CELEBRITY CEO
Fiorina keynotes a technology conference in 2004

CAN ANYONE SAVE HP?

Despite the board's insistence that it will stay the Carly course, a breakup may be the only way to turn the company around.

BY BEN ELGIN

Carleton S. Fiorina's last stand at Hewlett-Packard Co. took place, aptly enough, at an airport hotel. For six years the jet-setting CEO had flown the globe, smiling and perfectly coiffed even as she stepped off of red-eye flights. Jet lag never slowed down her delivery or muddled her message, which described the sprawling HP as nothing less than the beating heart of the tech industry. Yet on a damp Sunday evening in Chicago, as much of the nation focused on the Super Bowl, the 50-year-old Fiorina was embroiled in urgent talks with her board at a conference room at the O'Hare Hyatt, says an HP insider. The next day, Feb. 7, she was fired.

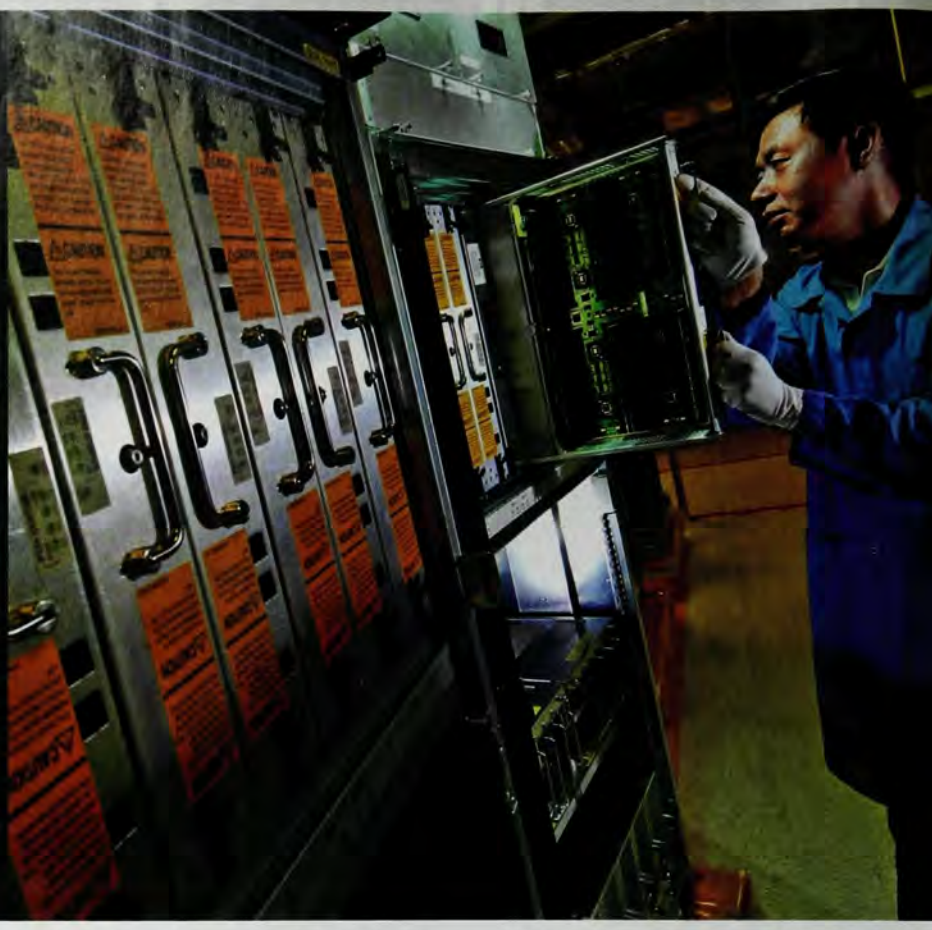
Thus ends the stormy reign of the highest-ranking woman in Corporate America and one of the boldest gamblers in the tech world. Fiorina pulled out all the stops as she hitched her soaring ambition to Silicon Valley's most venerable icon.

Not content to battle just one tech giant or two,

What Happens To the One-Stop Shop Carly Left Behind?

