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HP

The shift in innovativeness from HP's 'peak' to 2011. What now?

First published on November 28, 2014. This report is a modified, but not updated, version of the earlier report.

Was HP too big to manage? How will HP's culture, policies and management practices be different with two publically-listed companies?

Introduction

Value deterioration occurred over a period of ten-years of outside help but the latest restructuring with insiders suggests that HP may be set to return to its tradition of innovation and growth.

There were two 'cliffs' experienced by HP shareholders. One was shortly after its acquisition of Compaq and the other around the beginning of 2010.

Fiorina presided over the period from 2000 to 2005 and Mark Hurd over the subsequent period until his ouster in 2010. Meg Whitman replaced Hurd as CEO and remains as CEO, President and Chairman of the Board.

Periods of influence.
- Platt; 1992 to July 1999
- Fiorina; July 1999 to February 2005
- Hurd; February 2005 – August 2010
- Apotheker; September 2010 – September 2011
- Whitman; September 2011 to current

Under Hurd, shareholder value increased – see chart - but, as most would now understand, this was done at the cost of its research and development efforts, HP's reputation for innovation and the loss of morale throughout the organization was catastrophic. Innovators left the corporation. Morale was negatively impacted.

From a shareholder perspective, value deterioration has occurred over a decade and a half and under the watch of CEOs new to HP. One presumes, however, that the Board foresaw, prior to 2000, the impending decline and this led to its action to hire outsiders to turn the company around. Perhaps, as some state, the seeds of the decline were planted prior to the decline in actual shareholder value. Best practices in innovation processes were not working nor was succession planning.

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The company, at this point, has been set back 15 years in terms of its shareholder value. Worse than that, HP's share value did not increase over the same period as it should have done if it had been innovating successfully. The challenges have been enormous; both for strategic decisions and management practices.

Which Factors - i.e. policies and management practices are most relevant to explaining the decline in innovativeness? That is what we intend to pursue in this report. Cause and effect?

Update to November 2014

On October 6, 2014, Hewlett Packard[1] announced it was planning to break into two separate companies, separating its personal-computer and printer businesses from its technology services. The split, which was first reported by The Wall Street Journal and confirmed by other media, will result in two publicly traded companies: Hewlett-Packard Enterprise and HP, Inc. Meg Whitman will serve as chairman of HP, Inc. and CEO of Hewlett-Packard Enterprise, Patricia Russo will be chairman of the enterprise business, and Dion Weisler will be CEO of HP, Inc. The split is expected to be completed by the end of fiscal year 2015, in October 2015.

R&D expenditures as a % of revenue were at 3.1% for fiscal 2013, up from the latter period of the decline but still not up to the earlier rate of over 4%. Now with the split of HP into two companies one might see a return to this earlier indicator of HP's culture – at least as seen by insiders.

HP beginnings and at its 'peak'
At its 'peak', investment in R&D, was a proxy for HP's culture; the one characteristic which is so hard for outsiders to get a handle on and the easiest way to improve short term return and, at the same time, the most damaging to long-term innovation.

Since HP's inception in 1947 David Packard had the longest 'period of influence'[2] over HP affairs at 46 years, leaving in 1993. William Hewlett had the next longest tenure with 40 years ending in 1987.

Subsequent to these two leaders, the 'periods of influence' become ever shorter. John Young's period was for 14 years, Lewis Platt for 7 years, beginning in 1993 and ending in 1999. The innovation 'cliff' had yet to be evidenced at least to shareholders at large. There is some opinion that the decline in innovation type investment and thinking began during Platt's term.

The shareholder 'cliff' evidenced itself around 2000, coincident with the appointment of Carly Fiorina. Ms. Fiorina departed in 2005. There followed a brief interim arrangement and then the appointment of Mark Hurd. Under Hurd, shareholder value increase returned briefly only to fall

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[1] Wikipedia reference
[2] Period of influence is a recognition that the individual continues in a position of influence as a CEO, COO or as a member of the Board of Directors.

