

Vendor Focus: HP

Hardware heartbeat

Hewlett-Packard became the services company it said it was... but then lost the CEO who made it happen. The challenge ahead is all about identity, says **Chris Middleton**.

It's birth in a Californian garage might be an industry cliché, but HP remains the company with a shed load of hardware at its core. Dave Packard's garage in Palo Alto, where he and Bill Hewlett built electrical components, can be seen as the West Coast version of the American Dream, where a garage technology start-up can service the world. In August 2010 that dream was tainted by scandal – again – as CEO Mark Hurd resigned in the wake of allegations about expense claims and his relationship with former actress, Jodie Fisher. This is a good time, then, to ask what HP stands for.

The Hewlett-Packard company was established in 1939, as the US emerged out of the Great Depression towards the transformed global economy of the wartime and post-war eras. But is HP's future still one of equal promise today, as US labour exits the dust bowl once more, and a successful CEO joins the unemployed? HP has certainly grown organically in many of its core IP areas, and in others through ambitious acquisition and merger – Compaq, EDS, 3Com and Palm, for example. Today it employs 310,000 people.

Like IBM, HP has evolved into a broad-based, diversified behemoth deploying hardware, software, business automation

and services worldwide to sectors such as manufacturing, financial services, healthcare, communications, energy, transportation, and the consumer and retail industries. Also like IBM, it faces the challenge of sweeping public sector cutbacks in its Government markets.

BPO supported by ITO

IBM, then, is HP's Big Blue rival, and HP sees itself as a necessary alternative in the market. IBM might hold more patents than any other company, but HP's key differentiator is that shed load of hardware, supported by a \$3 billion annual R&D spend and the IP from its acquisitions. This, though, is part of the challenge it faces: anecdotally, HP is sometimes spoken of as being staffed by people who think like their former employers – 'Compaq people' or 'EDS people' – and who talk about HP as if they are somehow outside the organisation.

HP receives significantly more UK Government software and IT services spending than any other supplier, thanks to that acquisition of EDS two years ago. In fiscal 2009, HP brought in over £2 billion from UK Government contracts alone. Most of that money came from two clients: the Department of Work and Pensions (DWP, which outsources most of

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**Craig Wilson,
UK MD,
HP Enterprise
Services**

Mark Hurd: The CEO walked on August 7, 2010.



its IT to HP) and the Ministry of Defence (MoD), where HP outsourcing stretches from business space to battle space. “In the UK over 25% of HP's revenues come from public sector contracts,” notes Dr Katy Ring of analysts K2 Advisory.

Among HP's flagship projects in the public sector is the DII (Future) contract, through which it is creating a shared information infrastructure for the MoD. “According to HP, the project is on track to enable the realisation of £1.5 billion of efficiency savings across the Defence

Change Programme over the 10-year DII contract,” says Ring. This has partly been achieved by HP's approach to partnering as prime contractor within the ATLAS consortium of suppliers.

In the civil sectors, HP is planning to expand its footprint in local government, health, education and the police, largely through shared service/BPO contracts. There are persistent rumours, however, that HP lacks commitment to its BPO business – and yet BPO remains a nearly \$3 billion market for HP, similar in size to its

software business. “There is an explicit focus on opportunities that have process automation and the application of technology at their heart, particularly in higher-margin, industry-specific services,” says Rachael Stormonth, senior analyst at NelsonHall.

Those high-margin services are core to the HP message, post EDS – but Whitehall cutbacks mean that HP’s main Government deals must now be more of a challenge.

Former EDS man Craig Wilson is UK MD and VP of HP Enterprise Services. He says that HP’s DWP relationship dates back to 1989, and the MoD one even further, but accepts that those were a patchwork of deals compared with the massive Government presence it bought by acquiring EDS. “It’s a matter of record that HP did not have the strongest services arm,” says Wilson. “HP did not have extensive relationships with



HP’s image change: Ivanka Trump appears at an HP event in New York, June 2010.

contracts need upfront investment. EDS did not generate enough cash relative to its position in the marketplace. One of the strategic aims for HP *now* is to invest in big outsourcing operations.”

But is that a realistic strategy – in the public sector at least? In the Age of Austerity, it may be that the patchwork of

smaller deals that characterised ‘old’ HP forms a more realistic picture of public sector sourcing in 2010. Meanwhile, the Government says it will renegotiate all existing, large-scale contracts.

No ‘super profits’ in Government

“If it were the case that HP was making super profits out of Government that might be a valid point, but overall profitability is not appreciably greater there,” counters Wilson. “Most of what we do is not in the nature of stuff that Government can switch off, and as well as looking for savings, there are opportunities for us as well: for example, savings across the clerical side of what they do in Government.

