotiations would not continue. She blamed the "current market environment" and missed fourth-quarter earnings targets for the breakdown in the acquisition process, and stated,

> "I am unwilling to subject the HP organization to the continuing distraction of pursuing this acquisition any further."[26]

She also acknowledged concerns that HP might have difficulty retaining PwC employees. In addition to this public statement, it was rumored that PwC partners had been "unnerved" by the 26% decline in HP's share price in the months since the deal was announced.

Despite her disappointment, Fiorina quickly bounced back, promising revenue growth of 15 to 17% for HP in 2001. However, the end of the PwC negotiations also seemed to signal the end of Fiorina's honeymoon period at HP. In January 2001, HP missed profit expectations, and Fiorina cut the revenue growth projection to 5% for the year. HP stock was trading down 19% since Fiorina's arrival as CEO.

To be fair, Fiorina had done many things right. HP tripled patent applications in 2000, and the services division—Fiorina's top priority—was growing rapidly in both turnover and revenues. The restructuring of the divisions into front-end and back-end operations had streamlined customer service and was generally seen as a good move—although many managers were still confused about whether sales reps or back-end R&D managers should make production and development decisions. As one employee said,

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[25] P. Burrows and W. Echikson, (2001). "HP's woes are deeper than the downturn." *Business Week*, 3731, May 7, 48.

[26] Fiorina's comments appeared in several sources.

"The idea was to move the pain away from the customer and deal with it inside the company, but for whatever reason the managers under Carly have not been able to execute it well."[27]

Unfortunately for Fiorina, many internal and external stakeholders expected more and better things from HP. Many of the 8,000 HP employees surveyed in February 200l said they were angry about poor internal communication and a visible disconnect between top executives' stated intent and their actions. A former HP employee who left the company to become a venture capitalist said,

"HP is the anchor to the moral system of the [Silicon] Valley. There is a concern that they may be adrift."[28]

Employees' grumbling grew to a roar in July 2001, when HP announced that "deteriorating global economic conditions" would force a reduction of 6,000 jobs—and this just after 80,000 employees had taken voluntary pay-cuts the month before. Many employees expressed dismay; one posted an open letter to Fiorina on an Internet site:

"Dear Carly,

I was at HP for 15 years until you showed me the door. And you still haven't told me why. It was only last March that you paid me a retention bonus to stay with the company as a key contributor. And in May you sent me a generous stash of stock options and said, "This award represents a significant vote of confidence by your managers that you have and will continue to play a critical role in achieving HP's ambitious goals to reinvent the company." And then you told the press that I and 6000 others were dismissed because of job performance. Well shucks, Carly, you lied…."

Meanwhile, during the summer months of 2001, Fiorina, the HP board of directors, and Michael Capellas of Compaq were working behind the scenes on a restructuring of a much larger scale—a merger of their companies.

HP Corporate Governance—Lessons Learned?

HP board members and Fiorina publicly said that they had spent at least two years considering all possible alternatives for HP's future. In May 2001 Fiorina hired McKinsey consultants to look for strategic options. As a result of their findings, the board considered three choices: a) continue as a stand-alone company; b) split HP up; or c) consider high-tech acquisitions. According to official reports, in June 2001 Fiorina met with Capellas to discuss Compaq's licensing of HP software, but the talks turned instead to the possibility of a merger. McKinsey consultants analyzed the potential deal for Fiorina and gave board members a

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27   Anonymous website comment.

28   Q. Hardy, (2001). "Backstabbing Carly." *Forbes*, 167: 14, June 11, 55-55.

report on a Thursday in July—the day that Walter Hewlett was playing his cello at the Bohemian Grove.

McKinsey concluded that there was enough synergy between the two companies that the benefits would outweigh the risks. By August, the HP board was negotiating with Compaq and formulating an integration plan. Two of the HP board members had prior experience with big acquisitions: Boeing CEO Philip Condit (who led Boeing's 1997 acquisition of McDonnell-Douglas) and Sam Ginn (who was CEO at AirTouch Communications when it was sold to Vodafone in 1999).