Fiorina positioned HP as perhaps the widest-ranging tech company in the world, with offerings from digital cameras to supercomputers. If her successor opts to narrow the focus, these divisions are candidates for spin-offs.

Data: *BusinessWeek*



(LEFT) PHOTOGRAPH BY MUNSHI AHMED

she took on a whole stable of them, from IBM and Dell to Sony and EMC. In the end, she failed. Outside of its stellar printing business, the $80 billion HP she leaves behind is struggling in everything from PCs to software. The proud Fiorina departs as a humbled ex-CEO, but not a poor one: The board softened the blow with a $21 million severance package.

The board, which named Chief Financial Officer Robert P. Wayman, a 36-year veteran, as interim CEO, is now searching for an exec ready and able to rescue HP. The crucial question for the next leader: Should HP remain intact? For months a number of Wall Street analysts have pushed for a breakup, arguing that HP's pieces, from the dynamic printer division to the lagging computer businesses, would be worth far more apart.

Fiorina fiercely resisted the calls, and the board supported her. But following the Feb. 9 announcement of her departure, investors bid up HP stock by 7%, to $21.53, in part because of the possibility of a change in course. "We believe the long-term probability of a breakup of the company is rising despite indications from the board that no such move is currently planned," wrote analyst Steven Milunovich of Merrill Lynch & Co. in a report that day.

The forces for a breakup may grow by the time Fiorina's successor takes over. The logic is straightforward: HP may simply be trying to do too much. The giant lacks both the resources and management skills to compete with the best of the best in nearly every industry in tech. And investors aren't likely to wait patiently for a gradual turnaround.

SHOCK, THEN A PARTY

THE SIMPLEST CHOICE would be to spin off the corporate computing businesses, which are struggling against Dell and IBM, and force them to make the tough choices necessary to survive as independent entities. Then a trimmed-down HP could plow ahead as the world's leading printing and imaging company. No doubt analysts inside the company and out will be slicing HP into countless permutations over the coming months and feeding them into their computer models. "You want to organize your business around your customers, or at least around your markets," says Ted Schadler, a vice-president at Forrester Research Inc. "To do that, you want to split up your business."

At HP, where Fiorina was a deeply divisive figure, news of her departure brought starkly different responses. As the board stated its determination to stick with Fiorina's broad-based strategy, some employees felt sorrow at her departure. For others, "it was a shock, then it was a party," says one. Then an e-mail began making the rounds: "Dingdong, the witch is dead."

Now HP's board is on the hunt for a replacement. They're looking for a CEO who can rescue HP, much the way Louis V. Gerstner Jr. lifted a troubled IBM from the sick bay when he arrived in 1993. A leading candidate, say insiders, is MCI Inc. CEO Michael A. Capellas, who sold Compaq Computer Corp. to Fiorina in a hotly contested $19 billion merger three years ago and briefly served as her No. 2.

Other possibilities include IBM's global-services chief, John Joyce, and Edward J. Zander, the former president of Sun Microsystems Inc. who is now CEO of cell-phone giant Motorola Inc. But even the most talented exec will face an uphill battle trying to keep Fiorina's HP, with its sprawling array of products in dozens of different markets, in one piece. "It's a Herculean task," says Jay R.

PRINTERS

The star of the company, printers account for 76% of the HP's operating profits and nearly all of the company's $64 billion stock market valuation. Some analysts have been pushing for a spin-off, insisting its value is buried under HP's other tepid businesses. Another scenario? The next CEO sticks with printers—and sells the computer divisions.

PROSPECTS Great at least for a couple of years. But Dell is crashing into printers from below, threatening HP's margins. And HP will have to pour billions into R&D to stay in front of the pack.

VALUE $60 billion to $65 billion

CORPORATE COMPUTING

HP leads in storage and runs a strong second in servers. But profits and margins lag. Its corporate hardware businesses notched abysmal 1.1% operating margins in 2004. Services would likely be faring better if HP had bought PricewaterhouseCoopers three years ago. But HP balked at the price of the deal, allowing IBM to make the acquisition.

PROSPECTS HP will continue to be squeezed between Dell on the low end and IBM for the big corporate installations. HP desperately needs to bulk up its software business, a potentially profitable market.

