Leadership Challenges at Hewlett-Packard: Through the Looking Glass

By David F. Larcker and Brian Tayan
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INTRODUCTION

The board of directors has a long list of obligations that includes responsibilities to ensure the strategic direction of the company, hire qualified management, monitor their performance, design their compensation, oversee the establishment of risk management controls, ensure the integrity of financial reporting, oversee the work of the external auditor, ensure compliance with all legal and regulatory requirements, disclose material information to the public, oversee the acquisition and disposition of corporate assets, and communicate effectively with shareholders and stakeholders. Despite the length of this list, however, many believe the fundamental obligations of the board are quite simple and distill down to two: 1) evaluate and approve the corporate strategy and 2) hire and fire the CEO.

CARLY FIORINA (1999-2005)

In 1999, the Hewlett-Packard Company hired Carly Fiorina, former senior executive of Lucent Technologies, as its CEO. It was a striking announcement in many regards. Fiorina was the first external CEO in the company's history. She was also the first female CEO of HP and the first without a background in engineering (she oversaw sales and marketing at Lucent). The decision to bring in an outsider was championed by none other than outgoing Chairman and CEO Lewis Platt, a 32-year veteran of HP who himself had been promoted to the top job in 1992. Platt believed that the company had grown complacent in recent years and that an outsider with a fresh perspective was required to bring about needed change. The company's consensus-driven culture, long a source of pride for encouraging collaboration among workers, was now seen as an impediment to growth. Although HP's revenues were increasing at a double-digit rate, this was still below the hyperbolic growth rates of fellow Silicon Valley companies Cisco, Oracle, and Sun Microsystems.

Fiorina moved quickly to reenergize the company. She reduced the number of reporting units from 83 to 12 and consolidated back-office functions. She replaced the company's profit sharing program with a performance-based compensation system to encourage individual productivity. She revamped the company's sales and marketing functions.

In the process, she drew plenty of attention. *Fortune* magazine put her at the top of its list of the "50 Most Powerful Women in Business," a position she held for five years. *The Wall Street Journal* described her as epitomizing "an alluring, controversial new breed of chief executive officers who combine grand visions with charismatic but self-centered and demanding styles."[1] To many inside the company, the changes were extreme. One executive explained, "The feeling was, here was Carly, who wasn't a long time in the HP culture, who doesn't understand our business and the HP Way, and doesn't understand our strengths, particularly in businesses that were viewed as so successful for so long."[2] Another stated simply, "The HP we know is gone."[3]

Fiorina's most disruptive move came in 2001, when she announced a deal to acquire Compaq Computer for $25 billion in stock.[4] At the time, Compaq was the second largest producer of personal computers, after Dell, and a major supplier of servers. A combination of the two companies would establish HP as a market leader in computer hardware, which Fiorina believed would give HP the leverage it needed to compete successfully with competitors such as IBM in the enterprise systems market.

The deal, however, was controversial in two regards. First, analysts were not convinced that it made strategic sense. HP was seen as doubling down on the commoditized business of hardware manufacturing at a time when many believed it should focus on higher-margin activities such as software, services, and printing. According to one analyst, "Two losers don't make a winner."[5] As a result, HP stock traded down by 30 percent on the news (see Exhibit 1). Second, the deal was controversial in that it drew public opposition from Walter Hewlett, son of company co-founder William Hewlett and a member of the company's board of directors. Although he had originally voted with other board members to approve the deal, he subsequently changed his mind. In a written statement, Hewlett said that, "Given the lack of stockholder benefits, I believe the extensive integration risks associated with this transaction are not worth taking."[6] Shortly thereafter, David Packard Jr., son of second co-founder David Packard, also came out in opposition to the deal: "For some time I have been skeptical about management's confidence that it can aggressively reinvent HP culture overnight—a culture that developed over many years and was thoroughly tested under all kinds of business conditions. While change is necessary and inevitable, it does not follow that every innovation is an improvement."[7]

Opposition by these two men was significant not only because they were sons of the company's founders but also because the two foundations which they controlled—the William and Flora Hewlett Foundation and the David and Lucille Packard Foundation—together held 15 percent of HP's stock. In an escalation of the matter, Walter Hewlett led a proxy fight to terminate the deal.