Three days before the deal was announced in September, Fiorina asked 32-year veteran executive Webb McKinney, along with Compaq's chief financial officer, Jeff Clarke, to co-chair the team that would plan how to fit the two companies together. She asked McKinney to define the ways in which the merged company would achieve the cost savings and revenues she would be presenting to Wall Street when the deal was announced. McKinney later said that it was a complete surprise and a short conversation; he walked out of Fiorina's office thinking, "Oh, my Lord." He considered the job and what it entailed for two days, then called Fiorina and told her he was willing to do it.
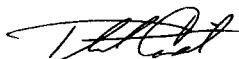
"TO REMAIN STATIC IS TO LOSE GROUND"

   Bill Hewlett and Dave Packard understood that in the face of change, HP could choose to lead or to follow. Always, they chose to lead. In the words of Dave Packard, "Continuous growth was essential for us to achieve our other objectives and to remain competitive. Since we participate in fields of advanced and rapidly changing technologies, to remain static is to lose ground."*

   Today, our industry is again in the midst of profound transformation driven by technical advances, intensified competition and changing customer requirements. To stand still — in these times, of all times — is to fall behind. Now is not the time to retreat.
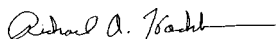
   Instead of resting on HP's legacy, let's build on it.

Sincerely,

Members of Hewlett-Packard's Board of Directors

Philip M. Condit
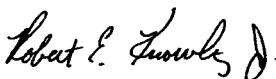HP Director

Richard A. Hackborn
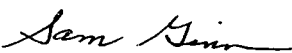HP Director

Patricia C. Dunn
HP Director

George A. Keyworth II
HP Director

Carleton S. Fiorina
HP Chairman of the Board
and Chief Executive Officer

Robert E. Knowling Jr.
HP Director

Sam Ginn
HP Director

Robert P. Wayman
HP Director, Executive Vice President
and Chief Financial Officer

* "The HP Way," p. 141

(The image above is taken from a letter to shareholders dated January 18, 2002. The only board member who did not sign was Walter Hewlett, for obvious reasons.)

The merger was announced on September 4, 2001, and the rest is history—although history itself is never objective. In February 2002, Walter Hewlett categorically stated in a press release:

> "The claim that Hewlett-Packard developed the plan to acquire Compaq as the result of two and a half years of careful consideration and evaluation of alternatives is pure fantasy. In fact, nothing could be further from the truth.
>
> The plan to acquire Compaq came as a result of a phone call from Michael Capellas to Fiorina just a few months prior to the announcement of the transaction, according to HP's own proxy statement. We believe that it was only after this that HP created its purported strategy to justify spending $25 billion to acquire Compaq.
>
> The notion that HP's full board has considered, debated and rejected every alternative we now suggest completely defies the record and common sense."

Although there were several sides to the story, by the end of March 2002, even before the result of the vote was announced, people were beginning to draw conclusions. Walter Hewlett was one of the first to come forward with an analysis of the governance issues involved. Speaking at the Council of Institutional Investors' conference, he said that he had learned a lot about the way corporate governance should change in the United States. In merger negotiations, he said, the board and management should have separate counsel to ensure unbiased advice and fair representation of shareholders' views. Boards are often too insulated, he noted, with few ties to company employees or shareholders. As a result, they usually share management's perspective. Hewlett said that he hoped his independent stand in the Compaq-HP merger would inspire other corporate boards to exert more independence.

Other observers saw the proxy battle as another example of the pitfalls of combining the CEO and chairman positions, a practice which is common in the US but less so in Europe. It also seemed as though HP was lacking a strong second-in-command. Fiorina was functioning as CEO, chairman, de-facto COO (chief operating officer) and visionary; in addition, she was the lightning rod for everyone's discontent. She was the chief strategist as CEO, *and* the chief decision maker as chairman. It could be argued that Fiorina had too much responsibility, although she dismissed the idea that she needed a COO, saying, "I'm running the business the way I see fit."[29] Certainly that's true: it appears that she arrived at HP with a deliberate strategy that she had devised *before* her meetings with HP executives and managers around the world.[30]

Some HP employees severely criticized the HP board members for appearing to put their own financial gain ahead of the long-term health of the company. Their point was that a CEO and directors are the virtual owners of an organization, but because they are non-permanent members, their priority is often to cash out as quickly as possible. Walter Hewlett put it bluntly: "Boards must be pried loose from the grip of management and their hired hands."