VALUE $18 billion to $22 billion

PCS

Combining HP with Compaq created a giant—but not a profitable one. Dell is clobbering HP in PCs, with its lead stretching to 18.3% of the global market. That compares to a 15.7% stake for HP. It's margins hit a meager 0.9% in 2004, far below what the company projected when it merged with Compaq.

PROSPECTS Poor, as long as Dell is in the market and customers are focused on traditional computing. But with its blend of consumer electronics and imaging, HP is well positioned for the digital home market.

VALUE $1 billion to $3 billion

Galbraith, a management consultant and author of *Building Organizations Around the Global Customer*.

One question is whether the board's stated commitment to Fiorina's plan will hamper the headhunting effort. The high-powered execs being considered may be loath to take on what has proven to be such a difficult task, particularly if they can't set their own strategy. "If some executives get the sense that their hands are going to be somewhat tied in making significant changes, that will limit the pool of eligible candidates," says analyst Tony Ursillo of Loomis Sayles.

While a miracle turnaround can never be ruled out, the more likely scenario is an eventual breakup of HP. That would spell the end of an era. Ever since its founding in a Palo Alto garage 66 years ago, HP has represented the triumph of a special brand of entrepreneurialism that came to represent Silicon Valley. At its heart it's an engineering-driven culture that values teamwork and rewards ideas and inventions, not pedigrees.

In truth, Fiorina was battling HP's storied culture from the day she arrived. A dynamic sales exec from Lucent Technologies, she was the first outsider to head the company. And she didn't hesitate to take out her hacksaw. Immediately, she began to reel in HP's 80-plus autonomous business units into a more centralized, four-division giant. She eventually laid off tens of thousands of workers.

Battling decades-old inertia, Fiorina began to centrally manage tasks such as branding and advertising. Even her critics say that these steps were needed, and that she fought some important battles to streamline HP's organization. "Carly recognized the need to start leveraging the common strengths of the company," says Bojana Fazarinc, HP's former director of marketing services and branding, who is now an independent consultant.

DECEMBER 2004
The drumbeat from Wall Street was getting louder

She was decisive, no doubt about that, and a gifted communicator. But even early in her reign at HP, she began to demonstrate the weaknesses that would lead to her fall. First, she fired or scared away execs in droves, including such prominent figures as Antonio Perez, now president of Eastman Kodak, and Mary McDowell, now a senior executive at Nokia. She also resisted changing course—a dangerous trait in an industry in which the most successful leaders have been those who don't fall in love with their strategies.

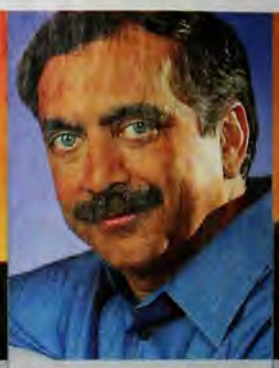
Throughout her tenure, say insiders, she continued to blame HP's woes on the company's culture—not on severe management shortcomings, including her own. "She didn't develop enough effective lieutenants," says Stephen P. Mader, vice-chairman of Christian & Timbers, the headhunting firm that recruited Fiorina into HP. "Twice she passed up...opportunities to have a chief operating officer. Looks like it bit her."

The Compaq merger was the defining

Who's Next On the Hot Seat?

HP is looking for a top-notch operations executive to succeed Fiorina as CEO. Here are some of the likely candidates:

MICHAEL CAPELLAS
MCI's CEO ran Compaq for three years before its merger with HP. Capellas, 50, knows HP well and excels at building morale and improving execution—just what's needed. He's tied up with the MCI turnaround attempt. But if it's acquired, he'll be available.



VYOMESH "VJ" JOSHI
The 50-year-old executive vice-president of HP's huge imaging and printing division just had PCs added to his list of responsibilities. He has to be considered the top inside candidate because imaging and printing supplies three-quarters of HP's profits.

EDWARD ZANDER
He has been CEO of Motorola for only 13 months, but already he has impressed analysts with his strategy and results. Would the former Sun Microsystems COO leave Moto so soon? Maybe. The 58 year-old kept his home in sunny California.