The controversy led to a rare, public squabble between the company and its major shareholders, with HP's directors joining the fray. Richard Hackborn, former executive vice president of HP and board member, defended the deal, stating, "The board thoroughly analyzed this transaction and unanimously concluded this is the very best way to deliver the value our shareholders expect."[8] He admitted, however, to originally sharing Walter Hewlett's skepticism: "We all had reservations. None of us was convinced that Compaq was the exact right answer at the start." Philip Condit, another director, said that the merger is "certainly not without risk, but I think the opportunity outweighs the risk." Director Robert Knowling said that at first he was "neutral" to the idea, but over time came to believe it was an important way to improve HP's competitive position. According to board member George Keyworth, "Very good people have tried to transform this company through organic growth, targeted acquisitions and the old way. I believe, this board believes, we have to take a big step."[9] Following several months of vigorous lobbying of institutional shareholders by Fiorina, the merger was ultimately approved by a razor-thin margin, with 51.4 percent of shareholders in favor and 48.6 percent opposed.[10]

The Compaq acquisition, however, did not prove to be the transformative event that Fiorina and the board envisioned. HP had forecasted in the merger prospectus that the PC division of the combined entities would generate an operating margin of 3.0 percent in 2003. The actual figure came in at 0.1 percent; in 2004, it was 0.9 percent.[11] Following a string of disappointing earnings reports, the board of directors asked Fiorina for her resignation. Robert Wayman, chief financial officer of HP, served as interim CEO while the board undertook a formal search for a successor. Fiorina made the statement, "While I regret the board and I have differences about how to execute HP's strategy, I respect their decision."[12] She left the company with a severance package valued at $21 million.

MARK HURD (2005-2010)

The search for Fiorina's successor was led by non-executive chairman Patricia Dunn and directors George Keyworth and Thomas Perkins. According to Dunn, "the board is firmly committed to the business strategy that is in place.... Looking forward, we think the job is very reliant on hands-on execution, and we think that a new set of capabilities is called for." When asked whether the company would consider internal as well as external candidates, Dunn responded, "We are not ruling anything out, but we are committed to a very thorough search for the most qualified candidate. We anticipate that that is an external candidate, but we don't know for sure."[13]

Ultimately, the company named Mark Hurd, former CEO of NCR, as chief executive. While a relative unknown in Silicon Valley, Hurd had a reputation for strong operations management and strict cost cutting. Although he had never managed a company of HP's size (NCR had $6 billion in revenue at the time, compared to $80 billion at HP), he had a long-track record of success. He described his management style in an interview: "I believe in very engaged management. I personally like to understand how the businesses work. You've heard the term 'management by walking around.' I like to move through multiple levels of the company and I like my management to do that. Great companies have boards, CEOs and management that all have one script."[14] Separately, he said, "I live by a code that I got taught very early in my career, that it's the company first, the employees second, and you're last."[15] The press labeled him "the un-Carly."

Hurd made aggressive changes to the company's operations. He announced a broad restructuring, including the layoff of 14,500 employees. He reduced management layers and eliminated the corporate sales group, reassigning workers to divisional groups (PC, printing, and enterprise) so that they would have deeper knowledge of the products they sold. To improve accountability, he gave executives more control over their budgets, and held them strictly accountable for performance. The company used the cash flow generated by reduced operating costs to fund a series of acquisitions, primarily in the software and services space. These included Mercury Interactive, Peregrine Systems, Palm, and Electronic Data Systems. The approach paid off. Over the next five years, HP's operating margins increased from 4 percent to 9 percent (see Exhibit 2).

