The Negotiation Process in a Recent Mega Merger:  
The Case Study of Hewlett-Packard / Compaq

by

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Submitted to the Alfred P. Sloan School of Management  
in partial fulfillment for the requirements for the degree of

MASTER OF BUSINESS ADMINISTRATION

at the

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ABSTRACT

This thesis intends to present a detailed analysis of the merger process carried out by Hewlett Packard and Compaq under the scope of the negotiation process. It will address how the parties involved negotiated, and how internal and external negotiations unfolded at the same time.

It starts with a description of the different parties involved and each interest at stake. It continues with a detailed explanation about the reasons that these two companies had to merge, the reasons why the Hewlett family opposed the merger, and how the competition was affected.

After a chronology of the merger, this research ends with an analysis of the behavior of each party in the negotiation process and from that perspective, what are the lessons learned from this case.

Morris A. Adelman Professor of Management
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This thesis is dedicated to my lovely family: my dear wife Lucita, my son Andrés, my daughter María de la Luz and my "not-yet-born" baby, to whom I am completely thankful for their love and support during the time I spent working in this research.

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INTRODUCTION

In 1999, due to an increasingly competitive market environment, the Hewlett Packard Company (HP) board of directors and members of HP management became particularly focused on developing strategies to secure HP’s future by strengthening HP’s products and services’ offering. This process consisted of developing several alternatives which allowed HP to face this challenging competitive market. These alternatives included, among others, a solution that consisted of developing its server, storage and services businesses by acquiring significant participants in the industry including Compaq Corporation (Compaq).

The alternative of merging HP and Compaq became later not only one of the largest mergers in the IT industry but also in the American economy.

The purpose of this thesis is to provide an analysis of this merger from the perspective of the negotiation process, but not provide an opinion on how good or bad, right or wrong the merger was, or if the price and the structure proposed was the right one. The thesis will also analyze how the CEO’s and teams’ management skills were deployed in an attempt to achieve the best outcome for the two companies.

Additionally, it will cover the different stages of the negotiation process and how the parties modified their strategies to achieve the final goal. In this part I will cover how HP, led by Carly Fiorina, faced two, not one, negotiations: internally they negotiated with the
Hewlett family – important stakeholder who strongly disagreed and still does- and externally with Compaq, key elements of the negotiation process.

I will address the reasons for this merger and what forced these two companies to sit down at the bargaining table and finally agree to merge. I will also address the reaction of the competitors and how they modified their strategies given the reshaped scenario.

Finally, the analysis will conclude by answering the following questions:

1. How effective was the negotiation process in achieving the goals and matching the interest of the negotiating parties?
2. Could alternative strategies have improved the outcome?
3. What were the strengths and weaknesses of the parties’ choices of tactics during the negotiation?

Given that this case is still sensitive and very much alive, it was very difficult to find “inside information” or opinions directly from the key players in this merger. Although we tried to contact the players, most of the research presented here comes from public information, basically newspapers, business magazines, press releases, HP web pages, Carly Fiorina’s speeches, SEC files, books and informal meetings with HP employees as well as several meetings with HP’s competitors and industry specialists.
CHAPTER 1

Parties to the Merger

This first chapter will describe parties to the merger and the team of people behind each party.

At the time the merger was announced on September 4, 2001 there were—apparently—two parties involved: Hewlett Packard Company and Compaq Corporation. However during the negotiation a third group arose. This group was composed of dissident shareholders: the Hewlett Family led by Walter Hewlett, son of William Hewlett, co-founder of HP. They opposed to the merger for reasons explained in Chapter II.

1.1. Hewlett-Packard Company (HP)

William Hewlett and Dave Packard founded Hewlett-Packard in 1939, after formalizing the company name with a coin toss. The company's first product, built in a Palo Alto garage, was an audio oscillator—an electronic test instrument used by sound engineers. HP went public in 1957, after its IPO was held for $16 a share. Employees at all levels with six months of service received an automatic stock grant and became eligible for a stock option program.

Under the leadership of John Young, the founders' chosen successor (named CEO in 1978) HP introduced its first PCs, the first desktop mainframe and the LaserJet printer.
Hewlett retired in 1987; sons of both Hewlett and Packard were named that year to the company's board of directors. In 1992, HP acquired Texas Instruments' line of UNIX-based computers and made a new commitment to product cost cutting. Lewis Platt, an EVP since 1987, was named president and CEO that year. Packard retired in 1993.

In 1999 Platt retired and HP appointed Lucent Technologies’ executive Carleton (Carly) Fiorina President and CEO to “lead HP's reinvention as a company that makes the Internet work for businesses and consumers.”1 She was named chairman of the board the following year.

HP is a leading global provider of computing, printing and imaging solutions and services for business and home, and is focused on making technology and its benefits accessible to all. HP currently organizes its operations into three major businesses.

**Imaging and Printing Systems** provides printer hardware, supplies, imaging products and related professional and consulting services. Printer hardware consists of laser and inkjet printing devices. Imaging products include all-in-one inkjet devices, scanners, digital photography products, personal color copiers and faxes.

**Computing Systems** provides commercial personal computers (PCs), home PCs, workstations, UNIX servers, PC servers, and storage and software solutions. Commercial PCs include the Vectra desktop series, as well as OmniBook and Pavilion notebook PCs.

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1 HP Website: http://www.hp.com
Home PCs include the Pavilion series of multimedia consumer desktop PCs.

Workstations provide UNIX, Windows and Linux-based systems. The UNIX server offering ranges from low-end servers to high-end scalable systems such as the Superdome line, all of which run on HP’s PA-RISC architecture and the HP-UX operating system. PC servers offer primarily low-end and mid-range products that run on the Windows and Linux operating systems. Storage provides mid-range and high-end array offerings, storage area networks and storage area management and virtualization software, as well as tape and optical libraries, tape drive mechanisms and tape media. The software category offers Open View and other solutions designed to manage large-scale systems and networks. In addition, software includes telecommunications infrastructure solutions and middleware.

IT Services provides customer support, consulting, outsourcing, technology financing and complementary third-party products delivered with the sales of HP solutions. Customer support offers a range of high-value solutions from mission-critical and networking services that span the entire IT environment to low-cost, high volume product support. Consulting provides industry-specific business and IT consulting and system integration services in areas such as financial services, telecommunications and manufacturing, as well as cross-industry expertise in Customer Relationship Management (CRM), e-commerce and IT infrastructure. Outsourcing offers a range of IT management services, both comprehensive and selective, including transformational infrastructure services, client computing managed services, managed web services and application services to
medium and large companies. Technology financing capabilities include leasing, solution financing and computing and printing utility offerings.

1.2. HP Team

Carleton (Carly) S. Fiorina – Chairman and CEO Hewlett Packard

Dick Hackborn – member of the board and Carly Fiorina’s mentor.

Duane E. Zitner – President Computing System

Ann M. Livermore – President HP Services (who was recommended by former CEO Lew Platt to replace him after he gave up).

Ann O. Baskins – Vice-President General Counsel

Robert P. Wayman – HP Director and Chief Financial Officer

By early 2001, in an effort to maximize opportunities for its UNIX business, HP began approaching other companies to determine whether they would be interested in licensing HP’s UNIX operating system, HP-UX. As part of these initiatives and following a series of previous discussions between business unit representatives of both companies, Ms. Fiorina contacted Compaq’s President and CEO, Michael Capellas, in June 2001 to discuss Compaq’s interest in licensing HP-UX.

1.3. Compaq Computer Corporation

Former Texas Instruments executives Joseph Rodney “Rod” Canion, Jim Harris and Bill Murto formed Compaq Computer Corporation, originally called Gateway Technology, in
Houston, Texas in 1982. The company's name was a combination of two the words "compatibility" and "quality."

During 1991, due to the economic recession and price competition, Compaq's revenue decreased. Canion was forced to resign as CEO and Eckhard Pfeiffer replaced him. Pfeiffer was the company's COO and a former marketing head at Texas Instruments. The change in leadership made Compaq withdraw from ACE and sell back its stake in SGI. Pfeiffer started a battle against IBM clones by cutting gross profit margins nearly in half, starting an intense price war. The aggressively priced ProLinea PC line was introduced by the mid 1990s. Compaq was shipping more PCs than any other company in the world.

To achieve Pfeiffer's vision of becoming one of the world's three largest computing companies by 2000, Compaq bought Tandem Computers in 1997. With the objective of boosting its service prowess, in 1998, Compaq acquired Digital Equipment Corporation for $9.6 billion.

In order to compete with Dell Computer's direct sales approach to the industry, Compaq began using the Internet to sell PCs to businesses. To accomplish this goal, in 1999, Compaq formed AltaVista Company and purchased the online retailer Shopping.com. The results did not arrive and Pfeiffer was pressured to resign due to disappointing earnings and shareholder suits.
Compaq’s board chose Michael Capellas, Compaq’s COO, as President and CEO and appointed Rosen as Chairman. Although there was some success in growing its services business, Compaq felt the results of a declining PC market and decided to join forces with a longtime competitor. HP and Compaq were officially merged into one entity on May 6, 2002, in a stock deal valued at $19 billion. The new entity serves more than one billion customers in 162 countries. It is a leading global provider of products, technologies, solutions and services in the IT infrastructure, personal computing and access devices, global services and imaging and, printing products industry.

Compaq is a leading global provider of information technology products, services and solutions for enterprise customers. Compaq designs, develops, manufactures and markets information technology equipment, software, services and solutions, including industry-leading enterprise storage and computing solutions, fault-tolerant business-critical solutions, communication products, personal desktop and notebook computers and personal entertainment and Internet access devices.

Compaq aggregates its strategic business units into three reportable segments:

**Enterprise Computing** designs, develops, manufactures and markets advanced computing and telecommunications products and solutions for enterprise customers worldwide. The Enterprise Computing segment consists of three global business units: Industry Standard Servers, Business Critical Solutions and Enterprise Storage. Industry Standard Servers designs and manufactures industry-standard servers, which are building blocks for IT
infrastructures, and integrates these with software and services to provide IT solutions for companies of all sizes. Business Critical Solutions provides solutions that deliver the highest levels of availability, performance, scale and manageability for the telecommunications, financial services, high performance technical computing and other business critical market segments. Enterprise Storage provides global storage solutions through the development and delivery of Compaq storage area networks, automated backup solutions, network attached storage and a complete suite of Compaq storage management solutions.