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quickly after his departure in 2010. The 'innovation cliff', one can say, was not arrested during either of their terms in office.

The Board of Directors which presided over the period of the two 'cliffs' has been almost entirely replaced except for three directors; Andreessen, Gupta and Lane. It is difficult to say whether the decline in innovativeness was evident to the Board of HP early on. The Board, at the time, did decide to hire outside the organization, usually a drastic step signaling the need for fresh ideas, action and innovation and, one might now presume, is an implicit recognition that innovation was not working before the year 2000.

At its best, and since its inception, HP had an outstanding reputation for innovation. Innovators stayed with the company and, based on our research, there was, up until the late 1990s, a sense that innovation was increasing. Shareholder value was on the rise. HP was a great place to work.

Culture[3] was always an important characteristic with HP. Culture is in many cases, the most difficult for an outside to understand. Passed down through generations of management, its texture and importance is often hard to ascertain. On the other hand, a Board, may make the decision that culture is getting in the way of progress and is more valued than exemplary financial return. Outside help was the option chosen by HP's Board at the time.

Lack of leadership at the Board and management levels, is clearly evident but, more specifically, the following reasons, by Factor, have been identified as equally significant contributors to the decline in actual and apparent innovativeness. Strategy is not part of this report but obviously acquisition decisions have had a major impact on financial returns and will have had an effect on the culture given the scale of the acquisitions.

HP's management practices during the period leading up to the 'cliff', are for most of the Factors, rated by us as close to the BofB[4]; our benchmark of excellence, for all three themes; *leadership, idea generation and realization* and the *organization and management of day-to-day affairs*. HP did deserve its well-earned reputation. A comparison with the management practices at 3M is set out in the Appendix. Again, at its peak HP's policies and management practices respecting the encouragement of innovation were superb.

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[3] The founders, known to friends and employees alike as Bill and Dave, developed a unique management style that came to be known as "The HP Way". In Bill's words, the HP Way is "a core ideology ... which includes a deep respect for the individual, a dedication to affordable quality and reliability, a commitment to community responsibility, and a view that the company exists to make technical contributions for the advancement and welfare of humanity". The following are the tenets of The HP Way: We have trust and respect for individuals. We focus on a high level of achievement and contribution. We conduct our business with uncompromising integrity. We achieve our common objectives through teamwork. We encourage flexibility and innovation.

[4] BofB refers to CIO's collage of the best practices of companies researched.

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Exploring the Factors impacting growth and innovation

HP's policies and management practices were, at its peak, amongst the best, but experienced a rapid and cataclysmic fall under a decade of outsider management.

CIO does not have complete data on each of the 25 Factors which typically make up our profile of the climate - culture - for innovation but we have researched and can comment on several Factors which point the finger at specific practices which contributed to the decline in the innovative capacity of the company with respect to innovation and ultimately investment performance.

For purposes of reporting on this portion of the report we have grouped our comments under three headings.

- Leadership
- Organization and management of day-to-day affairs
- Idea generation and realization.

CIO has some independent verification of our ratings by way of contributions to our on-line survey and through interviews with ex-HP employees.

This survey[5] asks respondents to provide their opinion on what value they would put on each of twenty-five Factors and then to rate their own 'Reality', the difference between the two ratings provides an insight into the degree of satisfaction or dissatisfaction of the responder.

One might have recognized the looming cliff if information on eight of the 25 Factors had been made available and listened to by HP leadership – both management and the Board. A different strategic course might have been set had the importance of management actions and their impact on the organization been recognized. Was the management style known as the 'HP Way', articulated by 'Bill and Dave' getting in the way of the creation of shareholder value? Has the 'HP Way' survived? These questions remain.

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[5] For information on the survey review http://www.corporateinnovationonline.com

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Outcomes

Using the on-line survey methodology, respondents were asked to provide their opinion on what is happening in their organization with regard to four Factors. The '+' indicates a desirable situation whereas the '-'would not.