Stability at the company, however, did not last. In 2006, Patricia Dunn was forced out as chairman of the board. Since 2004, the company had struggled to contain the release of confidential information regarding boardroom discussions that was being leaked to the press. This included private discussion among board members and management regarding strategy, leadership, and corporate structure. To identify the source of the leaks, Dunn hired a firm to investigate the matter, which in turn hired a second firm. The detectives of that firm used a questionable technique called "pretexting" (pretending to be someone else) to obtain the private phone records of both HP directors and reporters. Although Dunn was unaware that the technique was being used, she resigned from the board. George Keyworth was identified as the source of the leaks and not renominated at the following annual meeting.

In 2010, the company faced another scandal with the resignation of Mark Hurd. A company contractor had accused Hurd of sexual harassment. Although the charges were determined to be unfounded, the investigation revealed that Hurd had submitted inaccurate expense reports, purportedly in an attempt to conceal his relationship with the woman. Director Marc Andreessen called Hurd's resignation "a necessary decision."[16] This opinion, however, was by no means universal. Board members Joel Hyatt and John Joyce advocated that Hurd remain at the helm until an orderly transition could be arranged. They argued that an abrupt resignation was "a reckless way to make a change" that would cause damage to shareholders.[17] Others felt that Hurd had not been entirely forthcoming with the board and therefore could not be trusted to continue. The board split six to four. Although uninvolved, Larry Ellison, CEO of Oracle, expressed his own opinion: "The HP board just made the worst personnel decision since the idiots on the Apple board fired Steve Jobs many years ago…. In losing Mark Hurd, the HP board failed to act in the best interest of HP's employees, shareholders, customers, and partners."[18] Less than one month later, Ellison hired Hurd to be president of Oracle's hardware division. Hurd left HP with a severance package worth $35 million. CFO Cathie Lesjak was named CEO on an interim basis.

LÉO APOTHEKER (2010-2011)

The search committee for Hurd's successor included Marc Andreessen, Lawrence Babbio, John Hammergren, and Joel Hyatt. Unfortunately, the process was plagued from the outset. First, the dispute over Mark Hurd's resignation lingered to such an extent that it impeded the search committee's efforts. According to one director, "There were so many hard feelings. It became difficult to conduct business in a civil manner."[19] Second, board members were not in agreement whether an internal or external candidate was preferable. Third, despite the prestige of the Hewlett-Packard name, several highly talented external candidates were not interested in the job. According to some reports, the search committee approached executives at NCR, IBM, and Microsoft only to be rebuffed because they did not want to follow in Hurd's footsteps.

When the company named Léo Apotheker as CEO in October 2010, the announcement was greeted with a lackluster response. A native of Germany, Apotheker was the former CEO of SAP where he had overseen somewhat unremarkable results. "It's not something I would have expected," said one analyst about the appointment.[20] An opinion piece in the *Wall Street Journal* highlighted "the unsettling reality that Mr. Apotheker has never truly run his own show, having been SAP's solo CEO for less than a year before his abrupt resignation."[21] More striking was the news (not made public for another year) that not all members of the board had interviewed, or even met, Apotheker before he was given the position. One director explained: "I admit it was highly unusual, but we were just too exhausted from all the infighting." According to another, "among the finalists, he was the best of a very unattractive group."[22] Shortly thereafter, four members of the board resigned (Joel Hyatt, John Joyce, Robert Ryan, and Lucille Salhany). They were replaced by five new directors: Shumeet Banerji, Gary Reiner, Patricia Russo, Dominique Senequier, and Meg Whitman.

Apotheker's tenure at HP was brief and disappointing. At first, he committed to continuing the strategy that Hurd had put in place. Later, he reversed course and announced dramatic changes: the company would terminate its recent foray into tablet computing, sell or spin off its PC division, and purchase business-analytics company Autonomy for $10.25 billion—a price that was ten times revenue. The news triggered a one-day 20 percent decline in HP's stock. Recognizing the tremendous investor dissatisfaction, the board of directors terminated Apotheker's employment. He was given a severance package worth $9.6 million, after only 11 months (see Exhibit 3).