Access delivers products and solutions designed to provide home and business users with anytime, anywhere access to information, communication and entertainment. For the business customer, the Access segment offers a broad range of innovative commercial computing devices, services and solutions. These include desktop, notebook, workstation and thin client products marketed under the full line of Compaq-branded monitor and networking products. These include Presario™ branded desktop and notebook Internet PCs and a line of monitors and printers sold under the Compaq brand.

Compaq Global Services helps customers manage the complexities and risks of today’s multi-vendor, multi-technology IT environments. Compaq Global Services’ proven methodologies and best-in-class processes deliver IT solutions for today’s most challenging business issues. Compaq Global Services’ solutions are optimized for the highest levels of performance, availability and security. Compaq Global Services is a pioneer in wireless computing solutions, “Computing on Demand” or utility style
computing and an industry leader in delivering enterprise solutions based on Microsoft Corporation technologies.

1.4. Compaq Team

Michael D. Capellas – Chairman and CEO
Shane V. Robinson – Senior Vice-President, Technology and Chief Technology Officer
Jeff Clarke – Chief Financial Officer
Thomas C. Siekman – General Counsel

A couple of days after Ms. Fiorina’s first approach in trying to license its HP-UX, people from Compaq, led by Mr. Capellas, approached the HP team to eventually discuss a potential broader association with HP which would include a possible business combination. This perhaps was the first time in which the two companies started evaluating the idea of a potential merger.

For these two companies, there was one particular common interest, which was to develop some strategy that would allow them to enter the new century with a new way of doing business and to compete efficiently in an industry where growth rate was declining. There was a third group, however, who felt that the potential merger was definitely the beginning of value destruction in HP.
1.5. Hewlett Family

The Hewlett family had (at the time the negotiation was taking place and after few days after the merger took off) one member on the board of directors of HP: Walter B. Hewlett, who represents the family interest in HP. Persons and institutions represented within the board of directors are:

Walter B. Hewlett

Steve Neal – Walter Hewlett’s lawyer

Edwin E. van Bronkhorst

The William R. Hewlett Revocable Trust

This group of stakeholders opposed the merger because, although the merger would produce a much bigger HP, they thought that the company would be less focused and more troubled. To them, the merger was a backward-looking strategy and they thought that HP should keep its long tradition of inventing and investing for the future.
CHAPTER 2

Merger Considerations

This chapter will consider: the rational for the merger, the strategic benefits of the merger, what the new HP should look like, and each party's perspective on the merger, what the parties expected from the merger, what their interests are, and why the Hewlett Family opposed the merger.

2.1. Reasons for the Merger

The boards of directors and management teams of both companies, HP and Compaq, believed that the proposed merger represented the best strategic alternative for delivering increased value to their respective shareholders and addressing a number of challenges and opportunities their companies were facing.

Several of these opportunities and challenges are described below. HP and Compaq shared the conviction that advances in technology, increased competition and changing customer requirements are rapidly transforming the structure and economics of the information technology (IT) industry in ways that demand quick and decisive action to remain competitive. In the area of enterprise computing and IT services—areas they consider to be the primary engines for new value creation—customers increasingly are looking to purchase integrated solutions, not individual products and technologies, from a smaller number of global end-to-end solutions providers. These customers also are
seeking to take advantage of the economics and flexibility of standards-based platforms and architectures.

In the personal computer (PC) segment of the industry, which is maturing and consolidating, customers are looking for low cost products with greater features and functionality, as well as purchasing flexibility. As a result of these customer demands and intense competition among PC vendors, success in the PC industry requires increasingly lower cost structures, flexible distribution capabilities and continuous product innovation. HP has already undertaken independent actions, such as the recently announced outsourcing of its PC manufacturing operations in France, to improve the cost structure of this business, but HP recognizes that additional cost saving measures will be required. It is true that Dell is doing a fantastic job in the PC manufacturing and in the delivery of its products. HP and Compaq are conscious of that and part of this strategy is to try to reduce its delivery period substantially. However, as many competitors criticized, the reason why HP must be in this business is because it is part of the whole range of products HP is developing. To be number one in the IT industry, a company cannot even think of not being in the PC business. It could be an unprofitable business, as Walter Hewlett said, but HP can not be out and after a while, reenter. The cost is even larger.

In the services segment, both companies operate profitable, growing services businesses, but neither company alone has a services business of the size that places it among the top few global IT services businesses on a revenue basis. Accordingly, both HP and Compaq believe that the expansion of their services businesses is an important source of growth
and profitability for their companies. In addition, HP has identified the expansion of its imaging and printing business into new areas of growth as essential to maintaining leadership in that segment. HP believes that the strengthening of its professional services capabilities and its PC business, the expansion of its reach into enterprise accounts and improvements in the profitability of those businesses will benefit the long-term success of its imaging and printing business in new and emerging markets.

The proposed merger provides significant benefits and they believe that failure to take quick and decisive action to address comprehensively the business opportunities and challenges facing their respective businesses will weaken their respective long-term competitive positions and result in the deterioration of their respective businesses.

Similarly, they believe that maintaining the status quo or moving too slowly to address these items ultimately will erode the value of both companies to their respective shareowners.

2.2. Strategic Benefits of the Merger

HP and Compaq believe that the merger presents a unique opportunity to enhance their combined competitive position in key industries, while strengthening their sales force and their relationships, all in a single transaction. As global enterprises look to maintain stronger partnerships with a smaller number of vendors, it will be crucial not only to have offerings across a broad spectrum of products, but also to have market-leading products and solutions across that spectrum. The merger will greatly expand and strengthen their
product and service offerings, make them a compelling partner, and provide a more robust platform for innovation, all of which will combine to accelerate their leadership position as an end-to-end solutions provider.

Regarding Servers, HP and Compaq offer complementary solutions that, taken together, will give the combined company industry-leading product offerings spanning the server category. Compaq is also the segment leader in industry standard servers—the fastest growing area in the server industry—that operate on third-party operating systems like Microsoft Windows NT and Linux. Combining these offerings with HP’s strength in UNIX servers, which they believe will be further enhanced by Compaq’s technology, fills out the combined company’s server leadership. Combining the companies’ respective investments in Linux will also enhance the combined company’s innovation in this area.

In terms of Storage, Compaq is the leading provider of such systems in the world, measured on a revenue basis. Combining this leadership position with HP’s strength in high-end storage will create an even stronger industry leader in the enterprise storage area and especially in the fastest growing portion of storage where Compaq products will enable their customers to manage complex environments more efficiently.

In IT Services, the merger also will significantly strengthen their combined services business: the combined company will have available 65,000 IT architects operating in more than 160 countries around the world. This will provide the critical mass and scale to accelerate their growth in this key market.
The merger will expand their combined support business, which is an important driver of customer loyalty and provides a larger customer base to which the combined company can sell additional products and services. HP and Compaq also believe that their combined support business also will deliver a larger stream of predictable, regular revenues with higher net profits.

The combined company’s expertise in servers, IT, storage, desktops, printing and wireless devices, along with expertise in multi-vendor technologies, will make the combined company a leader in multi-vendor support.

HP and Compaq recognize the need to improve the overall economics of their respective PC businesses to create a sustainable and viable competitor. The combined company will have greater economies of scale that they believe will lower the cost structure of their combined PC business and have a positive impact on margins. Furthermore, the merger will combine HP’s strength in the consumer PC business and Compaq’s strength in the commercial PC business to create a more balanced industry leader. In addition, Compaq has made significant progress in developing its direct distribution capabilities in its PC business, which the combined company will be able to leverage to create a more flexible distribution model. With this progress and the accelerating momentum Compaq has demonstrated as a direct distributor, they believe the merger will substantially enhance HP’s distribution model.
With regard to Imaging and Printing the merger also will provide important benefits to HP business. By improving profitability in their other business segments, the merger will enable them to increase their investment in core research and development and new initiatives such as digital imaging and digital publishing. HP believes that this investment will be crucial to maintain its leading position in this business, HP’s primary cash generator. In addition, the merger will enable HP to extend the reach of its business into new customer relationships that Compaq brings to the combined company, and take advantage of Compaq’s direct distribution capability to enhance the distribution flexibility of the combined company’s Imaging and Printing business.

2.3. The new HP. (What is the structure the two teams think the merged company should have).

The new HP will offer the industry's most complete set of IT products and services for both businesses and consumers, with a commitment to serving customers with open systems and architectures. The combined company will have #1 worldwide revenue positions in servers, access devices (PCs and hand-holds) and imaging and printing, as well as leading revenue positions in IT services, storage and management software.

The merger is expected to generate cost synergies reaching approximately $2.5 billion annually and drive a significantly improved cost structure. The new HP would have approximate assets of $56 billion, annual revenues of $87 billion and annual operating
earnings of $4 billion. It would also have operations in more than 160 countries and over 145,000 employees.

Cost synergies of approximately $2.0 billion are expected in fiscal 2003, the first full year of combined operations. Fully realized synergies are expected to reach a run rate of approximately $2.5 billion by mid-fiscal 2004. These anticipated synergies result from product rationalization; efficiencies in administration, procurement, manufacturing and marketing; and savings from improved direct distribution of PCs and servers.\(^2\)

HP and Compaq plan to integrate their businesses and product lines and organize the combined company’s business into four major groups.\(^3\)

2.3.1. Enterprise Systems

The Enterprise Systems group will be led by Mr. Blackmore, currently Compaq’s Executive Vice President, Worldwide Sales and Services, and will include servers, storage and software. It will provide a full line of computing systems from high-volume industry standard servers to high-end, fault-tolerant systems; a wide range of storage solutions from mid-range and high-end array systems, to storage area networks and storage area management software; and industry leading offerings in management software, integrated services management and next generation operating environments.

\(^2\) SEC file Form S-4
\(^3\) HP Press Release September 3, 2001
2.3.2. Services

The Services group will be led by Ms. Livermore, currently President of HP Services, and will provide support, consulting and outsourcing to help design, build, and manage and support the Enterprise Systems group. The combined services organization is expected to include 65,000 professionals around the world. The business offerings of the Services group will include ongoing support and maintenance, in addition to proactive services like mission-critical support and networking services, IT consulting and system integration services, and comprehensive and selective outsourcing.

