

The HP-Compaq merger

Battle for the heart and soul of a company

JUST ABOUT EVERYONE with a stake in a publicly-quoted business has recently developed a keen interest in corporate governance. Politicians and professors suddenly have a great deal to say about what it is and how it should be done, and financial markets seem to react accordingly. Ironically, this focus on the governance of public corporations is drawing attention to what family businesses have always known: that effective corporate governance and responsible ownership are the firmest foundations for competitive advantage and long-term value creation.

In this context, the recent HP-Compaq merger and the dispute over HP's strategy may well prove to be an important turning point in corporate governance thinking. Given our academic focus on corporate governance in family firms, the HP story piqued our interest – because during the controversial HP-Compaq merger the family's role as shareholder and protector of the founders' legacy became a critical factor in the outcome.

Case summary

In the late 1990s, both Compaq and HP were struggling against three powerful forces: the information technology downturn; strong competition; and the transformation of hardware into a commodity. Neither company could foresee improvement in the near future without drastic change. In this light, the merger between Compaq and HP announced in September 2001 looked like the best option – at least for the two CEOs, Carly Fiorina and Michael Capellas.

However, the proposed merger was controversial from the moment the US\$25 billion deal was announced. Within weeks, the Hewlett and Packard heirs stated their intention to vote their 18% block of shares against the merger,

with family member and HP board member Walter Hewlett as their leader. They felt the merger would threaten all that their famous fathers had built, and was in direct conflict with the values stated in the famous “HP Way” corporate guidelines. Fiorina appears to have been blindsided by their opposition.

Then the plot thickened: a date for a proxy vote was announced and the mudslinging began. Both HP and the Hewlett and Packard families spent millions of dollars on advertisements and mailings to shareholders to try to convince them to vote “yes” or “no” on the merger. Consultants and institutional investors weighed in with their opinions.

On the day of the shareholders' meeting, a vote switch from “no” to “yes” by Deutsche Bank, allegedly as a result of a

back-office deal with HP, was leaked. Walter Hewlett sued HP. He lost the lawsuit, but as a result was not re-elected to the HP board. Although the merger was approved by a narrow margin, it was one of the nastiest, and most public, merger battles in recent memory.

Deconstructing the battle

Although the families themselves had always asked to be treated like other HP shareholders, when push came to shove in the heat of the merger debate, this proved to be a misjudgement on the part of both the families and the HP board. The HP-Compaq case demonstrates the importance of considering the concerns of business families – even if they are no longer majority shareholders – in shaping strategy. Consider the radical divergence of per-

Methodology

Our new case study, *The HP-Compaq Merger: A Battle for the Heart and Soul of a Company*, is a part of our on-going research on corporate governance in firms with family ownership or significant family influence. Our starting point for this project was an exploration of the idea that an entrepreneurial family may remain strongly influential after their company goes public and they are no longer majority shareholders. We also felt that HP story had value as a study of corporate governance because, despite the conflicts of the key players involved, it was a relatively open process that created accountability and a forum to consider management's strategy.

Our qualitative research methodology for this case study was designed to provide an in-depth analysis of the financial, strategic and emotional impact of the merger on the Hewlett and Packard families as well as the other stakeholders at HP. We looked at HP's past history – as an entrepreneurial firm with two well-respected founders – in order to provide a basis for understanding the differing strategic positions the key players took at the time of the merger.

Our literature review was complemented by interviews with HP executives as well as academic and financial outsiders and observers. As our work progressed, we became convinced that family issues must be considered an integral part of corporate governance, if any kind of family influence – be it emotional, social or economic – remains within an organisation.

HP shareholders – January 2001

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

spective in these two widely quoted comments that appeared when the families announced their opposition:

“We profoundly disagree with management’s assertion that HP needs to make this large and very risky acquisition. To undertake the proposed merger is to make a big, long-term, bet-the-company move,” announced Walter Hewlett, member of HP’s Board of Directors, on behalf of the Hewlett and Packard heirs and their foundations.

“There is a big difference between an individual managing his own personal assets and the assets of the foundation, and a board member going out and actively soliciting against a board’s decision. And I don’t know how to explain Walter’s behaviour,” said Carly Fiorina, Chairman and CEO of Hewlett-Packard.

The HP case is unusual in that there were powerful – and underlying – currents of business family dynamics that affected, and continue to affect, corporate governance decisions and outcomes at HP. For example, before the merger, HP’s corporate culture had not significantly changed from when the founding entrepreneurs, William Hewlett and David Packard, were leading the company.

The Hewlett and Packard siblings, now all mature adults, became fully autonomous in their emotional stewardship of HP only last year after the death of the last surviving parent, William Hewlett, in January 2001. They are still adjusting to their roles as competent owners and stewards of the family legacy.

As a result of this, the families had a preconceived bias against any strategy that would change the company. This pushed Walter Hewlett to examine CEO Fiorina and the HP’s Board’s deliberations and actions preceding the merger far more closely than he might otherwise have done – and in the process he uncovered corporate governance irregularities that became headlines around the world.

In telling the HP story, including many

of the differing perspectives, this case study addresses multiple family firm-related issues, such as:

- The importance of unifying the family ownership group and the management team around a shared vision and strategy.
- The changes that occur as subsequent generations of the founding family take control of large blocks of shares (and in particular their need to mourn the passing of an era before accepting major transformation of the organisation).
- The importance of securing family commitment, even in large, publicly-quoted companies, to major strategic initiatives.
- The challenges that non-family managers face in leading family-owned or influenced firms.

Corporate governance

However, a key theme is that the HP story has no villains; that is, all the players appeared to have been acting according to what they truly felt was best for the company. In this situation, an executive team, board members and family owners struggle to identify a strategy and make decisions that serve all the stakeholders. In addition, they are all concerned with maintaining the Hewlett and Packard family legacy – although they strongly disagree on the best way to do this.

The governance process at HP was seriously challenged by Walter Hewlett. As he argued forcefully, effective governance requires an objective decision-making process that engages management in a rigorous discussion about strategy and policies. The board of directors is the linchpin in the relationship between the shareholders and management; as such, they should provide the shareholders with accountability and protection.

Our case study addresses the multiple questions that arise in this context. What was Walter Hewlett’s role as a family and

board member? What was Fiorina’s role as CEO and Chairman? Did they act appropriately with their different constituents? What is the ideal relationship between the board and management? How responsive should the board be to shareholders’ concerns?

The insights we gained from exploring these questions point to one main conclusion. Walter Hewlett put it best: “My experience makes a clear and compelling case for aligning a director’s fiduciary duties as squarely as possible with the interests of stockholders.” Clearly, good corporate governance has the same invariable prerequisites in ‘public’ corporations as it does in privately-held family firms. ■

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This article is based on an INSEAD case study, which is part of a research programme on the role of corporate governance in family-influenced firms, supported by the TetraLaval Research Fund for the Large Family Firm. The case and teaching notes are available through the European Case Clearinghouse. Tel: +44 (0)1234 750903; fax: +44 (0)1234 751125; website: www.ecch.co.uk; email: ecch@cranfield.ac.uk.

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