JOHN JOYCE
Formerly IBM's CFO, the 51-year-old now runs the company's $46 billion global services unit. He has a strong operations background—as controller for IBM's global operations and as head of its internal reengineering project in the mid-1990s.

moment in Fiorina's reign. By buying Compaq, she created a giant with tremendous scale and all of the clout and economies that come with it. But she did not fundamentally change HP's ability to fend off Dell in the low end of computing or match IBM's sophistication in the enterprise. So HP has come up short against both of them. Equally important, the battle over the merger divided the once-collegial company into angry, partisan factions. Insiders say the contentiousness of the dispute was a key part of why Fiorina became so wedded to her plan for HP.

But Fiorina's soaring vision ran into a wall of opposition. Director and scion Walter Hewlett rose up against it, and huge swaths of employees and shareholders joined the cause. They feared that the deal would dilute HP's lucrative printing and imaging business and an influx of hard-charging Compaq execs would turn HP's hallowed culture upside down. The dispute spiraled into a bitter proxy battle and wound up in the courts. Hewlett was pushed off the board of the company his father founded.

While it's convenient for HP's leaders to blame poor execution for their problems, what ails the company runs much deeper than replacing a few top executives. In enterprise computing, HP has failed to improve its lot. While it is still narrowly the market share lead in storage and in key server markets, including Unix and PC servers, it's losing ground to EMC Corp. in storage and Dell Inc. and IBM in servers. In some cases, its technology just hasn't kept up. In others, it has made bad bets.

> The board softened the blow with a $21 million goodbye package

IN DELL'S SHADOW

THE BIGGEST OF those was forming a partnership with Intel Corp. to co-develop the Itanium processor as the brains for high-end servers. After half a decade of trying, Itanium has gained little ground. Meanwhile, HP stopped developing its own high-end processor, called PA-RISC. Now it's stuck slugging it out for share in the market for commodity servers that run on Microsoft's Windows—where Dell excels.

HP struggles just as much in software and services. Its tiny software unit lost $125 million last year on just $922 million in sales. It's highly unusual not to make money in enterprise software. In services it has a sizable but slow-growing maintenance and repair business, yet it has squeezed profits in an attempt to gain market share in managed services such as running corporations' IT operations. Acting CEO Wayman said during the company's press conference on Feb. 9 that while the unit's revenues have been growing strongly, the company has to focus more on profits now.

Even HP's gilded $24 billion printing business, viewed by many as the company's savior, faces a rising number of challenges. Since Dell jumped into the market in early 2003, it has quickly picked up market share in inkjet models, the low end of the business. During the first three quarters of 2004, Dell accounted for 13% of inkjet sales in the U.S., according to IDC. While still a fraction of HP's market share, it presents a troubling trend. A growing base of Dell printers means it could eat into HP's lucrative business of selling ink refills to existing customers. "Dell is on the radar. It's a big long-term issue for Hewlett-Packard," says Ken Smith, a portfolio manager at institutional investor Munder Capital.

HP is betting that it can stay ahead on printers by pouring resources into its labs—and innovating constantly. In time the company expects state-of-the-art printing technology to spread into new domains, with printers even being harnessed to spray out billions of precision-engineered semiconductors. Though HP spends more that $1 billion on printer R&D, analysts question whether it can keep its edge. "The have the ability to carry it off, but not indefinitely," says Joe D'Elia of researcher iSuppli Corp.

The management ouster at HP gives the company a chance to rebuild trust with investors. During Fiorina's 21 quar-

PHOTOGRAPHS BY MICHAEL L. BOWLES; ALAN DECKER/THE NEW YORK

ters atop HP, the company missed profit expectations eight times. Sure, that's better than the 21 quarters before Fiorina arrived. But it's also more than double the combined misses of IBM and Dell over the same period. "Investor credibility is a huge issue with HP" says analyst Laura Conigliaro of Goldman Sachs & Co. Indeed, in 2004, HP's stock plunged 8%, underperforming virtually every one of its competitors.