2.3.3. Imaging and Printing Systems

The Imaging and Printing group will be led by Mr. Joshi, currently HP’s President of Imaging and Printing Systems. The offerings of the Imaging and Printing group will continue to include HP LaserJet and Inkjet printer hardware (both monochrome and color), multi-function laser devices, wide- and large-format Inkjet printers, printing supplies, scanners, digital photography products, personal color copiers, faxes and all-in-one products that combine multiple functions like scanning, copying and printing in one device.

2.3.4. Personal Systems

The Personal Systems group will be led by Mr. Zitzner, currently HP’s President of Computing Systems, and will include business and consumer desktop and mobile personal computers, workstations, handheld computing devices, new types of Internet-access devices, personal storage devices, and digital music and entertainment devices.
The Personal Systems group will focus on serving customers through multiple channels including strong distributor, reseller, and retail channel efforts, in addition to directly serving customers through the Internet and by telephone.

In addition to these primary business groups, the combined company will include several corporate level organizations. Among these will be HP Labs, which will include part of Compaq’s research and development function, an organization focused on corporate philanthropy and community responsibility, and a corporate operations organization focused on areas of cross-company opportunity, including procurement. It is the intention that the combined company will use the HP brand for existing HP branded products and new products that will be introduced after the completion of the merger, while retaining the Compaq brand and Compaq sub-brands for selected commercial and consumer product lines.

HP recognizes the challenge inherent in integrating enterprises of the size and complexity of HP and Compaq. HP also recognizes that a swift and successful integration of the two companies is crucial for capturing the potential value of the merger. Accordingly, HP has established an integration office that will report directly to Ms. Fiorina. This office will be run jointly by Mr. McKinney and Mr. Clarke, each a key executive officer at HP and Compaq, respectively. Mr. McKinney currently serves as the President of HP’s Business Customer Organization and provides a proven record as a line manager and deep expertise in the HP organization. Mr. Clarke currently serves as Compaq’s Senior Vice President, Finance and Administration, and Chief Financial Officer and provides his
depth of knowledge of the IT industry and of Compaq. Mr. Clarke also brings significant expertise in finance and general corporate matters. The integration office now consists of more than 450 dedicated employees, supported by advisors and divided into teams with specifically defined functions.

2.4. Hewlett Packard considerations to the merger.

The factors, in addition to the reasons described above, that the HP board of directors considered in reaching its determination include the following:

- management’s view of the financial condition, results of operations and businesses of HP and Compaq before and after giving effect to the merger;
- current financial market conditions and historical market prices, volatility and trading information with respect to the common stock of HP and the common stock of Compaq;
- the relationship between the market value of the common stock of Compaq and the consideration to be paid to shareowners of Compaq in connection with the merger and a comparison of comparable merger transactions;
- other strategic alternatives for HP, including organic growth as an independent company, the potential to enter into strategic relationships with third parties were analyzed with unsatisfactory results.
2.5. **Compaq considerations to the merger.**

Like HP, the board of directors of Compaq, after a thorough analysis, determined to approve the merger unanimously. The factors that determined and supported the decision, in addition to what was mentioned above, were the following:

- the merger will present, based on current market price for HP common stock, the opportunity for the holders of Compaq common stock to receive a premium over the trading value of Compaq common stock on August 31, 2001, the last day of trading before public announcement of the proposed merger, while at the same time allowing Compaq shareholders to participate in a combined company positioned to benefit from new growth opportunities;

- the Compaq board of directors’ knowledge of Compaq and the industries in which the company competes and its belief that the greater resources which Compaq will realize as a result of the merger are important to the long-term future of Compaq;

- historical information concerning HP’s and Compaq’s respective businesses, prospects, financial performance and condition, operations technology, management and competitive position, including public reports concerning results of operations during the most recent years;

- the strength of the management team of the combined company, including the addition of Michael Capellas as president of the combined company;
the ability to complete the merger as a reorganization for United States federal income tax purposes in which Compaq shareholders will not recognize any gain or loss.

In addition, the HP and Compaq boards of directors acting separately also identified and considered a variety of potentially negative factors or risks in its deliberations concerning the merger, which include among others:

- the risk that the potential benefits sought in the merger might not be fully or immediately realized;
- the belief of HP and/or Compaq management that it will not begin to realize the benefits of the anticipated synergies until mid-2002 and will not fully realize these synergies until new HP’s fiscal year 2004;
- possible difficulties in integrating two organizations of the size and complexity of HP and Compaq, which could delay some of the expected benefits of the merger;
- the risk that, notwithstanding the long-term benefits of the merger, HP and/or Compaq’s financial results and stock price might decline in the short term;
- possible effects on HP and/or Compaq’s long-term stock price and financial results if the benefits of the merger are not obtained on a timely basis or at all;
- the possibility that the merger might not be completed, or that completion might be unduly delayed, and the effect of public announcement of the merger on HP and/or Compaq’s sales and operating results, and HP and/or Compaq’s ability to attract and retain key management, marketing and technical personnel;
- the substantial charges to be incurred in connection with the merger, including costs of integrating HP and Compaq and transaction expenses arising from the merger;
- the risk that despite the efforts of the combined company, key technical and management personnel might not remain employed by the combined company;

The HP and Compaq’s board of directors separately and collectively concluded, however, that these negative factors could be managed or mitigated by HP, Compaq or by the combined company, and were unlikely to have a material impact on the merger or the combined company, and that, overall, the potentially negative factors associated with the merger were outweighed by the potential benefits of the merger.

Finally, both board of directors’ resolution was “The HP and Compaq board of directors believe that the merger is advisable, and is fair to and in the best interests of both companies and their shareholders.”

2.6. The Hewlett Family considerations to the merger.

In the middle of the merger process, a part of the stakeholders led by Walter Hewlett opposed to the merger arguing that the merger will significantly diminish HP value on both short and long term basis. Although they were not advocating not doing anything regarding strategy, they strongly opposed to the merger and spending $25 billion in acquiring a company like Compaq which will reduce the importance of HP in the

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4 SEC file Form S-4
imaging and printing profitable businesses and at the same time increase the exposure of the company to the troubled and unprofitable business of PCs.⁵

Since the very beginning when Mr. Hewlett was made aware of the merger he carefully considered the merits of the proposed transaction; however, he always voiced his concerns, which were that the proposed merger will permanently destroy stockholder value.

Despite Mr. Hewlett’s vocal opposition, the board of directors led by Mrs. Fiorina continued to pursue the proposed merger. After several conversations and after he realized that if he votes against the proposed merger HP would have to pay a higher price for Compaq, he decided to vote for the proposed merger as a member of the board. Mr. Hewlett informed the board that he might not support the merger as a stockholder.

Walter Hewlett’s position was that he could go along and watch HP buy a wilting company (Compaq), or he could fight and cause the company to pay even more for it. It was even worse than that for Hewlett because of the many hats he was wearing in this situation. As an HP board member, he had a fiduciary duty to do what was the best for HP’s shareholders. Two cents difference in the price already negotiated could cost them $800 million. Thus, how could he vote for a deal he hated to avoid spending more to buy Compaq at the outset, when that same deal could take billions out of the family and foundation coffers by driving the stock down over the long haul? Hewlett then, began looking for convenient exits.

⁵ SEC filing dated January 14, 2002
In summary the two rationales, in favor of and against the merger can be stated as follows:
<table>
<thead>
<tr>
<th>Why Support the Merger</th>
<th>Why Oppose the Merger</th>
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<tr>
<td><strong>[HP's version]</strong></td>
<td><strong>[Walter Hewlett's version]</strong></td>
</tr>
<tr>
<td>- The new HP will become the market leader in servers, storage, management software, printing and imaging, and PCs, improving our ability to offer the end-to-end solutions customers demand.</td>
<td>- Acquiring market share does not translate to leadership, i.e., demonstrated better business model, technology innovation or success at winning business from competitors.</td>
</tr>
<tr>
<td>- HP will double its profitable and growing services business, enhance its R&amp;D efforts, and extend its customer reach in 160 countries.</td>
<td>- Admission of no new significant technology/capabilities added to HP's portfolio. Significant overlap creates cost synergies which are offset by revenue losses from rationalized products and services.</td>
</tr>
<tr>
<td>- HP will achieve annual cost savings of $2.5 billion, adding $5 to $9 in present value to each HP share; and increase earnings per share by 13% during the first year following the merger.</td>
<td>- Large stock transactions statistically more risky. Upon announcement of the proposed merger, Moody's downgraded HP's debt rating and put it on negative watch, S&amp;P has also put HP on negative outlook.</td>
</tr>
<tr>
<td>- By improving profitability in enterprise computing systems, in PCs and access devices, and in IT services, HP will have the financial strength to extend its successful imaging and printing franchise into new multi-billion dollar categories like digital imaging and digital publishing.</td>
<td>- Bigger, but in an unattractive business, commodity computing. Hardware as diminishing economies of scale and HP and Compaq already has significant scale. HP is doubling its exposure to a volatile business with declining margins, betting on cost savings in 2004 to achieve profitability.</td>
</tr>
<tr>
<td>- The merger of HP and Compaq is the single best way to strengthen their businesses and improve their market position, deliver more of what their customers need, enhance opportunities for their employees, and increase the value of investment.</td>
<td>- Integration planning is not integration. The impact is felt after closing. HP has outlined a plan for gradual integration over the next 18-24 months. Remember, this is a lifetime in technology and will be highly disruptive to business.</td>
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CHAPTER 3

Competitors’ Reaction to the Merger

This chapter will address the reaction of competitors and the industry as a whole when the merger was announced, and how they adjusted their strategies. It will also describe what (if any) were the effect of competitors’ behavior on the negotiation process.

After the announcement of the merger, some competitors made comments related to the merger demonstrating the level of importance that each of them attributed to this deal.

Dell launched a couple of new products in the same month the merger was announced and also subscribed to a strategic alliance with EMC. However, Michael Dell’s comments were more related to how pleased he and his company were about the merger rather than how concerned they were. The stock pricing and the market reacted negatively and Michael Dell’s words were “So far, I like it…”6 Recall that Dell computer took number 1 position as PC supplier from Compaq in 2001 (a couple of months after the merger was announced).