MEG WHITMAN (2011-)

This time, the board of directors did not form a search committee or name an interim CEO. Immediately following Apotheker's resignation, the board named director Meg Whitman as CEO. Director Ray Lane became executive chairman. Whitman promised to continue the basic strategy of the company, although she would review the decision to spin off the PC division.

Many in the investment community were puzzled by the sudden appointment. Although Whitman was well known in Silicon Valley for her tenure at eBay and her unsuccessful run for the California governorship, she did not have experience managing a company in the enterprise technology space, nor had she managed a company of HP's size. Ray Lane defended the decision: "If we thought there was a better choice outside, we would have conducted the search." When asked whether the board would make further changes to shore up investor dissatisfaction, Lane replied: "This is not the board that was around for pretexting. This is not the board that fired Mark Hurd. This is not the board that did everything you want to write about…. It's just like open season to write about this board. It's not this board, okay?"[23]

WHY THIS MATTERS

1. The two primary responsibilities of a board of directors are the approval of the corporate strategy and the selection of a CEO to refine and execute that strategy. Has the board of HP settled on a corporate strategy? Do they understand the skills and experiences required for a CEO to manage the company? What are the necessary skills and experiences to guide HP over the next three to five years?
2. The hallmark of a well-governed company is a reliable system for the development of internal managerial talent. For decades, HP had turned inside for its chief executive officers. Beginning

with Fiorina that changed. Why has HP since only appointed outside executives as CEO?

3. In explaining why a company has decided to appoint an external CEO, boards often claim that there are no insiders who are "ready now." However, every executive who becomes CEO at one point had to make the transition having never done the job before, and it is the responsibility of the board to mentor him or her through this process. Is it appropriate for a company to repeatedly view internal candidates as inferior to external candidates? At some point, shouldn't the board look at the "viability" of candidates rather than whether they are "ready now"? ■

[1] As a case in point, whereas Platt had travelled by coach, Fiorina asked HP to purchase a $30 million Gulfstream IV for her use. See George Anders, "H-P Board Ousts Fiorina as CEO," *The Wall Street Journal*, Feb. 10, 2005.

[2] David P. Hamilton, "Soul Saver: Inside Hewlett-Packard, Carly Fiorina Combines Discipline, New-Age Talk," *The Wall Street Journal*, Aug. 22, 2000.

[3] Quentin Hardy, "The Cult of Carly," *Forbes*, Dec. 13, 1999.

[4] The announcement came one year after Fiorina abandoned an $18 billion bid to purchase the consulting arm of Pricewaterhouse, following a precipitous decline in HP stock. In 2002, IBM acquired the business for $3.5 billion.

[5] Molly Williams, "H-P's Deal for Compaq Has Doubters As Value of Plan Falls to $20.52 Billion," *The Wall Street Journal*, Sep. 5, 2001.

[6] Brian Bergstein, "Family, Foundation of HP Co-Founder Oppose Compaq Deal," *Associated Press*, Nov. 6, 2001.

[7] Brian Bergstein, "Rebukes from Hewlett-Packard Sons Make Fiorina's Life Hard," *Associated Press*, Nov. 7, 2001.

[8] *Ibid*.

[9] Steve Lohr, "It's the Scion vs. the Board in Merger Fight," *The New York Times*, Feb. 4, 2002.

[10] Following the outcome of the vote, Walter Hewlett resigned from the board. Both the Hewlett and Packard Foundations sold the majority of their holdings in HP stock. See Hewlett-Packard, form 8-K, filed with the SEC, April 18, 2002.

[11] Carol J. Loomis and Oliver Ryan, "Why Carly's Big Bet is Failing," *Fortune*, Feb. 7, 2005.