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[29]   P. Burrows, (2001). "The Radical." *Business Week*, February 19, 70-80.

[30]   Dr. Henry Mintzberg, McGill University, in private discussion.

What is notable in this case is that the key people on both sides of the merger battle appeared to feel genuinely that HP was a great company, and to be acting according to their vision for a viable future. There really were no villains in this melodrama. However, people were beginning to realize that corporate governance was of interest to a wide—and influential—constituency, and was therefore too important to be left to a select group behind closed doors. This realization would undoubtedly affect corporate governance in the future—and not only at HP.

The Battle for the Heart and Soul of HP

If Fiorina had made the merger proposal a year earlier at the height of her popularity (and in the stronger economic climate of 2000), it might have sailed through with little objection from shareholders or the founders' heirs. But by 2002, Fiorina's reputation had dimmed somewhat, partly because of missteps and bad timing, but also, in some people's minds, because of her hubris. (As one observer said, "She brought to her stewardship a star quality at a company where no one was a star"[31]—and within a corporate culture where, it could be added, no one was *supposed* to be a star.) As a result, Fiorina came under far closer scrutiny not only from Wall Street, but also from the Hewlett and Packard heirs, than she otherwise might have.

The heirs had rational reasons for opposing the merger, and they offered some valid alternative strategies. But the reasons articulated weren't the only possible explanations for the Hewlett and Packard families' rejection of the Compaq-HP merger. Another far more significant event had occurred only a few months before Fiorina proposed her "bet-the-company" move to the board of HP—the death of William Hewlett on January 13, 2001. Steve Jobs remarked that when David Packard died in 1996, it was the beginning of the end of an era; with William Hewlett's death, the era ended.

Years ago, Walter Hewlett was asked what his life's motivation was. He answered, "The privilege of my life is to be my father's son."[32] Therein lies a clue, perhaps, to the some of the irrational forces that sparked the battle for the heart and soul of HP.

Perhaps the connection that he felt with his father also helps to explain why, in a letter from Walter Hewlett sent to shareholders the week before the vote, Hewlett wrote:

HP IS NOT JUST ANOTHER COMPANY

MARCH 19th IS NOT JUST ANOTHER STOCKHOLDER MEETING

Behind all of the … heated rhetoric from HP lies this simple truth: you as a stockholder have the opportunity to decide what kind of company HP will be. HP management has consistently tried to present this decision as a choice between HP's past and HP's future. **Rather, it is a choice between different futures. For**

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[31] M. Simon, (2022). "Whatever the vote, HP Way is long gone." *San Francisco Chronicle*, San Francisco, March 20, A18.

[32] P. Burrows, (2002). "What's the Truth about Walter Hewlett?" *Business Week*, 3769, February 11, 2002, 74-77.

many decades, HP has represented a unique vision of the best an American corporation could be. This merger threatens everything that has made HP great [bold appeared in original text].

On May 9th, two days after the final approval of the merger (by a margin of 2.8%) was announced, David Packard posted an open letter on the door of the Stanford Theater in Palo Alto, which had been restored by the family's foundation. He wrote,

> "The HP Way touched many people's lives. Most of us expected that it would last forever—that it would prove as timeless as a Frank Capra movie.… It's hard to imagine that [the leaders of the new HP] can invent something better than what they left behind.… The old HP is gone, R.I.P. (rest in peace)."

The HP Way Is Dead—Long Live the HP Way!

