

ISS and FTC Give Momentum to HP/Compaq Merger

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Approval by the U.S. Federal Trade Commission (FTC) and Institutional Shareholder Services (ISS) makes it more likely Hewlett-Packard (HP) will buy Compaq. But ISS may not change the minds of some institutional investors.

NEWS ANALYSIS

Event

On 5 March 2002, ISS, an influential proxy advisory firm, recommended that HP investors vote in favor of the proposed acquisition of Compaq Computer. On 6 March 2002, the FTC gave the deal final regulatory approval.

Analysis

Recognizing that ISS can sway many crucial shareholders, HP's management has persuaded ISS to recommend acceptance of its plans to merge with Compaq. The dissident faction, led by Walter Hewlett and aided by HP's former CEO Lew Platt, actively attempted to convince ISS otherwise. The dissidents argued that HP did not properly consider alternative strategies (including spinning off the printer business) and that there are no precedents for such a merger having worked before. Although ISS considered both points of view, HP's response to these claims clearly swayed ISS, which agreed that HP considered many alternative strategies but dismissed them all for various reasons. However, ISS provided no analysis of the proposed acquisition price.

HP and Compaq also demonstrated that the merger plans recognize the lessons learned from previous mergers (including Compaq's takeovers of Tandem Computer and Digital Equipment). Compaq listed four main reasons why the Digital acquisition did not fully succeed:

- Lack of clearly articulated product road maps available from day one
- No clear profit and loss accountability for business units
- Not enough focus on keeping the sales force and other customer-facing units loyal and motivated
- Unclear management responsibilities

HP asserted that it will not repeat these fundamental errors if the merger proceeds. Gartner has already published a checklist of milestones by which enterprises can determine whether the merger is proceeding smoothly (see *Research Note E-14-4901 "Monitoring the HP/Compaq Merger: From Six to 36 Months"*). Even if the merger succeeds and goes smoothly, it will involve some turmoil as management struggles to unite two multinational companies while competitors try to pick off their customers. During this transition, enterprises should know how to get the most out of negotiations with HP and Compaq (see *Research Note E-14-4581 "Negotiating With HP and Compaq in a Time of Transition"*).

Although quantifying the influence ISS has on shareholders is difficult, its recommendation will likely balance out some of the contrary votes from the Hewlett and Packard Foundations, which control about 17 percent of voting rights. Gartner expects that institutional shareholders will widely vary in the degree of influence they attribute to the ISS recommendation. Even so, this recommendation, combined with other recent moves such as the European Commission's approval and unqualified approval from the FTC, increases Gartner's expectation that the merger will occur (see *Gartner FirstTake FT-15-4307 "Odds Improve for Hewlett-Packard to Acquire Compaq"*). Indeed, HP has targeted 2 April 2002 as a possible closing date. Should the merger go ahead on that date, affected enterprises can expect long-awaited road maps for vulnerable product lines and strategies by the end of April 2002 at the latest.

Analytical Sources: Andrew Butler and Paul McGuckin, Unix & Midrange Strategies

Need to Know: Reference Material and Recommended Reading

- “Odds Improve for Hewlett-Packard to Acquire Compaq” (FT-15-4307). The European Commission's approval of the merger and the calling of shareholder meetings shift the odds in favor of the deal going through. **By Andrew Butler and Betsy Burton**
- “HP-Compaq Deal Less Likely; Buy Products With Caution” (FT-15-0893). Gartner believes that competitive pressures and the determination of both companies to meet financial targets will increase opportunities for negotiation leverage in 1Q02. **By Paul McGuckin, Tom Austin, Thomas Bittman, Charles Abrams, Matthew Boon, Betsy Burton, Brian Gammage, Michael Glennon, Rolf Jester, Daniel McHugh, Martin Reynolds, Phillip Sargeant and George Weiss**

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