The merger itself is seen as complicated and will produce many opportunities for Dell. The history doesn’t privilege this kind of merger because it is too difficult to find what real synergies are. Anyway, HP and Compaq are seen as a great competitor to Dell.7

6 Michael Dell’s speech at MIT September 26, 2002.
7 Michael Dell’s speech at MIT September 26, 2002.
IBM also intensified its marketing to highlight the importance of this company and also to show that they are still in the market and ready to compete.

However, the most negative reactions appeared in several articles written by analysts who believed the merger would not succeed. Most of them said that the merger was an effort by two desperate companies and two desperate CEOs to demonstrate results that they had not individually been able to achieve.  

For the two companies, the press and competitors said that it seems to be a good deal. HP gets a better short term earnings, and Compaq gets a higher price for its shares. Together they can improve results in the short run because there are many things to do to cut cost, so better results are imminent. However, the market seems to identify this already since the price of both stocks did not support the merger. For growth in a business it is not necessary to buy companies. Organic growth in this kind of industry is generally welcomed.

The PC business -according to many people- is a losing money business, and as such, many people including large producers, think that in a very short period of time just two companies will remain playing: The new HP and Dell.

However, many companies that are still losing money in PC business are trying to replicate what Dell is doing, trying to sell directly to the consumers avoiding extra cost.

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8 Fortune Magazine, September 4, 2001
As Fortune Magazine wrote once: “The others are going splat for the same reason that Dell is succeeding: commoditization. The desktop PC has become a commodity. That's great for consumers, who get standardized, easy-to-use, cheap PCs. But it's horrible for all but one manufacturer. As prices plummet, CEOs of most PC makers find it so hard to make a dime that they must justify to shareholders staying in the business at all. Commoditization persistently drives consolidation. And so it is no surprise when former highflying PC makers like AST crash. Or when IBM stops selling PCs in stores. Or when Gateway pulls back from selling overseas. Or when Micron shunts its PC business off to LBO artist Alec Gores. And the latest chapter of the consolidation story, of course, is the proposed HP/Compaq deal.”

Apparently, companies that spend too many resources in R&D or innovation or investing in new things, many times end up with no customers to which to sell their products. People don’t like to be locked-in.

Even with this new bigger company, for HP IT will be very difficult to reach Dell's cost structure, thus the savings they are trying to reach should come from other synergies. HP will have, at least for the next three to four years, a weaker position with regard to the competitors because of the integration issues.

HP and Compaq are both strongest in the most mature part of the business, like PCs and PC servers, where growth is weak and price competition is greatest. And they are

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9 Fortune Magazine, January 6, 2002
10 Michael Dell’s vision on the success of his company.
weakest in the sweet spots of the market, like software, service and storage, where value and growth are greatest.\textsuperscript{11}

Synergies are seemed to be the reason for this merger. However the market doesn’t believe this is going to work and even more, some comments were even sarcastic about the process: “Synergies are like UFOs. Lots of people claim to have seen them, but no one can prove they really exist.”\textsuperscript{12}

One of the major criticisms of Carly Fiorina was that she failed to get the family (both Hewlett and Packard) on board with this deal. The Packard Foundation for instance didn’t get a briefing of the merger until ten days after it was announced, when she and Bob Wayman addressed a regular board meeting of the board.

CHAPTER 4

A Chronology of the Merger

This chapter will describe how the merger was shaping and how the parties involved were developing their strategies to influence the final agreement. In a timeline (Chronology), I will describe how the negotiation dance developed and the process took place.

Additionally it is important to include an analysis of how the Hewlett family affected the negotiation process and how the price was ultimately determined or affected (if any) by this internal conflict between shareholders.

In early 2001, in an effort to maximize opportunities for its UNIX business, HP began approaching other companies to determine whether they would be interested in licensing HP’s UNIX operating system. As part of these initiatives and following a series of previous discussions between business unit representatives of both companies, Carly Fiorina contacted Michael Capellas in June 2001 to discuss Compaq’s interest in licensing HP-UX. After several days of deliberation, Mr. Capellas contacted Ms. Fiorina to suggest that the synergies between the two companies were broader than HP-UX and that HP consider whether a broader strategic relationship might be a viable option.

On June 22, 2001, based on the initial conversations between Ms. Fiorina and Mr. Capellas, Mr. Capellas and Shane V. Robison, met with Ms. Fiorina and Duane E. 

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13 SEC File Form S-4 filed on February 5, 2002
Zitzner to discuss the possibility of Compaq licensing. They also discussed the potential for a broader relationship between HP and Compaq, including a possible business combination.

On June 24, 2001, the HP board of directors convened a telephonic meeting. All HP directors attended this meeting, other than Philip M. Condit, George A. Keyworth II and Robert E. Knowling, Jr. Also in attendance were Ann M. Livermore, Ann O. Baskins, and a representative of Wilson Sonsini Goodrich & Rosati, external legal counsel to HP. To note, Walter Hewlett did not attend this board meeting. Ms. Fiorina apprised the HP board of directors of her discussions with Messrs. Capellas and Robison and the preliminary analysis that HP had performed regarding a possible business combination with Compaq.

On June 27, 2001, the Compaq board of directors convened a regular meeting. All Compaq directors attended this meeting. Mr. Capellas informed the Compaq board of directors of his conversations with Ms. Fiorina.

On July 7, 2001, Ms. Fiorina and Messrs. Wayman and Zitzner of HP, together with representatives from McKinsey & Co. and a representative from Wilson Sonsini Goodrich & Rosati, met with Messrs. Capellas, Clarke, Sickman and Robison of Compaq, together with representatives from Accenture (external advisors to Compaq), to further discuss various strategic, operational, financial, legal and regulatory aspects of the business combination.
On July 10, 2001, the HP board of directors convened a meeting to consider further the business combination with Compaq. All HP directors attended this meeting, except Walter B. Hewlett.

From July 10 through July 17, 2001, Ms. Fiorina and Mr. Capellas had numerous telephonic meetings to discuss further valuation concepts and issues as well as strategic synergies associated with the business combination, and the governance and management of the combined company. These discussions also remained general in nature.

On July 19, 2001, the HP board of directors convened a meeting to further consider the business combination with Compaq. The discussions centered on HP’s strategic strengths and weaknesses, in particular in the PC and server businesses. Members of HP management and representatives from McKinsey & Co. (external advisor to HP) then reviewed the state of the computer systems, software and services industries and HP’s competitive position, including trends in the PC, server, storage, software and services businesses.

On July 19, 2001, Walter Hewlett missed the first day of a two-day board meeting where the Compaq deal was discussed in detail. The next day, when all the other directors agreed drastic action is needed, Hewlett said: "I don't know why you guys want to make a crisis out of this."
On July 20, 2001, the HP board of directors reconvened the meeting adjourned the prior evening. All HP directors attended this meeting. The HP directors then stated and discussed their views on the merits and risks of the transaction, integration of the companies, critical factors to the success of the merger, valuation of the transaction and potential reactions from competitors and partners. The board also discussed alternatives to the Compaq transaction.

On July 26, 2001, the Compaq board of directors convened a regularly scheduled meeting at which it considered a potential business combination with HP. All Compaq directors attended this meeting.

From July 26 through July 30, 2001, Ms. Fiorina and Mr. Capellas had a number of telephonic meetings to further discuss economic contribution and valuation issues relating to the business combination and the governance and management of the combined company. Although Ms. Fiorina and Mr. Capellas did not reach agreement on these issues, they each agreed to meet again to further discuss them and to authorize their respective advisors to continue discussions regarding other aspects of the business combination.

On July 31, 2001, Compaq delivered comments to the draft merger agreement that HP had previously delivered on July 25, 2001. In addition to the economic contribution and valuation issues relating to the business combination and the governance and management of the combined company then being discussed by the parties, Compaq’s
principal disagreements with the proposed terms of the merger agreement were the scope of certain representations and warranties, the scope of the restrictions on Compaq’s conduct of business between the execution of the merger agreement and the completion of the transaction.

From July 30 through August 6, 2001 HP and Compaq convened a series of meetings among the management teams of HP and Compaq, as well as each of their respective business, financial and legal advisors. The parties also negotiated the proposed terms of the merger agreement. During the foregoing period, Ms. Fiorina and Mr. Capellas continued to speak on a regular basis regarding the management presentations, as well as various proposed terms of the business combination. Ms. Fiorina and Mr. Capellas did not reach agreement on these issues during this period.

On August 6, 2001, the HP board of directors convened a meeting to consider further the business combination with Compaq. All HP directors attended this meeting. Ms. Fiorina reported that valuation concepts and issues related to the business combination, the governance and management of the combined company and other terms of the transaction remained unresolved. The HP board of directors discussed strategic alternatives to the business combination with Compaq, and determined that a business combination with Compaq continued to offer the best strategic alternative and benefits for HP. The HP board of directors concluded the meeting by authorizing Ms. Fiorina and other members of HP’s management to continue their discussions with Compaq regarding the business combination as management deemed advisable, but directed HP’s management to
discontinue further due diligence meetings with Compaq until progress was made regarding some of the unresolved issues relating to the business combination.

From August 6 through August 10, 2001, HP and Compaq independently reviewed the unresolved issues relating to the business combination. On August 10, 2001, Mr. Clarke contacted Mr. Wayman to discuss the business combination. During this meeting, Clarke and Wayman discussed a number of the unresolved issues relating to the business combination. Although Wayman and Clarke did not reach specific agreement on these issues, they agreed that HP and Compaq should renew in deep their discussions and due diligence regarding the business combination.

From August 10 through August 23, 2001, Ms. Fiorina and Mr. Capellas had a number of meetings to discuss some of the unresolved issues relating to the business combination. During these meetings, Ms. Fiorina and Mr. Capellas reached an understanding regarding the governance and general management structure of the combined company. Ms. Fiorina and Mr. Capellas also agreed upon an approach to resolving valuation issues relating to the business combination, subject to approval of each company’s board of directors and final negotiation of a definitive agreement for the business combination. As a result of these agreements, Ms. Fiorina and Mr. Capellas agreed that HP and Compaq should reinitiate discussions in connection with, and preparations for, the business combination.

On August 30, 2001, the Compaq board of directors convened a meeting to consider the business combination with HP. At the invitation of the Compaq board of directors, Ms.
Fiorina attended a portion of the meeting and made a presentation to the Compaq board of directors regarding the expected benefits of the proposed business combination and discussed those benefits with members of the Compaq board of directors. The Compaq board of directors discussed a number of issues that remained unresolved in connection with the negotiation of the business combination, including the final exchange ratio and management retention issues.