Factor	Description	Measurement	Outcome	Outcome
21	**Retention of innovators.**	Innovators tend to stay with the organization. -	Most stay	Most leave
22	**Innovative tradition.**	The organization has not or has an innovative tradition. +	None	A fine reputation
24	**Perception of innovation trend.**	Innovation is perceived as decreasing or increasing. +	Decreasing rapidly	Increasing rapidly
25	**Role of employee groups.**	Employee organizations discourage or encourage innovation. -	Very much encourage	Very much discourage

The four Factors are all related to the results – the outcomes - of an organization's policies and management practices. CIO was able to report on three of these Factors only since we have no consistent information on the role of employee groups as they could impact innovation. For the remaining three Factors a desirable opinion would likely be that, innovators stay (F#21), and that the organization has a fine reputation (F#22) for innovation and that the perception is that innovation is increasing (F#24).

Opinions from our respondents who are knowledgeable about HP provide their opinion on both what HP was like at its 'peak' and the situation in 2011, shortly after Hurd left as CEO.
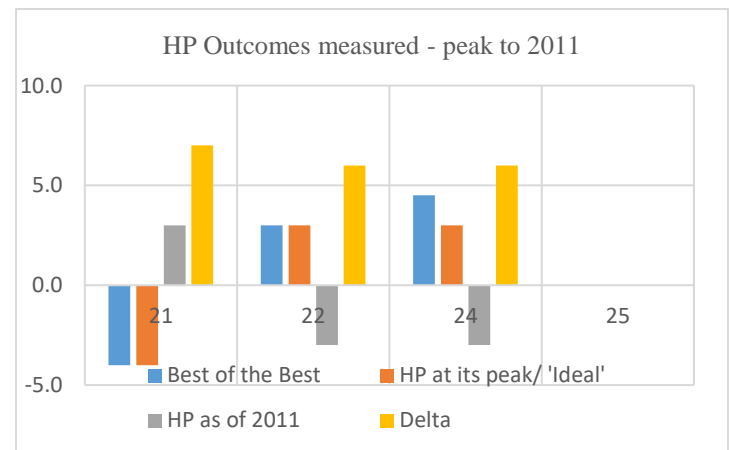
At its 'peak' the opinion on Factors #21 and #22 was that HP was in complete synch with the 'Best of the Best'. For Factor #24, the opinions were very close. In summary, innovators were not leaving, HP had a fine reputation for innovation and its reputation was increasing.

What, who, caused the change?

By 2011, the situation had changed dramatically. Innovators were leaving, HP's reputation was not so fine, and its reputation was decreasing. The change which we call the 'Delta' for 'peak' to 2011 is set out. A disaster was building.

HP Outcomes measured - peak to 2011

Other Factors provide some insight into the reasons.

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Leadership

Six Factors are used to probe and measure leadership's role in the management of innovation.

Opinions on whether management places an undue emphasis on the need for short-term profits requires examination. If the message from the Board or management is that quarterly profits are most important then there is little room for people to think too far ahead or expect that funds for new ventures, however appealing, will materialize. There is need for management to convey a balance between short-term and longer-term profit motives.

Surprisingly, some management's do not call for innovation and this could be appropriate in certain circumstances. But if the latent desire of the organizations' employees (and stakeholders let alone shareholders) is to be innovative, then there is disconnect between top management including the Board and others in the organization.

Cost reduction, if that is the explicit focus of an organization, can act to discourage innovation. Opportunity identification becomes an unrewarding task and slips from sight. Innovators need to be rewarded in some way – not always with monetary rewards – but some special singling out for their ideas or initiatives.

Our research indicates clearly that risk taking is, at all levels, a feature of highly-innovative companies. Without risk there can be no innovation. Mergers, acquisitions etc., do not have to upset innovation but can if jobs/employment are seen to be vulnerable.

HP's situation changed dramatically over the period examined. The 'Delta' is high for each Factor. At its 'peak' there is a strong congruence between HP and the 'Best of the Best'. Let's face it, the legacy of leadership in 2011 was not held in high regard at least by those responding to our request.