“We hold a lot of different desktop contracts, and if you look across those deals the pricing is not all the same – but, then again, nor is the specification. So the simplest thing is to pick the very best of those contract definitions and see if we can apply them across all of Government. Increased standardisation means more efficient delivery.”

So HP is to renegotiate proactively rather than wait for Osborne’s axe to fall.

All this suggests HP is beginning to lead by example: the hallmark of a services company. HP first began talking about itself as a services company when Carly Fiorina – now on the Republican campaign trail endorsed by Sarah Palin – became Chair and CEO in 1999. However, at the time the services message seemed mismatched: HP acquired hardware maker Compaq and blew half of its own share value along the



IBM chief Sam Palmisano: HP is IBM’s ‘alternative’.

central Government, it had a smaller number of discrete contracts. When we joined the two together, the EDS footprint was about four times bigger than that of HP in services, so it was essentially the EDS relationships that we leveraged.

“What’s changed, of course, is that EDS now has the power of a much bigger company with deeper pockets, and some

Photos: Press Association

way. Fiorina was ousted in a 2005 coup that re-energised HP's share price, but replacement Chair, Patty Dunn, mired HP executives in the 'pretexting' spying scandal in an effort to halt boardroom leaks.

Hurd took over in 2006, which is when the services message began to make sense. Hurd slashed the company's own IT spend from \$4 billion to \$2 billion. Reining in IT was an important step for HP, because it discovered that 70% of that expenditure was not measured by the central organisation at all, but only by its separate business divisions. Then Hurd slashed his own job prospects and reintroduced HP to an old friend: scandal at the top.

EDS puts HP back on message

Today, leaner, fitter HP admits, as Wilson says, that the reality of its services presence has only matched the rhetoric since buying EDS. In fairness to Hurd's predecessors, though, an EDS deal was first proposed by Fiorina a few months into her tenure, but then rejected. At that time in 2000, EDS was in the ascendant after a period in the doldrums. Its massive contract wins over the ensuing 12 months might have secured Fiorina's place in the pantheon of visionary CEOs had HP bought EDS when it first had the opportunity.

When it did happen under Hurd, the acquisition of EDS also brought to HP an established BPO business in a number of industry-specific areas, such as Medicaid in the US. EDS also has longstanding financial services BPO contracts: before the HP acquisition and the recession (during which transaction volumes declined), NelsonHall estimated this was worth \$1.1 billion to EDS.

In addition, EDS has given HP an extensive contact centre-based BPO business. Also embedded in many of its BPO deals was document management, although this was not promoted as a standalone offering. Additionally, EDS brought to HP its HR BPO capability.

Not long ago, HP's slogan was 'Invent', and some might say that capacity for invention has applied, at times, to its own identity. While HP now recognises that its



"Over the years, numerous transformative initiatives have helped HP better serve our customers and profitably grow our business. The results speak for themselves."

Hurd, ex-CEO

hardware heart is merely one stage of an evolving customer relationship with its wider business portfolio, which includes consulting, outsourcing and technology services, it retains a strong 'lifestyle' focus on mobility and consumer plays. For example, in April HP snapped up Palm and its well-regarded webOS for \$1.2 billion and also recently acquired music streaming service Melodeo.

Those acquisitions pitch it into Apple's space – where powerful branding positions Apple as sexy, chic and aspirational. By comparison, HP risks being 'all things to all people' – to business and consumer markets alike. That said, the divisions between 'business' and 'consumer' are now party walls, and each dances to the other's tune.

However, the fact that HP's current branding is no longer 'Invent', but 'The World's Biggest IT Company', suggests that HP feels the need to tell people it exists. Sorting out 'the vision thing' must be the prime demand of whoever replaces interim CEO, HP CFO Cathie Lesjak, at the helm. Will it be someone with a hardware heart?

Still inventing the future?

Nevertheless, HP's old capacity for invention remains core to its success, said Hurd in May: "Over the past five years, numerous transformational initiatives have helped HP better serve our customers and profitably grow our business. The results speak for themselves." So what of those results? Although HP was founded for \$538 and the toss of a coin over whether to call it 'Packard Hewlett', its recent market capitalisation has been massive: in July 2010 it stood at the \$100-110 billion mark.

IBM's stock market value, on the other hand, stood at roughly \$160 billion in the same period, while Apple's was more than \$230 billion. So while HP's finances might be healthy, the macho stock market has seemed lukewarm about them, if only by comparison. HP is seen as a solid performer but rarely as a market definer – beyond that sticky 'printer company' label, of course.