On August 31, 2001, the HP board of directors convened a meeting to consider further the business combination with Compaq. All HP directors attended this meeting. During this meeting, Ms. Fiorina provided the board of directors with a report regarding her attendance at the Compaq board of directors meeting, noting that the Compaq board of directors had expressed an understanding of the potential synergies as well as the integration challenges of the merger.

On August 31, 2001, Walter Hewlett saw that the merger agreement claims unanimous board support and protested. HP’s attorney, Sonsini told him the deal will be done even if he votes against it. Hewlett concludes the terms may have to be renegotiated; possibly costing HP money (HP denied having suggested this). Sonsini apparently told Hewlett he could vote with the board to agree to the merger and later vote his own shares as he saw fit without breaking his fiduciary duty to shareholders.

On September 1 and 2, 2001 Walter Hewlett considered resigning before the final vote is taken but decides not to. On September 3, he voted with the board but says he told the
board that he planned to vote his shares against the merger. In government filings, HP says Hewlett said no such thing. While Hewlett never warned HP that he might publicly oppose the deal or declare a proxy fight, "no one had reason to believe he would come out quietly."

On September 2 and September 3, 2001, members of the management of HP and Compaq and their respective financial and legal advisors met to negotiate the final terms and conditions of the merger agreement and to prepare for the announcement of the transaction. Mr. Wayman and Mr. Clarke ultimately agreed upon the exchange ratio of 0.6325 of a share of HP common stock for each share of Compaq common stock, subject to approval of the boards of directors of HP and Compaq and final agreement on the terms and conditions of the merger agreement. Ms. Fiorina and Mr. Capellas agreed on this exchange ratio as well, subject to the board approvals.

On September 3, 2001, the HP board of directors convened a meeting to consider the business combination and the terms and conditions of the merger agreement that had been negotiated by the management teams of HP and Compaq. All HP directors attended this meeting. After deliberating on the foregoing, the HP board of directors unanimously determined that the merger is advisable, and is fair to and in the best interests of HP and its shareowners, approved the merger agreement. They also resolved to recommend that HP shareowners vote "for" the proposal to approve the issuance of shares of HP common stock in connection with the merger.
Also on September 3, 2001, the Compaq board of directors convened a meeting to consider the business combination and the terms and conditions of the merger agreement that had been negotiated by the management teams of HP and Compaq. All Compaq directors attended this meeting. The Compaq board of directors unanimously determined that the merger is fair to, and in the best interests of, Compaq and its shareowners and declared the merger to be advisable, approved the merger agreement, resolved to recommend that the shareowners of Compaq approve and adopt the merger agreement and approve the merger, and directed that such matter be submitted to Compaq’s shareowners at a meeting of Compaq shareowners. Following the meetings of the board of directors of each of HP and Compaq, HP and Compaq executed the merger agreement as of September 4, 2001.

The proposed merger was announced in the late evening on September 3, 2001. On the day after the announcement, HP’s share price dropped from $23.21 to $18.87, a decline of 18.7% and an aggregate loss of approximately $8.5 billion of stockholder value. After a couple of more days, the stock price continued to fall reaching $16.89 on September 5, 2001, a decline of 27.2% from the pre-announcement price, an aggregate loss of approximately $12.3 billion.

After a complete and thorough analysis done by independent advisors to the Hewlett Foundation, Mr. Hewlett determined that it was in HP’s stockholders’ best interests to make his views known publicly in an effort to terminate the transaction as soon as possible and avoid exposing HP to continued uncertainty about its future.
On September 6, 2001, he announced that the Hewlett Foundation, the Trust, his sisters Eleanor Hewlett Gimon and Mary Hewlett Jaffé and he would all vote against the proposed merger. Later that same day, David Woodley Packard separately announced that he too was against the proposed merger and would vote his HP shares against the proposed merger. Once again, the market reinforced Mr. Hewlett's belief that the proposed merger was not beneficial for HP — HP shares rose from $16.89 to $19.81, or 17.3%, gaining $5.7 billion in aggregate market value on the day of Mr. Hewlett’s announcement.

On September 23, 2001, Walter Hewlett visited the law offices of Cooley Godward in Palo Alto to make plans. He first asked the stock committee of his parents' foundation to do their own financial analysis of the merger. The committee gave the job to foundation Chief Investment Officer Laurence Hoagland. While Hoagland originally planned to make his recommendation by January 2002, Hewlett accelerated his timetable.

In October 2001, Walter Hewlett hired San Francisco investment firm Friedman Fleischer & Lowe to do an analysis of the merger and Hewlett asked them to have their findings ready by November 6, when the foundation's stock committee agreed to meet on the subject.

On November 6, 2001, the conclusions reached by both Hoagland and Friedman
Fleischer were that the deal would be bad for HP. Hewlett informed Carly Fiorina to let her know what he was about to do and just half hour later, issued a press release.

On November 7, 2001, David Woodley Packard – who had resigned both from the HP board and the board of the David & Lucile Packard Foundation, announced he would vote his 1.3% stake against the deal as well. He felt the massive layoffs that would be brought on by the merger were contradicting the “HP Way”.

In November 2001, Walter Hewlett hires proxy solicitation advisors MacKenzie Partners Inc. to aid in his opposition. “Mr. Hewlett has been making his case to a number of Hewlett-Packard shareholders that the merger does not make sense,” said Charlie Koons, assistant vice president with MacKenzie Partners in New York.

In December 2001, the board of the David and Lucille Packard Foundation, headed by Susan Packard Orr (one of the daughters of HP co-founder Dave Packard), which holds nearly 10 percent of HP’s stock, said it would likely vote its shares against the deal.

On December 5, 2001 Walter B. Hewlett files papers with the U.S. Securities and Exchange Commission highlighting the poor financial performance of the two companies since the merger was first announced.

On December 13, 2001 Hewlett sends a letter to the board asking HP to scrap the merger since 18% of its shares have been pledged against the deal.
On December 16, 2001, because Carly Fiorina and board member Richard Hackborn hint that they may quit if the Compaq deal is scrapped, Hewlett's attorney asks HP to disclose whether they or others plan to resign.

On January 7, 2002 in a letter to the SEC, HP accuses Hewlett of lying in his SEC filings when he claimed to have been pushed into voting for the Compaq merger. Hewlett says HP's filing is filled with "half-truths".

On January 14, 2002 HP files registration statement with the SEC soliciting proxies from the shareowners of HP in favor of the merger with Compaq.

On January 17, 2002 HP runs print ads suggesting that HP founders "Bill and Dave" would have blessed the Compaq merger. Some HP insiders are irked. "There are a lot of people who are really offended by this," says Hewlett Foundation director Jim Gaither.

On January 18, 2002 HP sends a letter to shareholders characterizing Hewlett as an "academic and a musician" and questioning his business insight.

On January 23, 2002 David Woodley Packard, son of co-founder Dave Packard, takes out an ad in The Wall Street Journal criticizing Fiorina's attempt to invoke the HP legacy in her pro-Compaq ads. The final sentence: “There is now a real danger that HP will die of a broken heart.”
On February 21, 2002 Walter Hewlett takes out a full-page advertisement in The Wall Street Journal in a move to outline the reasons he is against the deal. HP launched its own ad, a two-page spread in the Journal. The ads go from occasional to weekly to nearly daily as the March 19 vote draws near.

Between March 10 and 16, 2002 Hewlett spends the week traveling to lobby for votes from undecided shareholders. HP uses its final days for a blizzard of conference calls and other communication intended to convey the depth of its integration planning and commitment to promptly addressing employee and customer uncertainty once the acquisition is approved.

On March 19, 2002 HP releases a statement that, "Based on a preliminary estimate of shareowner proxies by its proxy solicitor, HP believes it has received sufficient votes to approve HP's merger with Compaq."

On March 28, 2002 Walter Hewlett files suit against HP, taking issue with the process by which HP solicited votes for approval of its acquisition of Compaq Computer. The complaint focuses on HP's process for soliciting votes from large institutional stockholders, particularly Deutsche Bank AG. Deutsche Bank originally voted more than 25 million shares against the merger, the suit states. On the morning of the vote, Deutsche Bank held a telephone call with Hewlett's team, followed by a 'fast scheduled"
telephone consultation with HP's management, following which the Bank switched up to
17 million of its votes to support the acquisition, the suit says.

According to Mr. Hewlett advisors, and based on forecast done at that time, HP would
have to pay 183 times Compaq's 2001 earnings, 73 times 2002 earnings and 37 times
2003 earnings. These numbers, according to them, demonstrate clearly that the interests
of Compaq's stockholders are not the same as those of HP.

On May 6, 2002 the deal was closed: HP and Compaq merged into one company. The
trading of Compaq common stock was suspended before the opening of the market on
this day, and HP began trading under the new NYSE symbol HPQ. The launch for the
new HP took place on May 7, 2002.

The HP-Compaq merger was the biggest corporate buyout in IT history; the deal value
was around $19 billion.

After barely succeeding in winning stockholder approval of the merger, Carly Fiorina is
about to face the most difficult challenge of her career: pull off the merger and steer the
combined company through what are likely to be some very difficult times. She has to
win the support of consumers and businesses that vote with their dollars, euros and yens
while at the same time focusing on the momentous task of combining two very different
companies.
Four months after the deal was completed, HP's revenues had fallen more than the company had anticipated. Perhaps more troubling, the merged company continued to lose market share in both PCs and servers, according to IDC. During the third quarter of 2001 HP + Compaq had around 17% of market share on the PC market. Now the new HP has 15%. The numbers on the servers market have also declined: from 27% to 25%. While HP continued to be No. 1 in both markets, according to various studies, it was losing ground to its competitors. Dell looked set to return as the PC king according to a Gartner Dataquest report.

Today, mid-April 2003, after 19 months of the announcement date of the merger, the HP stock price did not improve a lot and is traded at around $15.50 far from those “good old days” previous to the merger. The market does not seem to have priced in any of the proposed benefits of the merger. However, to be consistent with the market and industry behavior, the trend was not favorable to them either. The market was falling down dramatically and couple with that pessimistic forecast about the industry the merger was announced. Today, although the price is still low, HP stock price tendency apparently is revealing some signs of recovery, maybe associated to the success of Carly Fiorina’s merger plan. It is too early to determine (seriously) how successful or not this merger will be.