Based on our research, there are several actions on the part of management and the Board which contributed the most to the decline in HP's innovativeness. Of the three themes examined, leadership (or lack of same) is represented by five Factors. Overall, leadership scores as a negative contributor. Of the 5 Factors three had a larger impact than the other two. Management and the Board shifted emphasis to achieving short term profit (F#1), looked less explicitly for innovation (F#2), and shifted from looking for opportunities to seeking cost reductions (F#4).

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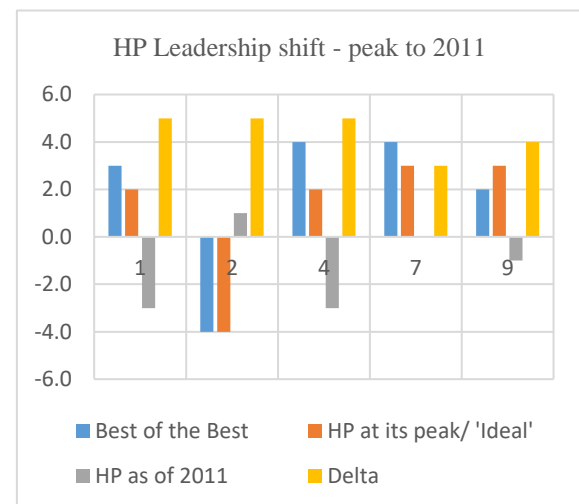
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Idea generation and realization

Six Factors, mainly comprised of attitudes and decisions by management, are seen to impact the flow of ideas in an organization.

For those companies which place a priority on innovativeness, it is clear that some notion of how ideas develop and are implemented within an organization should be well understood by all employees. Recent software developments are facilitating the means of capturing and managing ideas through to implementation. This is further evidence of the importance of 'idea management' to many companies.

> ### *Idea generation and realization Factors*
> - *Tolerance for mavericks – F#3*
> - *Tolerance for failure – F#5*
> - *Tolerance for variation from a corporate norm – F#8*
> - *Mechanisms in place to reward innovators – F#14*
> - *Resources generally available for new ventures – F#19*
> - *R&D budget levels above the competition – F#23*

Tolerance plays a big part in this process. Tolerance for failure, tolerance for mavericks, and different values and ways of exhibiting tolerance is an important attribute of those companies which we have researched. Often it is difficult for senior management to get an objective handle on these important Factors since the opinions are very much a subjective judgment and not easily rendered even in an otherwise open and transparent corporation.

Reward mechanisms are important as had been stated before. There should be a sense in the organization that if there are good ideas, investment monies will be available; albeit recognizing the need for investment to meet established criteria. R&D expenditures for innovative companies are an important indicator of the commitment by management and the Board to idea creation.

None-the-less, opinions on several of these Factors can be game-stoppers when it comes to surfacing ideas.

While product-inspired innovation is much impacted by spending on R&D, as noted earlier, the effectiveness of spending is equally if not more important. Again a value judgment!

Innovativeness is composed of a broad spectrum of initiatives from science-based ideas to what could be referred to as 'suggestion-box' ideas; just good ideas for improving