[12] Pui-Wing Tam, "Fallen Star: HP's Board Ousts Fiorina as CEO," *The Wall Street Journal*, Feb. 10, 2005.

[13] Edited lightly for clarity. "Hewlett-Packard Conference Call-Financial Analysts," FD (Fair Disclosure) Wire, Feb. 9, 2005.

[14] Pui-Wing Tam, "Boss Talk: Hitting the Ground Running—New CEO of H-P Immerses himself in Studying Company," *The Wall Street Journal*, Apr. 5, 2005.

[15] Adam Lashinsky and Doris Burke, "Mark Hurd's Moment," *Fortune*, Mar. 16, 2009.

[16] Ashlee Vance, "Hewlett-Packard Ousts Chief for Hiding Payments to Friend," *The New York Times*, Aug. 7, 2010.

[17] Ben Worthen, Justin Scheck and Joann Lublin, "H-P Defends Hasty Whitman Hire," *The Wall Street Journal*, Sep. 23, 2011.

[18] Ashlee Vance, "Oracle Chief Faults HP Board for Forcing Hurd Out," *The New York Times*, Aug. 10, 2010.

[19] James B. Stewart, "Ouster of Hewlett-Packard CEO is Expected: Most Voted to Hire Apotheker without Meeting Him," *The New York Times*, Sep. 22, 2011.

[20] Ashlee Vance, "Ex-Chief of SAP is Named to Lead H-P," *The New York Times*, Oct. 1, 2010.

[21] Rolfe Winkler, "Is Apotheker Right Potion for H-P?" *The Wall Street Journal*, Oct. 2, 2010.

[22] James B. Stewart, loc. cit.

[23] "Hewlett-Packard Names Meg Whitman President and Chief Executive Officer Conference Call," Sep. 22, 2011. Available at: http://h30261.www3.hp.com/phoenix.zhtml?c=71087&p=irol-irhome.

David Larcker is the Morgan Stanley Director of the Center for Leadership Development and Research at the Stanford Graduate School of Business and senior faculty member at the Rock Center for Corporate Governance at Stanford University. Brian Tayan is a researcher with Stanford's Center for Leadership Development and Research. They are coauthors of the books *A Real Look at Real World Corporate Governance* and *Corporate Governance Matters.*
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EXHIBIT 1 — HEWLETT-PACKARD: STOCK PRICE HISTORY AND SELECTED EVENTS

Note: Adjusted for stock splits.

Source: Center for Research in Securities Prices (University of Chicago).

EXHIBIT 2 — HEWLETT-PACKARD: SELECTED INFORMATION AND BOARD OF DIRECTORS

Year	2000	2001	2002	2003
Revenue ($ mm)	$ 48,782	$ 45,226	$ 56,588	$ 73,067
Earnings ($ mm)	$ 3,697	$ 408	($ 903)	$ 2,539
Operating Margin	9.5 %	3.2 %	(1.8 %)	4.0 %
CEO	Fiorina	Fiorina	Fiorina	Fiorina
Board of Directors	*Executive* Carleton Fiorina Robert Wayman *Nonexecutive* Philip Condit Patricia Dunn Sam Ginn R. Hackborn Walter Hewlett George Keyworth S. Packard Orr	*Executive* Carleton Fiorina Robert Wayman *Nonexecutive* Philip Condit Patricia Dunn Sam Ginn R. Hackborn Walter Hewlett George Keyworth Robert Knowling	*Executive* Carleton Fiorina Michael Capellas *Nonexecutive* Lawrence Babbio Philip Condit Patricia Dunn Sam Ginn R. Hackborn George Keyworth Robert Knowling Sanford Litvack Thomas Perkins Lucille Salhany	*Executive* Carleton Fiorina *Nonexecutive* Lawrence Babbio Philip Condit Patricia Dunn Sam Ginn R. Hackborn George Keyworth Robert Knowling Sanford Litvack Thomas Perkins Lucille Salhany