On November 11, 2002, HP announced that Michael Capellas, its President and Chief Operating Officer, was leaving the company to become CEO of WorldCom. Capellas had been CEO of Compaq before the merger with HP. Capellas had displayed a high level of
commitment to the merger, despite the certainty that he would not be the CEO of the new entity. He had worked hard to convince investors the deal was right for Compaq's shareholders (and HP's). Thus, the present CEO, Carly Fiorina had the challenge of leading both companies without the knowledge of Compaq's prior CEO.

At the time the merger was announced, there were no signs of a potential conflict between HP shareholders. In fact, at the time of the vote, each member of the board voted in favor of the merger. This included Walter Hewlett who expressively said that he votes in favor of the merger for the benefits of the negotiation process, but later he voted against it as a shareholder. In other words, he protected the price of the share under negotiation but clearly stated his disagreement later. This prevented people from Compaq and from HP from being contaminated with this counter argument which could have damaged the final outcome.
CHAPTER V

Analysis of the Merger Negotiation

In this chapter I examine each of the parties’ behavior and how their different interest affected negotiation styles and tactics with particular attention to how the parties were affected by the decision of the Hewlett family to not support the merger.

This analysis, which includes Carly Fiorina, Michael Capella’s and Walter Hewlett’s different styles, as well as how HP’s interest was understood by Compaq and vice versa will be also addressed, and also I intend to determine if there was a clear understanding of the interest at stake.

Although both companies knew that the merger was a great deal, they started analyzing the possibility of licensing HP Unix unit to Compaq. They practically didn’t negotiate the intention to merge. It was pretty clear to both companies that the merger was the solution. However, not all the parties thought the same way. Walter Hewlett didn’t support it.

Carly Fiorina was maybe one of the brightest minds in the telecom industry -- savvy, personable and marvelously persuasive. As one of her employees at HP once said: “it is unthinkable to have a female executive who was that attractive, that young, that effective, and……. that smart”

She started her career at Lucent and what has been common in her professional development is that most of her jobs were related to troubled situations. She initially convinced San Ginn (HP member of the board) to take her as the new CEO of the company. She finally made it. She had such amazing self confidence that before she was appointed CEO, she told her closest friend that she would be offered the position. Probably her self confidence was her most valuable asset, coupled with her ability to convince others. And unlike Lew Platt (former CEO), she thrived on being the center of attention. These features were recalled by many people that know her.

Since her arrival to the company, Carly Fiorina focused on the idea of producing big changes. The company had been too passive over time and competitors were ahead of HP. It was time to produce a complete reengineering of the company. She was very enthusiastic about the idea of transforming the company based on other companies to improve HP’s position, an idea that Bill Hewlett and Dave Packard never liked.

Internally, they analyzed many different companies. Eastman Kodak was one of them but it was discarded. Even Dell, Apple, and Sun were also under the scope of HP. The ultimate goal was to improve its competitive position relative to IBM, which was at that time twice as big as HP.

The first time that Carly Fiorina and Michael Capellas met was in late 1999 and since then there were signs of a business combination. Over the last couple of years Compaq had been behaving like a company that might want to be acquired. Even once Capellas
approached Fiorina and told her that the market was talking about a potential acquisition of Compaq by HP. “How do you feel about it?” said Carly Fiorina. “It depends on the price,” Capellas replied.¹⁵

By the end of 2000, Dick Hackborn had stepped down from the board and Carly Fiorina was confirmed as the new Chairman and CEO of HP. Since that day she defined a team in charge of finding a way to boost HP’s competitive position. To work with the team, and analyze the alternative that HP had in the market, Carly Fiorina hired McKinsey & Co.

However, by the spring of 2001 Carly Fiorina was very worried about the stock price and the status quo of the company. Wall Street analysts were also concerned. According to McKinsey, there was no reason to trade the share over $30...... At that time the stock was traded at $33, thus the HP board, led by Fiorina, quickly realized that it needed to do something dramatically different.

However, for HP the results were not what the company expected and many explanations were offered to Wall Street analysts.

At this stage of her career and facing many troubles trying to validate herself at HP, Carly Fiorina really demonstrated her power. Regarding the poor results, Fiorina sent an internal memo to employees that was outright defiant, saying that “in blackjack you

double down when you have an increased probability of winning. And, we are going to
double.”¹⁶ She doubled their growth target.

After that, the explanation was even more aggressive demonstrating again that she was
thinking about something bigger: “when you sail, you don’t get there in a straight line.
You adjust the course to fit the times and the current conditions. We see where the
market is going and we are perfectly positioned.”¹⁷ She increased the revenues
expectations for next quarter once again demonstrating how aggressive she was; however,
a couple of months later she had to admit to Wall Street that revenues would not even
grow close to that number promised.

As times got tougher, Fiorina talked more and listened less. She became Antigone again,
speaking her mind, standing apart from the crowd and letting her opponents know that
she was afraid of nothing.

At this time, she really needed to present a big change for the company. On the afternoon
of July 19, 2001, Carly Fiorina started perhaps the most important board meeting of her
career. For some time, she had been mentioning to directors that archrival Compaq
Computer might be interested in combining forces with HP.

Fiorina saw only three directors clearly intrigued by the merger prospect: Dick Hackborn,
Jay Keyworth and Bob Wayman. Four others were neutral or wary. An important issue

¹⁶ “Perfect Enough”, page 118.
¹⁷ “Perfect Enough”, page 118.
here that will generate future problems arose. Across from Fiorina was an empty chair where Walter Hewlett normally sat. He was skipping the meeting in favor of a personal commitment. However, it was pretty known that to Hewlett, any giant acquisition would limit HP’s mobility.

The explanation given to the board justifying the likelihood of a merger with Compaq was prepared with the help of their advisors at McKinsey. HP was strong in Unix based servers, weak in Windows NT market, and in storage, strong in consumer PCs. Compaq was just the opposite. Put the two companies together and the combined lineup looks a lot stronger than what either company could do alone. The two companies fit together like a zipper.

At the time she presented this to the board she was very well prepared. She handed in three questions to the board members which were clearly oriented towards clarifying even more that the right decision was the merger. With this approach she really demonstrated that she was managing the conversation. Three questions were:¹⁸

1. Do you think that the IT industry needs to consolidate and if so, is it better to be a consolidator or a consolidatee?

2. How important is it to our strategic goals to be the number one or number two in each of our chief product categories?

¹⁸ Board meeting last two days and these questions are supposed to be discuss the second day after Carly Fiorina presented the benefits of the merger.
3. Can we achieve our strategic goals without a complete scene change?

The next day, the three questions framed the debate in a fascinating new way. Walter Hewlett showed up the next day and after reviewing the answer he said: “I don’t think this is the right choice”. Walter Hewlett wanted to slow things down. That meeting was a different one. The HP board room was a polite place, but all of those around the table were visibly exasperated at Hewlett’s stance.

Even worse, when directors found out why Hewlett had missed the Thursday board session, they were even more flabbergasted. He had been playing the cello at an outdoor concert stage at the Bohemian Grove. Faced with a schedule conflict between his cello and the HP meeting, the cello won.19

After that board session, clearly the relationship between the board members and Hewlett worsened.

On the other side, Compaq’s board encouraged Michael Capellas to explore some sort of alliance or partnership with another computer company. They wanted it to be IBM.

During the crash of the “dotcoms” many of the companies’ shares plummeted. Among them was Compaq. The Houston-based PC manufacturer, which was aggressively diversified in the late 1990’s by acquiring Tandem Computers and Digital Equipment

19 Perfect Enough, page 129.
both for $11.5 billion showed results that didn’t appear to be working. By that time, Compaq’s share had plunged more than 60% which persuaded the board to make important decisions.

Capellas brought a stack of charts into the boardroom comparing the different competitors and the possible acquisitions. Amid all the pairings the alignment between Compaq and HP was intuitively obvious. Later, he was authorized by his board to start talking with Carly Fiorina. For them, licensing some of HP’s Unix architecture was a safe starting point.

Fiorina typically chatted with other CEOs very often, so the first call or two from Capellas didn’t stand out. However, she began to notice that Capellas was calling more often and staying on the phone longer than was necessary just to discuss the licensing of Unix deal. Something might be afoot, then she realized.

Capellas’ style was different from Carly Fiorina’s. He was more low profile and, according to many people comments, he was a manager who did all the little things right but would never evoke the crowd’s roar just for walking onstage.

One story that really describes him and his perseverance was when he was in high school. His football coach told him that he wasn’t tough enough to be a linebacker. Capellas went on a weight-lifting binge, bulked up and got to play the position he wanted. He became co-captain of the team and ultimately led his High School team to the championship in 1971. He did the same with his career. He started as an accountant in
Republic Steel and after 22 different jobs in six different companies he ended up leading Compaq Computer. “I always wanted the toughest jobs”.  

He repaired the relationship with key suppliers such as Microsoft and Seagate, which were eroded under previous leaderships.

In the opinion of Wall Street analysts however, because of Capellas’s hard-grinding background, he got tagged as a “non-visionary”. No matter how hard Capellas tried to convince Wall Street and the media that he did have big ideas, his less glamorous image persisted. After a year in charge of Compaq, investors still couldn’t tell where he wanted to take Compaq.

Inside Compaq board, some members believed that HP’s name had enormous cachet in the market.

In the middle of the conversation that Capellas and Fiorina had regarding the licensing of Unix, Capellas told Fiorina that sharing licensing and competing for the same customers didn’t really make sense. Maybe it was time for the two companies to work much more closely together.

Although Carly Fiorina had already spoken with the rest of HP’s board, she had the following conversation\(^1\) with Capellas, which is the beginning of a negotiation process which ended three months later in the merger:

\(^{20}\) Michael Capellas in an interview in Business Week Magazine.
Capellas: “Is your board prepared for such a broad-based conversation?”

Fiorina: “Well Mike, I am not sure I am ready to have this kind of conversation. (She wanted him to signal a little bit more about Compaq’s intention).

Capellas: If you are, call me back.

A few days later she did.

Without initially realizing it, the two parties were already in a negotiation process that from the beginning was hard and complicated. In fact, since its start, Carly Fiorina looked at this merger as her “baby” and she did whatever necessary to run this show. In fact, deciding what to do about Michael Capellas was much harder. He hoped to be co-CEO of the combined company.