HP Idea generation and realization - peak to 2011

productivity – so valuable to the process of continuous improvement. Idea generation is not limited to spending on R&D.
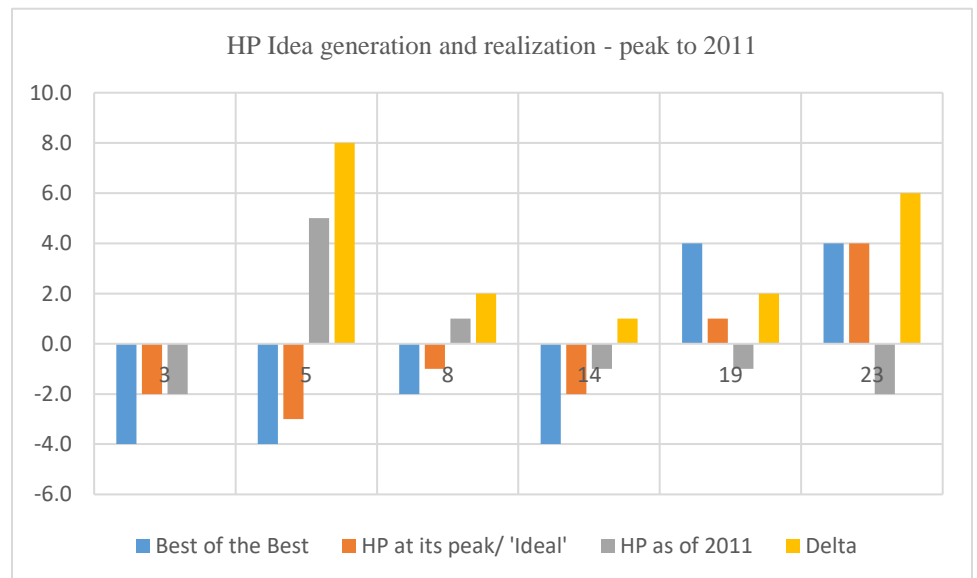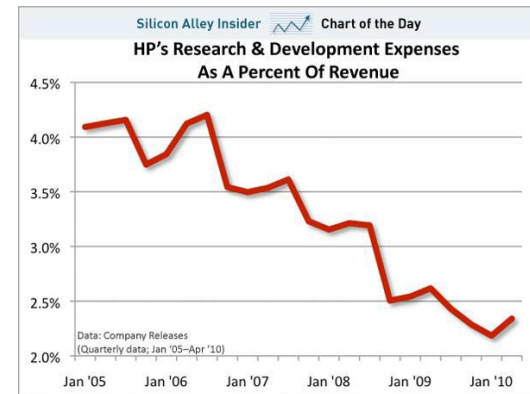
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The opinions expressed, as set out in the chart, again would suggest that there is a relatively strong correlation between HP and the 'Best of the Best in all Factors save Factor #19; that resources were generally available. Not so, even at the 'peak'.

The largest shifts in opinion were for Factor #5, the tolerance for failure and Factor #23, spending on R&D[6]. A drop in management's tolerance for failure (F#5) was noted. Highly innovative companies have a relatively high tolerance for failure. HP had it but lost it!

A reduction of R&D spending (F#23) occurred mainly under Hurd. This move struck to the core of HP's culture. Some reports noted that Hurd was dismissed, not so much for competence where he was having some affect nor the expense issue, nor the reduction in R&D spending, but that he was simply disliked.

Silicon Alley Insider — Chart of the Day
HP's Research & Development Expenses As A Percent Of Revenue
Data: Company Releases (Quarterly data; Jan '05–Apr '10)

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[6] How Mark Hurd Killed What Was Sacred At HP. JAY YAROW AND KAMELIA ANGELOVA. AUG. 17, 2010.

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Organization and management of day-to-day affairs

Eight Factors address how management goes about organizing and managing routinely and how these practices impact a company's innovativeness.

These Factors have much to do with people management, internal communication, delegation of responsibility, accountability, and reporting; i.e. management practices which are well recognized as good management practice.

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Organization and management of day-to-day affairs Factors

- *Emphasis on management of people and their interactions – F#6*
- *Degree of formal communications in the organization – F#10*
- *Use of independent work groups – F#11*
- *Management decisions with input from a broad cross section of employees – F#12*
- *Formality of the decision process – F#13*
- *Planning versus action orientation – F#15*
- *Decentralization versus centralized hierarchy – F#18*
- *Staff versus line involvement in the decision process – F#20*

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There is not much new in this category. The question is, however, how all of these practices are actually viewed by employees. Is there a consistency of viewpoint or are there disconnects which could inhibit innovation? Are the views of employees in line with those of senior management and the Board? If not, why not?

Some of the Factors overlap. Factor #11, dealing with the subject of the use of independent work groups, is in some respects a proxy for Factor #18, whether the organization is decentralized or not. Both involve the notion of delegation down the organization by management, and meaning it.