R.I.P.—or the beginning of a new lease on life? By late spring, the value of HP stock was rising. When Carly Fiorina and Michael Capellas appeared on stage to launch the new HP, they were greeted by a standing ovation from employees. Although everyone realized that there was a tremendous amount of integration work to be done, many observers, HP clients and other stakeholders were optimistic. There seemed to be a feeling of: "The die has been cast; now let's get on with it."

Walter Hewlett, on the other hand, was no longer on center stage, but he was still active nonetheless. He seemed determined to carry on his advocacy of more effective—and responsive—corporate governance. The collapse of Enron and the deflation of WorldCom (the latter a victim of what one observer called "takeover-itis run amok") had sensitized people to governance issues. Would Walter Hewlett now become the leader of a grassroots revolution? (See Appendix A, Walter Hewlett's March 2002 Speech to the Council of Institutional Investors).

In retrospect, the proxy battle and merger were only the first act. After a short pause to regroup, HP and Walter Hewlett would undoubtedly continue to make history—in one Way or another.

Exhibit 1
Excerpts from Walter Hewlett's Speech to the Council of Institutional Investors
March 25, 2002

Thank you. I am delighted to be here today.

I wish to thank you for your support over these past several months. I thank those of you who spoke out publicly on behalf of HP stockholders and, in doing so, spoke out for all shareholders everywhere. …

We took on quite a powerful machine. It had many levers of influence at its disposal and a firm determination to employ them. I believe, however, that what we lacked in relative resources, we made up for in passion and conviction. Regardless of how one voted, I think everyone understood that we are taking an important stand in this effort—one with potentially far-reaching repercussions. …

Indeed, it is my hope that the experiences of the past several months will come to be viewed as a turning point in the evolution of accountability and transparency in the governance of corporations. Issues of corporate governance—from fiduciary responsibility to boardroom ethics—can be highly complex, difficult for even sophisticated shareholders to grasp. These issues arise in a sometimes turbulent environment of strategic risk, corporate politics, personal ambition and high finance. Even in stable, successful companies, such waters can be treacherous. In companies grasping for new strategic direction or reinventing businesses in a changing marketplace, they can at times be downright destructive.

Despite the fact that billions of dollars and the future of great companies are at stake, standards of corporate governance are neither robustly developed nor rigorously examined or enforced. To be blunt: the stakes are high; the standards are not. I have been a director of Hewlett-Packard for 15 years. I believe my recent experiences as a director might provide a useful case study—for this group, for my peers on other boards, and for others engaged in managing and monitoring corporate behavior. If nothing else, I believe my experience makes a clear and compelling case for aligning a director's fiduciary duties as squarely as possible with the interests of stockholders.

Of that I have no doubt.

But we still have a long way to go toward achieving that end. Boards are too easily insulated from the stockholders whose interests we [board members] are obligated to protect. Board members talk to one another and to management. And most often it is management's perspective that they share. Rarely do

they have substantive, ongoing relationships with employees, stockholders, clients and other key stakeholders. Rarely do they acknowledge these other, highly valuable perspectives. …

At the very least, boards must be pried loose from the grip of management and their hired hands. I firmly believe that, in considering grand strategic designs such as mergers and acquisitions, boards must have access to legal and financial counsel that is separate and distinct from management's team. Boards need independent sources of information in order to evaluate plans and ask the tough questions of management. They need to probe executive decisions to be certain the right choices are made. And they need to do so in an environment that rewards honest inquiry, not conformity. Executive committees should meet periodically outside the presence of company managers to assist the free flow of ideas and information.

Despite more than 200 years of political practice in the United States, democracy remains an ideology strangely alien to many corporate boardrooms. And too many corporate executives still fail to distinguish dissent from disloyalty. Above all, too many corporate managers too readily forget who owns the company: the shareholders. …