"IBM is our principal competitor, but we don't want to beat them by being like them," says Wilson. "We see our printer and



Photo: Press Association

See through: HP shows its wares in Chongqing.

personal systems businesses as a source of strategic advantage to us, whereas IBM has exited those businesses." Those ink-jets still print cash for HP, it seems.

HP's recent figures are, in fact, as solid as you might expect. "Year over year we added \$3.5 billion of growth and over \$500 million of net earnings," said Hurd announcing HP's Q2 results in May. "Revenue of \$30.8 billion was up 13% over the prior year." HP reports again mid-August.

Services delivered revenue of \$8.7 billion, up two per cent from the previous year. Within services, the IT outsourcing business grew six per cent, with strength in the Government and financial services sectors. Revenue in both technology services

and BPO was flat compared with 2009 and applications services declined two per cent. That said, both application services and BPO saw solid signings in the quarter.

But what of the *underlying* financials? A like-for-like reading of HP's balance sheet against IBM's sees HP with a profit margin of seven per cent against IBM's 14%, a return on assets of 6.7% versus IBM's 11.4% and a return on equity of 20% against IBM's 77%.

HP's latest reported net income (profit) was \$8.5 billion on revenue of \$120.4 billion, compared with IBM's \$14 billion on revenues of \$97 billion. However, year-on-year quarterly earnings growth of 28% at HP is three times higher than IBM's, and HP is still digesting its acquisitions.

"Let me reiterate why I'm so confident in HP's future," says Hurd. "First, our broad

market portfolio. HP is the only company with significant IP, global scale and market leadership in servers, storage, networking, software and services, to deliver the next-generation data centre. HP is winning in the market, investing in innovation and moving deeper into high-growth segments like networking and mobility.

"Second, our ability to leverage scale and global reach. The global demographics are rapidly changing, with a fast-growing middle-class population migrating to large cities in emerging markets. This class of people will expect to be seamlessly and securely connected to the global community with mobile devices and the underlying infrastructure."

Enterprising moves

Enterprise services are core to where HP sees itself heading. As the UK Government cutbacks grabbed headlines this summer, HP announced that it will invest \$1 billion to upgrade its Enterprise Services business – promising productivity gains and increased automation.

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Part of the package is the loss of 9,000 existing jobs – three per cent of its global workforce – and the claimed creation of 6,000 new sales and service delivery jobs. If those appear, many will be offshore. HP currently employs about 3,600 people in China, for example, and may boost that figure by as much as 25%, according to some reports.

“The speed with which HP has taken out cost from the EDS business is awesome,” says NelsonHall’s Stormonth. “In its fiscal Q4 2009, HP Enterprise Services achieved an operating margin of 16.2%. By comparison, EDS’ operating margin in 2007 had been 5.8%. HP made no bones about its need to cut staff in Services.”

The job cuts furore

The challenge for HP was that, while there was little contractual overlap between it and EDS, the staffing overlap was considerable, admits Wilson. “If you hark back to Mark Hurd’s original comments on this in September 2008 you can see the strategy set out,” he says of the savage job cuts. “He gave a figure for the overlap between the two businesses. It was always part of the original plan.

“But it’s fair to say the speed with which we had to react to the changes in the global downturn was unexpected. Faced with the same circumstances we would do the same thing again: we had to move quickly.”

However, the inefficiencies HP is grappling with again are partly of its own making – and, arguably, rooted in the very speed at which it acted. “We can go back now and do the re-engineering of the processes with a lot more care,” says Wilson. “Because we had to make the changes so quickly, we didn’t have time to integrate around a single toolset. With the worst excesses of the downturn behind us, we can go back and re-engineer those processes – such as move all our separate ticketing systems onto HP systems worldwide.”

The union Unite warned that the 934 job losses at HP in the UK could be followed by a further 1,000 cuts next year. National officer Peter Skyte says: “This is



The red box: It holds little promise for profit.

“HP has to make this work. In the UK, it derives 50% of its revenue from services. Its future is as an IT infrastructure market gorilla.”

a further cull by HP of its skilled and experienced UK workforce, and follows nearly 4,000 jobs being cut over the past two years since the takeover of EDS.

“This will create further insecurity and uncertainty in HP with the threat of yet more redundancies to come, and it undermines the coalition Government view that the private sector will fuel job growth out of the recession.”