However, the Compaq team not only wanted HP to treat their CEO decently, they also wanted to ensure that other senior executives at Compaq thought they had a future in the combined company. Since most of these things were not in line with Compaq’s intentions, Capellas called Carly Fiorina to tell her that the whole deal was off.

From the negotiation process standpoint, this was a very good strategy because it allowed Compaq to achieve a better (and maybe larger) piece of the pie. If they would

have accepted the initial “informal” proposal, the outcome would be more likely an acquisition and not a merger.

Right from the start, Fiorina assumed that Capellas was negotiating. “I am very disappointed” she said, “but if you want break off discussion, so be it.” 22

Conversations and meetings didn’t have to wait too long to resume. Three days later in a cocktail party held in San Jose to celebrate the 20th anniversary of the Personal Computer, they met with each other.

Business combination of the two companies was the toughest part the negotiation. Although each party understood fairly well the other party’s interest in this negotiation, the final details almost created a deal breaker and the end of the largest deal in the IT industry.

From HP’s point of view, they saw Compaq as their potential partner in trying to compete in this very competitive market. They had many things in common as stated earlier. Compaq understood the same thing pretty well and that was maybe the easiest part of this agreement. Both companies knew that the right way to keep moving was the merger. Regardless of who would eventually lead this new HP, the understanding and the interests were pretty well aligned.

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22 Phone conversation held between Capellas and Fiorina on August 5, 2001.
Given that the competitive position of each company was different, perhaps HP achieved a better place compared to Compaq, which was facing more dramatic problems because it was in the spot of many companies already as a potential company to be acquired. This weaker position was without a doubt used by Fiorina for her own purposes.

At the beginning of the conversations between these two business leaders, the intention was the licensing of HP Unix, however it is worth mentioning that it was Capellas’ idea to think about a more interesting and long life association which eventually became the merger.

Negotiations especially in terms of the leading role of each of the CEOs were the final issue and perhaps, in my opinion, the unresolved issue.

By late August 2001, the issue had been resolved in a thoughtful compromise. Capellas would become president of the new HP, reporting to Carly Fiorina. Five out of nine top executives would come from Compaq and the rest from HP.

However, as a curious note that shows their different leadership styles is when lawyers needed code names for their paperwork, Fiorina decided that HP should be called “Heloise” and Compaq “Abelard”. Even more curious was that the love letters from Heloise and Abelard are an important part of the French Literature. Later, it was discovered that in this letter Abelard was castrated when Heloise family grew angry at

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23 Perfect Enough, page 133.
him. The “curiosity” was kept hidden from Capellas until a year after the merger was completely done.

A third party, without being considered relevant at the beginning, suddenly became a decisive part on the negotiation. Walter Hewlett’s opinion was key for the success of this merger. He not only represented a large stake in the company (almost 15% of the shares) but also represented the way his father and Dave Packard built a company: the HP Way.

Walter Hewlett was the only member of the board that belonged to the founders’ families. He was very well respected by the members of the board because he was prepared and knowledgeable about the IT business. Although very quiet at the board meetings he knew that he had a strong amount of power because he represented the soul of the company. People inside HP really loved him because he was the image of his father and all of those “good old days”.

Carly Fiorina didn’t realize this de facto power Walter Hewlett had. In my opinion that this was the first mistake she made.

At the beginning, about three members of the Hewlett and Packard families were on the board, but ultimately they were more interested in philanthropic activities, thus they stepped down from the board. Lucy Packard Children Hospital, The Packard Foundation and the William Hewlett Foundation were among those organizations that kept the family busy but not necessary out of their interest in HP.
To be in these kind of activities reflected the spirit behind the founders’ families. They grew up in modest towns and always remembered the image of their fathers working very hard and saving every dollar.

Each member of the family had to spend a couple of years working in HP learning how the company worked. They learned what the flagship of the company was for many years: The HP Way. They were taught to respect the people that work for the company and trust them.

Walter Hewlett follows the path traced by his father and in that sense it was hard for him to see the real need of a change. He thought that HP could have made changes without the help of anybody from outside.

He was well prepared and understood very well the business HP was in. He understood that the PC business was losing money and that imaging and printing was a nice business to exploit even more. However, altering the way that the company had been managed for many years was too much for him. He acknowledged that something had to be done but he thought that the merger would not provide any help to the company.

He was the person in charge of the whole business of his father, but he was also wearing too many hats: director of the board of HP, shareholder, executor of his father’s estate and chairman of the family foundation. With all these responsibilities, at some point he
felt the pressure that the merger was producing. He got the feeling of having been railroaded into a director’s vote that didn’t express his true beliefs. He really felt that he needed to unload that decision to support the board.

In some capacity it was clear that Walter Hewlett wanted to speak out against the deal, if only to clear his conscience. The problem was how could he do that and still handle all his obligations to the trust and the foundation?

On November 6 and after the merger was approved, he together with his family and the Walter Hewlett foundation prepared a Press Release to say publicly that they were against the merger.

He was recasting himself as a man of principles, speaking out in an effort to prevent HP from making a horrible mistake. “This is a bad transaction. The sooner it ends the better”\textsuperscript{24}. He hammered home that point in a half dozen other interviews. He explained that buying Compaq would increase HP’s exposure to the dismal personal computer sector and dilute the lucrative printing business.

As he described himself, he prefers engineers over marketers and historians over politicians. This, at some point reflects what happened in the board room and why the relationship between him and Carly Fiorina was deteriorating over time.

\textsuperscript{24} Interview with Bloomberg Business News
In the famous board meeting where the merger was presented as an idea, everybody but Hewlett agreed. Hewlett said that the merger would take in the wrong direction. Nobody in the board including Carly took his opinion seriously..... Perhaps it was another big mistake.

He feared the deal would put at stake the unique corporate culture “Bill and Dave” had nurtured over the years. The famous HP Way was built on teamwork and a tight social contract between management and employees.

After this press release, the negotiation process of this merger turned in another direction. The initial negotiation between HP and Compaq was almost done. The two parties knew that there was no other way to survive and the process went relatively smoothly.

However, the real negotiation was about to start.

To me, the negotiation between Carly Fiorina and the members of the board and Walter Hewlett and his interest in the company was the real negotiation. In this process there were many interests at stake, power struggles, egos, etc., that finally ended up in a very painful process for the company.

From one side, maybe it was good that Walter Hewlett’s manifestation was done after the merger was announced because it didn’t interrupt the negotiation between the parties. At the time Walter Hewlett spoke, Compaq and HP had already reached an agreement on the
business combination and about the price of the new stock. If he dissented, Compaq would have more bargaining leverage.

In this sense, walkaways between HP and Compaq were very few and only related to those mentioned above regarding the initial negotiation process in which each party tried to set their own best alternatives to non agreement and targets beforehand. Other than that, the process went very smoothly without interruptions.

However, current lawsuit imposed by Walter Hewlett and his family and those against him, presented by HP could eventually damage the merger but I don’t believe it will hurt too much to the extent of declaring it void.
CONCLUSIONS AND LESSONS LEARNED

The HP-Compaq negotiation process was carried out in a relatively short period of time compared to the time to complete many recent mergers and acquisitions that have taken place in the last 10 years. Both companies had a compelling need to assure a continued presence in a market that has significantly declined.

The negotiation began and ended quite well from the perspective of two of the three stakeholders groups. Both Carly Fiorina and Michael Capellas found a solution that, for them, was well above theirs BATNAs\(^{25}\). From both a personal and a company point of view the merger made sense for Fiorina and Capellas and for HP and Compaq. The merger allowed them to show immediate results and an increase in earnings per share, due largely to economies of scale in a deteriorating and highly competitive industry. It also resulted in higher bonuses for both individuals than would likely have been attainable without the deal.

The \textit{inside} negotiation with the Hewlett family proved more difficult than the \textit{outside} negotiation with Capellas. For the first time HP hired an outsider as CEO. Her style was totally different from the HP style and even more, very different from the style that the founders perceived as the “HP Way”. The Hewlett family’s opposition to the merger was likely heightened by the conjunction of their concerns with Fiorina, with lost of control over HP and with disappearance of the HP Way.

\(^{25}\) BATNA stands for “Best Alternative to a Negotiated Agreement”
The Hewlett Family had do be convinced that these concerns would be outweighed by the benefits of the merger. The internal negotiation between Fiorina and the family was handled poorly. Had it been managed differently, the outcome might have been dramatically better for HP in terms of market image.

While she needed only a Board majority and Walter Hewlett held only 15% of the voting rights, Carly Fiorina initially misjudged the alignment of inside stakeholders. Hewlett had important links with HP employees. His influence on the company and on public opinion should have been given special consideration from the very beginning and action taken to ensure his alignment.

The lack of strongly positive results after the merger is likely in part to the reluctance of many employees to adapt to the new culture and accept that their HP Way no longer exists. Bill Hewlett and Dave Packard tainted employees’ view of the deal and convinced many of them that the HP Way was being eliminated. The HP Way had its core business among employees. Many felt that this “Way” was dying.

The merger was not unpopular just among employees. In fact the influential column “Lex” in the Financial Times in October 2001, just a month after the announcement said: “Both companies have a good excuse for walking away from this merger.”\(^{26}\) This suggestion was in light of September 11. In particular, the terrorist attack on the World Trade Center, the Anthrax threat, the decline in price of HP shares because of the opinion...

\(^{26}\) Financial Times, October 2\(^{nd}\), 2001
of analysts about lack of clarity of benefits of the merger and minority Board members’
opposition to the deal struck a chord among a number of constituencies.

Despite the opposition of Walter Hewlett and problems with the deal itself, it proved
difficult to oppose the merger. The transaction was supported by almost the entire board
and ratified by the highly respected financial advisors Goldman Sachs and McKinsey.
However, these advisors did receive significant fees from the transaction and some
criticized these fees as exorbitant.

Additionally, a lot was at stake for Fiorina. She had been brought in after a very
successful career at AT&T and Lucent Technologies and had personally bet her
continued success at HP on this transaction. Because of that, the efforts made to close
this deal were tremendous.