Other examples which have been researched include; John Deere, 3M, Starbucks, Nucor, and Toyota. The pattern is clear. People come first. A degree of informality in communications and decision making is called for as is the delegation of responsibility, authority and accountability.

These are essential elements in innovative companies. A balance between shooting from the hip and planning paralysis is also seen as a desired management practice.

HP's shifts mostly took place for; F#6 – people management issues, F#12 – inputs from 'others' in the organization, F#15 – emphasis on planning and not on action, and F#18 – changes in the practice of decentralization.

HP Organization and day-to-day management - peak to 2011

Legend: Best of the Best, HP at its peak/ 'Ideal', HP as of 2011, Delta

The management of people and their interactions (F#6) was receiving less attention as the decline became more evident.
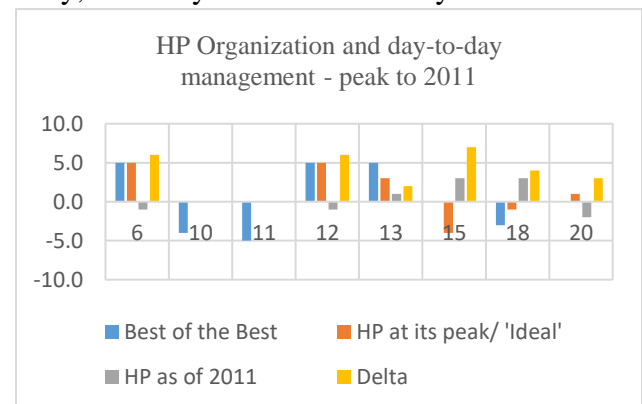
HP's approach to planning went from an organization which carefully analyzed and thought through its strategy and then acted to one that became more 'shooting from the hip' (F#15); action oriented but seen to be taking the wrong kind of action.

Decision making, which was broadly based (F#12), shifted to the point that decisions did not recognize input from its broad base of in-house staff and executives. Over the period of the decline, decision making became much more centralized.

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Conclusion

There are indications that with the division of HP into two ultimately publically listed companies, there will be an opportunity to apply different criteria to their performance and manage accordingly. Whether the culture of HP – its original - will survive or take hold again after so many changes is a mute question. People have moved on. On the other hand, with over 300,000 employees scattered around the world – and somewhat divorced from head office actions – there may be a light at the end of this struggle.

HP's return on assets (ttm) at 5.28% is well below IBM at 10.52%, Microsoft at 11.43% but is close to CISCO's at 6.46%. The challenge remains to return to being effective at innovation and at the same time, improve financial performance.