The good news for HP? Even if the board clings to Fiorina's vision, the next CEO is sure to have a bold mandate for change within the divisions. That's sorely needed. Take the PC business. Before the merger, Compaq was making significant strides following Dell's efficient model of direct sales to customers. Yet when the companies merged, this initiative never won broad support. Why? HP couldn't aggressively push PCs and bypass retailers, when it needed their help to sell printers. The result: HP has stuck to the old industry model as it battles super-efficient Dell. HP's market share is eroding in PCs, and the division struggles to eke out a profit.

If the new CEO hangs on to the $24.6 billion PC business, the boss is likely to move quickly toward the Dell model—even at the risk of angering retailers. Should the direct-sales model sputter, the choices grow starker. IBM finally resolved the same issue in December, selling its PC division to China's Lenovo for $1.25 billion.

More bold moves are needed in HP's enterprise business. While the company acquired more than a half-dozen small software companies in the past 18 months, it has balked at a bigger acquisition. Insiders say that some board members were upset that Fiorina didn't more aggressively pursue Veritas Software Corp., a profitable maker of storage software that was acquired by Symantec Corp. in December. The bottom line is that HP lost money in

The Inside Story Of Carly's Ouster

By the end of 2004, the pressure in Hewlett-Packard Co.'s corner office was almost unbearable. With Chief Executive Carleton S. Fiorina's efforts to fix the $80 billion computing colossus stalled and tensions building with the board, one of high tech's most powerful executives began mulling an exit plan, *BusinessWeek* has learned.

Around the holidays, Fiorina held separate meetings with at least four high-profile chief executives to glean advice on making a "graceful exit" from HP, according to industry sources. These industry luminaries, approached by Fiorina at yearend business conferences, included Cisco Chief Executive John T. Chambers and Intel President Paul S. Otellini. During the conversations, Fiorina told the CEOs she was feeling some pressure from HP's board and inquired about face-saving ways to leave the company should she decide it was in the best interest of shareholders, according to the sources. Fiorina, Chambers, and Otellini didn't return requests for comment.

It was a decision she didn't get a chance to make. On the evening of Sunday, Feb. 6, HP's board hunkered down with Fiorina in an emergency meeting held at Chicago's O'Hare Hyatt Hotel. As a light rain drizzled outside, the directors stewed over their star CEO's failure to execute her ambitious plan for the company. In addition, directors were concerned about the "board's inability to work constructively with [Fiorina]," according to an HP insider. The next day, they asked Fiorina to step down. And on Wednesday, Feb. 9, at 5 a.m. Pacific time, HP stunned the world, announcing Fiorina's dismissal, ending her 5½ year stint atop one of the legends of Silicon Valley.

Despite the surprise announcement, the board's concerns about its chief had been mounting for nearly a year. Sure, she had dazzled directors and many investors with her passionate work in pushing through the controversial merger with Compaq Computer Corp. in 2002. And the immediate integration of the two companies bested expectations, silencing even her fiercest critics. But by late 2003, investors

Days of Promise Days of Pain

In five and a half turbulent years, Fiorina took a Silicon Valley legend on a wild and high-profile ride as she made her name as the most-powerful woman executive in America

JULY 17, 1999 Carly Fiorina takes over as CEO of Hewlett-Packard, the first outsider to run the Silicon Valley icon.

SEPT. 3, 2001 Fiorina and Compaq **CEO Mike Capellas** announce a controversial merger, spawning bitter opposition from board member Walter Hewlett.

MAY 3, 2002 After a narrow proxy victory, HP's merger with Compaq closes.

MARCH, 2003 Dell enters the printer market, threatening HP's cash cow.

DECEMBER, 2003 Dell pulls ahead of HP in overall PC shipments during 2003.

Data: Bloomberg Financial Markets

JUSTIN SULLIVAN/GETTY IMAGES;AXEL KOESTER; ZUMA PRESS; CHART BY ALBERTO MENA/BW

software last year, despite it being one of the most profitable markets for most corporate computing rivals. "The software business is way behind what you'd expect from a company this size," says Goldman's Conigliaro.