Is this the beginning of a new wave of advocacy for corporate democracy and accountability? Or is this simply further proof that if you take on a corporate giant, you'll have a heck of a time getting out from under the heel of his boot? The answer is up to all of us. …
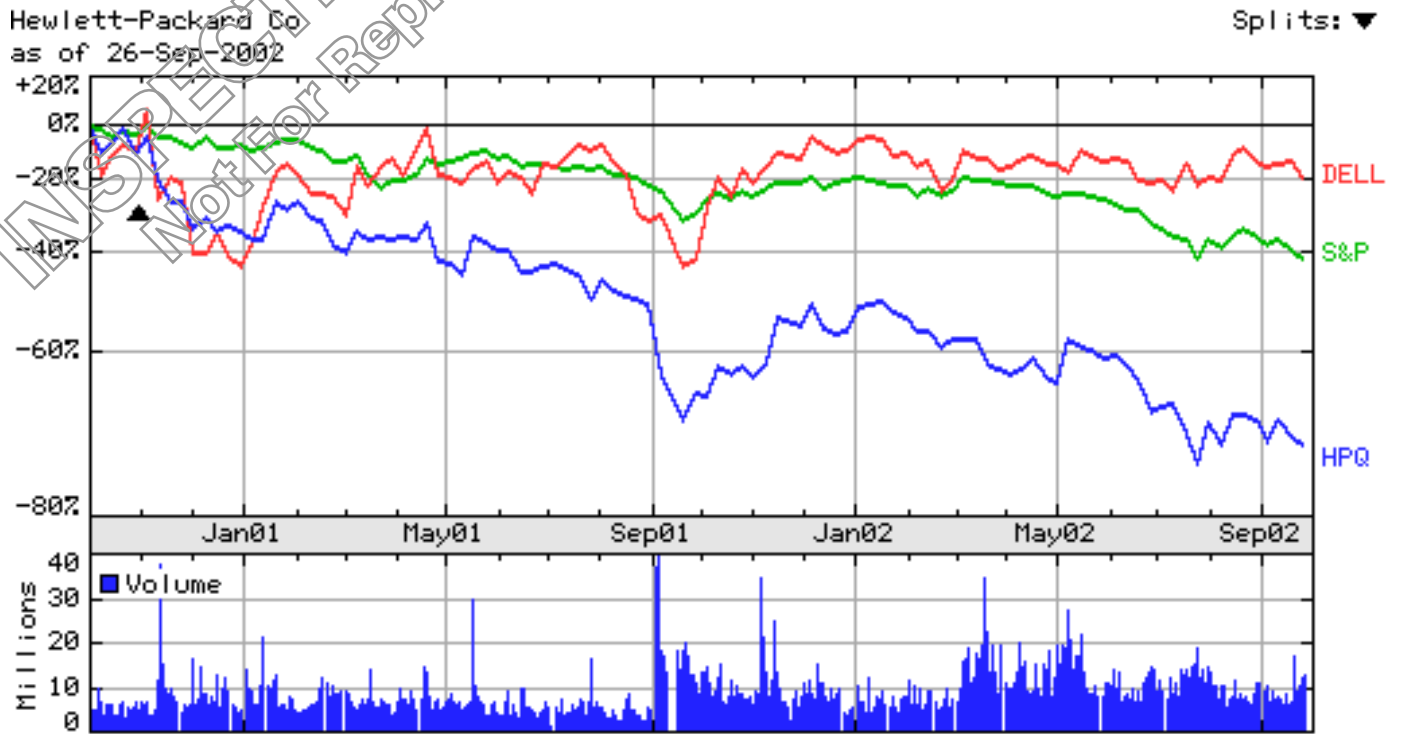
Thank you.

Exhibit 2
The Seven Principles of the HP Way
(From the HP Annual Report 2001)

1. Recognize that profit is the best measure of a company's contribution to society and the ultimate source of corporate strength;

2. Continually improve the value of the products and services offered to customers;

3. Seek new opportunities for growth but focus efforts on fields in which the company can make a contribution;

4. Provide employment opportunities that include the chance to share in the company's success;

5. Maintain an organizational environment that fosters individual motivation, initiative and creativity;

6. Demonstrate good citizenship by making contributions to the community;

7. Emphasize growth as a requirement for survival.

Exhibit 3
HP Stock Price Sept 2001 – Sept 2002
(Compared to S&P 500 and DELL)

Hewlett-Packard Co
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