HP has to make this work. In the UK, it derives roughly 50% of its revenues from services. “The future of HP Enterprise Services lies with its potential as an IT infrastructure market gorilla,” says K2 Advisory’s Katy Ring.

Wilson prefers a different word: he sees HP as a “utility” for a mobile, cloud-computing-based future, with HP Enterprise Services at its core. “It’s public utility versus private power plant,” he says. “Today, why would people build their own IT infrastructure? In the early days of the industrial revolution, people might have built their

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This vision of ‘technology on tap’, alongside comparisons with the industrial age, are old industry marketing tropes, but Wilson’s point here is about the suppliers, not their customers. Of HP’s large-scale competitors in the outsourcing space – the systems integrators, the large consultancies – he says: “Once we move towards utility computing, then providers have to decide whether they are niche consultants or a big utility like HP. A lot of our competitors are still stuck in the middle. That’s the place you don’t want to be. There is a bright future for utilities, and an equally bright one for niche, capable, client-side consultancies.”

If HP is banking on its biggest customers moving towards a utility model, then there is evidence that is already happening. “One analyst suggested that, by 2012, 80% of all IT organisations would have outsourced all their assets,” said Jamie Erbes, CTO HP Software and Solutions, in a recent Ovum interview. “I asked an advisory board of Fortune CIOs whether that was bogus and what percentage of IT they expect to own as an asset. Two of them said they already only own about 20% of their assets.”

The utility approach

This type of utility services approach makes cultural sense to HP, because it is close to its hardware heart, suggests K2 Advisory’s Ring. “In terms of cross-sell, the HP hardware salesforce is proving to be the secret weapon for HP ES in growing market share for utility services. In a nutshell: if you run HP kit, chances are you will soon also be buying HP services.”

And vice versa, perhaps. “Are we just the sales arm of the hardware side of HP? To some extent that’s fair comment,” says Wilson of its Enterprise Services unit. “But increasingly, clients don’t care about the underlying technology, they want to consume IT as a service. They want to know the service is cost effective and works.”

Somewhere in Silicon Valley, a shed full of hardware will be servicing their needs. ■



• **Sky falls on HP**

HP recently agreed to pay broadcaster BSkyB £318 million in compensation over a failed CRM implementation, a contract won by EDS in 2000. The total settlement includes £230 million in damages, as well as millions in interest and tax, already paid by HP.

EDS was found to have lied about the time needed to complete the implementation. After this, EDS “failed properly to resource the project” and was “seriously in delay” against contract milestones, said the judgement.

• **Professional Outsourcing** published a detailed legal analysis of the case in our Spring 2010 issue.

Accenture responds to Professional Outsourcing

Last issue, our Vendor Focus was on Accenture. In response to that profile, Accenture issued a written statement saying: ‘Accenture pays, and has always paid, its fair share of taxes in each of the countries in which it generates income’.

Professional Outsourcing did not claim otherwise. We stated correctly that the company was incorporated in Bermuda until 2009, and that since then it has been headquartered in Ireland. Transcripts of earnings calls to analysts, in which CEO Bill Green has made various statements about the company’s location, are available on seekingalpha.com.

Accenture asked us to clarify that Andersen Consulting operated as a separate legal entity from Arthur Andersen after 1989, and that the company was renamed Accenture in 2001. **Professional Outsourcing** believes that this was implicit in the piece, but we are happy to make that explicit for the record.

In our article we also reported, correctly, that the US state of Connecticut sued Accenture in 2007. The legal action was over a lost backup tape that contained state bank account details. Accenture wishes it to be known that the Connecticut suit was subsequently withdrawn.

Our Editor Chris Middleton says: “This was not a feature about litigation. Some other legal disputes were omitted from the article, because I took the view that they risked unbalancing a fair and focused analysis of Accenture’s business models.”

However, the feature did also refer to the ongoing legal dispute between Accenture and British Gas parent Centrica. In 2008, Centrica alleged that Accenture was responsible for problems with Project Jupiter, a billing system intended to consolidate the records of gas and electricity customers into a single entity. The system was brought back in house by Centrica in 2006.

Accenture says: ‘Accenture is vigorously defending this claim. Accenture’s position is that problems only started to arise after Centrica took the business decision to take implementation of the system back in house. We are confident, based on the facts of the situation, that Centrica’s claim is without merit.’

Preliminary High Court hearings intended to narrow the scope of the lawsuit were held in June and July 2009, and their findings were widely reported in the press at the end of last year. The judgement found for Centrica on nine out of the 10 contractual issues under discussion. Accenture said it would appeal that decision.

The trial of Centrica’s claims is expected in late 2011.

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