As HP embarks on a difficult transition, execs will be working hard to put forth an image of calm and stability. The company's business depends on it. Indeed, competitors from IBM to Dell to Sun will be highlighting HP's management turmoil as they compete on large corporate-computing deals. Even with longtime HP veterans, from Wayman to printers chief Vyomesh Joshi, sticking around, this promises to be a difficult task. "If somebody has a pen poised over a purchase order, HP doesn't want there to be a moment of hesitation," says Andy Butler, a vice-president at researcher Gartner. "The company will go to great pains to show the world that nothing is changing right away."

The new CEO will have a broad mandate for the change that's needed

While execs press forward with gritted teeth, the drama at HP seems to come full circle. Six years ago, it was at another airport hotel in Chicago that directors hired Fiorina. But things aren't going back to where they started. Not a chance. She may be gone, but HP now carries the indelible stamp of Carly Fiorina. ■

–With Steve Hamm and Spencer Ante in New York and Robert D. Hof, Cliff Edwards, and Peter Burrows in San Mateo

BusinessWeek online For more on HP and Carly Fiorina's ouster, please visit us online at www.businessweek.com

began shifting their focus from the Compaq deal to HP's ebbing position against key competitors IBM and Dell. They bored in on the ragged financial performance that led to the swooning stock price. "[Fiorina's] good with marketing; she's a good speaker for the company," says a former HP executive. "But this is a company that doesn't need a statesman. It needs a hands-on operations person."

The tide really began turning against Fiorina following HP's massive profit shortfall in the third quarter of last year. That marked HP's second miss in five quarters and further damaged the company's credibility on Wall Street—a major issue, since HP's stock has long traded at multiples well below those of its competitors. Although Fiorina fired three top sales executives for the miss, the board's doubts about its CEO grew. At the same time, the board's proddings of Fiorina to bolster HP's operations talent went largely unheeded.

As HP struggled to nail down its operations, some directors were chagrined that Fiorina didn't move more quickly to strengthen HP's position against Dell and IBM. For instance, although HP has gradually built up its direct-sales efforts to better compete with ultra-efficient Dell, some directors felt the company wasn't moving fast enough, according to the HP insider.

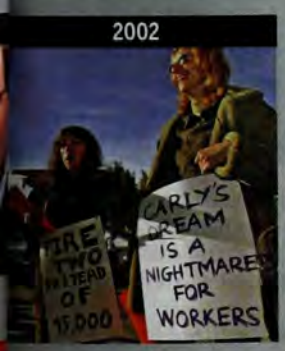
In addition, HP balked at a major acquisition to bolster its money-losing software business. In 2004, HP had considered acquiring Veritas Software but didn't move quickly enough, according to current and former HP execs. In December, Symantec gobbled up the profitable software company—leaving some HP directors unhappy. "Things needed to make us more competitive in certain segments weren't being done," says the insider.

By November of 2004, HP's directors began holding periodic conference calls—without Fiorina—to discuss their CEO's performance. And by the time of the board's January meeting in San Francisco, it enlisted three directors to meet with Fiorina to discuss its concerns with her performance. The trio produced a document indicating their concerns represented the consensus of the entire board.

The ensuing board meeting, which was supposed to be an annual strategy review, became focused on the performance of Fiorina and HP. And during the meeting, directors pushed forward a plan to distribute some of Fiorina's operating responsibilities to her key lieutenants. Sources familiar with the reorganization plans say they are on hold because of the management shake-up.

It was a heavy blow to Fiorina's credibility as the company's leader. Just weeks later, she was out. It had become increasingly clear that HP's need for a nuts-and-bolts operations whiz far outweighed the benefits of a high-profile CEO.

–By Ben Elgin in San Mateo, Calif.



AUG. 12, 2004 HP badly misses third-quarter expectations, raising questions about Fiorina's ability to execute

DECEMBER, 2004 Fiorina seeks advice from several CEOs on how to make a "graceful exit" from HP.

JAN. 12 - 15, 2005 HP's board holds an offsite meeting in San Francisco. Increasingly frustrated, the directors move to shift operating responsibilities from Fiorina to key lieutenants. They also bring former director Tom Perkins back to the board.

FEB. 7, 2005 At a meeting in a Chicago area hotel, HP's board asks Fiorina to step down. She agrees.

FEB. 9, 2005 At 5 a.m. local time, interim **CEO Bob Wayman** sends an e-mail to employees informing them of the management change.