In addition, there were some “questionable” pressures exerted by Deutsche Bank to vote
for the merger (Deutsche Bank held an important stake at HP). Moreover, some
information was allegedly hidden from investors at the time they had to make the
decision about the merger. All of these forces, together with Walter Hewlett’s concerns
about the strategy of the deal itself, combined to trigger Hewlett’s anger. He took legal
action against HP to stop or abort the merger.

Today, early 2003, many analysts continue to criticize the effectiveness of the merger.
They advise investors that it may take years to accurately judge the success or failure of
the merger. However, much has been lost. Internally, a widespread sense of resignation has taken over at HP. Many employees feel HP is now just another company.

Considering this and assuming the job market recovers, many observers expect a major exodus of talent after May 2003 when the merger bonus retention expires.

A couple of months ago, Walter Hewlett said: “I am very sad that HP has been transformed. It’s a different kind of company now. And it was all unnecessary.”27 If there are many questions about HP’s future, it is clear the company has already lost much of its old value. The unique bond between management and employees has been largely severed.

The critical question is whether Fiorina’s changes will work in the long run. In the first two years of her tenure, they did not. Realistically it will be impossible to know how the merger is doing until the economic downturn that began in 2001 ends.

The proxy fight did not enhance the company’s reputation for integrity, though it actually could have been far worse. Many corporate governance experts think Fiorina should have earned Walter Hewlett’s support, or not risked opening the company up to the divisive fight, and questioned the personal nature of the attack of HP on Hewlett’s qualifications. “To bludgeon a guy that represents at least 50% of the owners showed a tremendous lack of respect for corporate governance.”28 And although the company did nothing illegal, its ethical standards can be called into question.

27 “Back Fire” by Peter Burrows.
28 Jeffrey Sonnenfeld, associated Dean of Yale School of Management.
Fiorina introduced a new ad campaign titled “Everything is Possible”. She explained the campaign in a speech: “It is an affirmation of our beliefs that progress is not made by the cynics and the doubters. It is made by those who believe everything is possible.”

On the other side, Walter Hewlett disappeared back into his former, non-public life as a philanthropist, musician, and academic but he continues to watch the situation. He had resolved to stay on the sidelines until at least 2004, to give Carly Fiorina and her board an opportunity to make the merger work. By his own admission, he should have done more to stop the deal before it was announced.

In terms of her battle with Hewlett, Carly Fiorina has won an important victory. She has landed on her feet, with the support of her board for the most part, although some of them were frustrated with her unwillingness to listen to criticism. She is reconstructing the company in her image.

One way or another, HP will move forward. The HP Way is not the only way to run a company, as just a quick glance around the computer business will show. The old HP Way was an approach that was admirable and benefited and improved many who came in touch with it: customers, employees, investors and society at large. But the company was no longer in the same position financially and it may have been time to modify the HP Way.
From the above perspective it is relevant to come back to the questions made at the outset. How effective was the negotiation process in achieving the goals and matching the interest of the negotiating parties? Could alternative strategies have improved the outcome?

In the end, there are two answers to each of these questions. From the point of view of the companies involved, HP and Compaq, the negotiation process was very effective. It allowed them to reposition the two companies in order to face the competition more effectively. However, seen from inside HP, a very different set of negotiation tactics may have been much more effective. If the parties had put their own interests aside on behalf of the company and worked together to devise common ground, the trials, internal disputes, public comments, etc., which followed the merger could likely have been avoided. In particular, if Carly Fiorina would have spent more time and effort to involve Walter Hewlett from the beginning, she would likely have had more success in gaining his support for the deal. Perhaps the merger, the outcome of the transaction, and the financial performance of the company would be different today.
Lessons Learned and Questions Raised.

What lessons emerge from study of the HP-Compaq merger through the lens of negotiation theory? What could have been done differently in order to improve both the process and the outcome of the negotiation?

The first lesson is that for significant mergers, external negotiations with an outside corporate party may be just half the battle. Identifying different constituencies within one’s own company and strategizing about how to align potentially competing views internally is as important, if not more important, than negotiations with the other party.

At least two important negotiations took place at almost the same time: an “outside” negotiation between HP and Compaq and an “inside” negotiation between HP management led by Carly Fiorina and a subset of board members led by Walter Hewlett on behalf of certain stakeholders. While the board members were indeed alerted at the outset by HP management of their intention to negotiate with Compaq, the outcome that ultimately unfolded suggests that tactics employed by the HP managers to bring aboard the Hewlett family were unsuccessful. This lesson leads us to question whether or not a different approach to the inside negotiation from the outset would have made a different outcome. This question remains open.

The second lesson, as Leigh Thompson suggests, is:

“Do not lose sight of your own interests. In any negotiation situation, it is important not to lose sight of your own interest. Individualists do not need to worry about this, but cooperators do. Often, two cooperators end up with a lose-
lose agreement because they fail to make their interest known to the other party (Thompson and DeHarpport 1998). Similarly, competitors are often so intent on ‘beating’ the other side that they do not pay attention to their own interests. In a sense, they win the battle but lose the war. Thus it is important that one maintain a high level of concern for your own interests as well as the other party’s.”

She also suggests:

“Be aware of the positive effects of cooperation. When both negotiators have a cooperative orientation, they can be more effective in terms of maximizing the pie.”

In this case, personal, financial and cultural interests were involved. It is, more often than not, difficult for one party to make inferences about the interests of a counterpart as a complex negotiation unfolds. If a stakeholder cannot clearly articulate his or her own interests to him or herself, there is little chance that a negotiating counterpart will be able to understand these interests and use that understanding to facilitate agreement. Walter Hewlett was unable to communicate effectively why he opposed the merger. He tried to justify his opposition by claiming that cultural differences between the two companies and among the members of the board would render the merger ineffective, but without really setting forth a convincing vision that proved that keeping HP alone would be better for the company’s future.

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When the individual interests of one stakeholder are not aligned internally with members of his putative stakeholder group, creating value is very difficult. In this case, the dissention among HP stakeholders slowed outside negotiations with Compaq, cost HP stakeholders and HP stockholders a considerable amount and resulted in a loss of negotiating power.

Projection of the consequences of adoption of different negotiating tactics by Fiorina is necessarily speculative. However, if the HP board had considered including Walter Hewlett as a member of the negotiation team with Compaq from the outset, the outcome might have been different. The Hewlett family might have been more accepting of Fiorina’s perspective if included in the shaping of the negotiations and the rationale underpinning them; incorporating their tactical suggestions may have tilted Walter Hewlett’s perceptions in a more favorable direction. More importantly, earlier and more integral involvement by Walter Hewlett and his supporters would have better enabled them to address and try to resolve issues of cultural differences between the companies’ managements and Boards.

An alternative projection: Walter Hewlett’s core interests were at odds with Fiorina’s strategic image for HP, so much so, that no changes in planning, communicating and execution of the negotiation would overcome the differences short of Fiorina “caving in” to Hewlett’s demands. Fiorina had a clear perception of her BATNA—relative to Hewlett, who did not early on have a clear perception of his BATNA. She, in effect, finally “walked away” from the internal negotiation.
Now, the HP foundation, the Hewlett and Packard families, and the current HP management and board members are locked in a broken relationship. What can be done to smooth this relationship and render it less abrasive as time moves forward? Is it in the parties’ interests to achieve this? Does the market still perceive this as an issue that impedes the stock from advancing? These questions are open as well.

A third lesson learned here is to avoid what Leigh Thompson describes as “Escalation of commitment.” This situation refers to the unfortunate tendency of a negotiator to persist with a losing course of action, even in the face of clear evidence that his tactics are not working and the negotiation is quickly deteriorating. Walter Hewlett first and the board soon after escalated their commitments. Each party was too single-minded in trying to defend their point of view and not sensitive enough to the interests of others. There were many different ways for Walter Hewlett to present his arguments against the merger and to explore a less divisive solution for HP. Instead, he retained the service of an investment bank that attempted to justify with numbers his opposition to the deal. He did not seem willing to discuss or try to understand others’ contentions that a big change in HP was needed in order to survive.

A fourth lesson applies to all three parties -- HP, Compaq and the Hewlett family:

“Don’t limit your thinking to your own interests and those of your competitor across the table on the immediate issue under negotiation. Instead, think broadly,

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deeply, and strategically about the full set of actual and potential interests at stake: your own, your counterpart and your competitors.\textsuperscript{32}

At the start of negotiations with Compaq, HP’s initial goal of HP was limited to expansion of its Unix License. Compaq was able to see more fruitful alternatives; it was Compaq who broached the idea of a business combination instead of only licensing Unix. Internal negotiators (HP board members and the Hewlett family), however, were focused on their own, short-term interests. They ignored longer term interests. They failed to think in terms of creating value on a sustainable basis rather than claiming value in the short run.

The “Browser Wars”, an elegant analysis of negotiations between AOL, Netscape and Microsoft suggests ways to change the game: “Don’t just play the ‘given’ negotiation game well; look for ways to change it advantageously. If you are weak in one set of issues, consider actions to change the game toward other issues and parties where you have an edge.”\textsuperscript{33}

Compaq clearly was the weakest party to the negotiation. However they were clever in approaching HP and establishing an angle that weighed in their own favor. From an economic point of view, HP paid a high price for each Compaq share and Compaq shareholders did very well financially. On the contrary, the internal negotiation within HP was not resolved amicably but rather required court involvement to resolve. As

\textsuperscript{32} Excerpt from “The Browser Wars”, Sloan Management Review, Vol. 43, No. 4, pp11.
\textsuperscript{33} The Browser Wars, pp. 17
pointed out earlier, this may have interfered with HP’s ability to strike a better financial deal with Compaq.

Both Carly Fiorina and Walter Hewlett were so convinced that their solution was the best for the company, neither managed to bend their positions enough to establish a more productive discussion. In the face of unclear signals from counterparts, negotiators frequently arrive at one of several possible judgments and rapidly become attached to one of them. Several unwarranted assumptions and psychological biases were at play in the HP vs. Compaq negotiation process. The lesson here is to remain open-minded and to avoid becoming wedded to one’s initial instincts. Individuals should often question their own positions and be willing to adjust their positions based on additional and different data.

The results support this: HP’s stock price has declined considerably and the company is still dealing with internal trials and conflicts derived from the parties’ inability to resolve their differences amicably. Trying to understand each other’s positions and agree on a solution that would maximize long-term shareholder value would have been a preferred alternative to resorting to a “winner takes all” conflict that needed to be resolved externally rather than by the parties themselves.