EXHIBIT 2 — CONTINUED

Year	2004	2005	2006	2007
Revenue ($ mm)	$ 79,905	$ 86,696	$ 91,658	$ 104,286
Earnings ($ mm)	$ 3,497	$ 2,398	$ 6,198	$ 7,264
Operating Margin	5.3%	4.0 %	7.2 %	8.4 %
CEO	Fiorina	Fiorina / Hurd	Hurd	Hurd
Board of Directors	*Executive* Carleton Fiorina *Nonexecutive* Lawrence Babbio Patricia Dunn R. Hackborn George Keyworth Robert Knowling Sanford Litvack Robert Ryan Lucille Salhany	*Executive* Robert Wayman *Nonexecutive* Lawrence Babbio Patricia Dunn R. Hackborn George Keyworth Robert Knowling Thomas Perkins Robert Ryan Lucille Salhany	*Executive* Mark Hurd Robert Wayman *Nonexecutive* Lawrence Babbio Sari Baldauf Patricia Dunn R. Hackborn J. Hammergren George Keyworth Thomas Perkins Robert Ryan Lucille Salhany	*Executive* Mark Hurd *Nonexecutive* Lawrence Babbio Sari Baldauf R. Hackborn J. Hammergren Robert Ryan Lucille Salhany G. Thompson

EXHIBIT 2 — CONTINUED

Year	2008	2009	2010	2011
Revenue ($ mm)	$ 118,364	$ 114,552	$ 126,033	N/A
Earnings ($ mm)	$ 8,329	$ 7,660	$ 8,761	N/A
Operating Margin	8.9 %	8.9 %	9.1 %	N/A
CEO	Hurd	Hurd	Hurd / Apotheker	Apotheker / Whitman
Board of Directors	*Executive* Mark Hurd *Nonexecutive* Lawrence Babbio Sari Baldauf R. Hackborn J. Hammergren Joel Hyatt John Joyce Robert Ryan Lucille Salhany G. Thompson	*Executive* Mark Hurd *Nonexecutive* Lawrence Babbio Sari Baldauf Rajiv Gupta J. Hammergren Joel Hyatt John Joyce Robert Ryan Lucille Salhany G. Thompson	*Executive* Mark Hurd *Nonexecutive* Marc Andreessen Lawrence Babbio Sari Baldauf Rajiv Gupta J. Hammergren Joel Hyatt John Joyce Robert Ryan Lucille Salhany G. Thompson	*Executive* Leo Apotheker *Nonexecutive* Marc Andreessen Lawrence Babbio Sari Baldauf Shumeet Banerji Rajiv Gupta J. Hammergren Raymond Lane Gary Reiner Patricia Russo D. Senequier G. Thompson Meg Whitman

EXHIBIT 3 — HEWLETT-PACKARD: CEO SIGNING BONUSES AND SEVERANCES

	First Year Compensation	Severance
Carly Fiorina	Salary: $1 million Signing bonus: $3 million Annual bonus: $1.25 to $3.75 million Stock and options: $80 million	Severance: $14 million Performance bonus: $7.3 million Accelerated vesting of options
Mark Hurd	Salary: $1.4 million Signing bonus: $2 million Annual bonus: $2.8 to $8.4 million Long-term bonus: $4.2 to $12.6 million Stock options: $6.9 million Restricted stock: $8 million Relocation: $2.75 million	Severance: $12.2 million Stock options: $8.9 million Performance units: $12.7 million Restricted stock: $0.6 million
Léo Apotheker	Salary: $1.2 million Signing bonus: $4 million Annual bonus: up to $6 million Stock and options: $36 million Relocation and other: $4.6 million	Severance: $7.2 million Performance bonus: $2.4 million Accelerated vesting of shares and options
Meg Whitman	Salary: $1 (not million) Performance bonus: $2.4 million Stock options: $45.2 million	