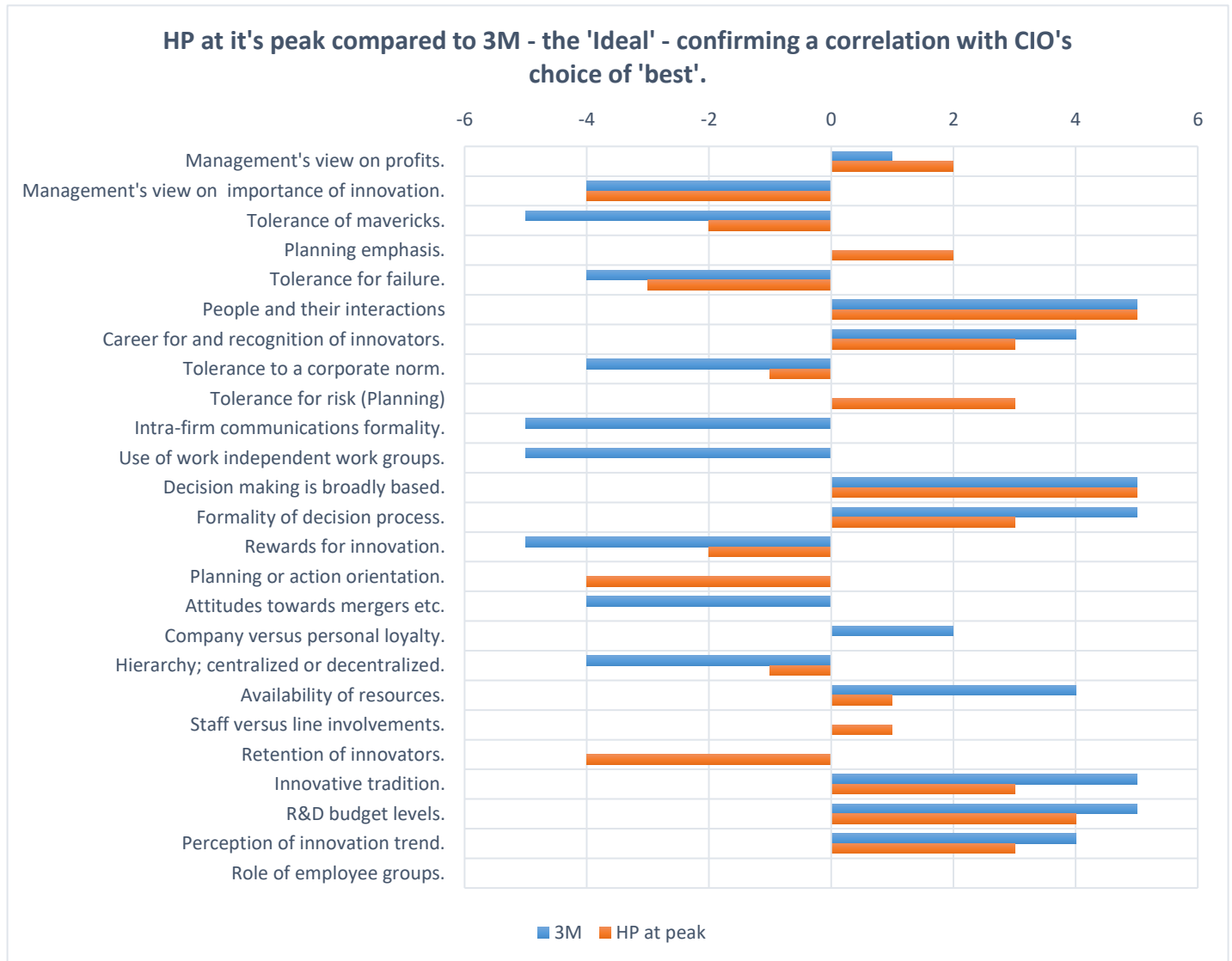Everything depends on decisions of the Board and senior management!

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Appendix
Comparing HP to the ratings for 3M, CIO's choice of the best-managed diversified company.

This comparison was done as a check on whether HP responses regarding the 'Ideal' bore any resemblance to an actual high performing company – in this case 3M[7]. The correlation is clear!

HP at it's peak compared to 3M - the 'Ideal' - confirming a correlation with CIO's choice of 'best'.

Legend: ■ 3M ■ HP at peak

Categories (top to bottom):
- Management's view on profits.
- Management's view on importance of innovation.
- Tolerance of mavericks.
- Planning emphasis.
- Tolerance for failure.
- People and their interactions
- Career for and recognition of innovators.
- Tolerance to a corporate norm.
- Tolerance for risk (Planning)
- Intra-firm communications formality.
- Use of work independent work groups.
- Decision making is broadly based.
- Formality of decision process.
- Rewards for innovation.
- Planning or action orientation.
- Attitudes towards mergers etc.
- Company versus personal loyalty.
- Hierarchy; centralized or decentralized.
- Availability of resources.
- Staff versus line involvements.
- Retention of innovators.
- Innovative tradition.
- R&D budget levels.
- Perception of innovation trend.
- Role of employee groups.

Ratings and those of 3M. Rating for at least 15 of the Factors are closely correlated. Eight Factors are unable to be correlated due to lack of adequate information.

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[7] See additional information on the web site.

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