Publication Date: 14 May 2008 ID Number: G00158082

HP-EDS Deal Seeks to Close Gap in Outsourcing Dominance

Lorrie Scardino, Dane S. Anderson, Martin Reynolds, David W. Cearley

HP would jump to No. 2 in worldwide outsourcing services with the acquisition of EDS. But HP will have to manage a complex integration and take a fresh approach to the consulting and integration business to reap rewards.

NEWS ANALYSIS

Event

On 13 May 2008, HP announced it would buy EDS for $13.9 billion. HP would merge its outsourcing operations into EDS, keep EDS's Texas headquarters and name the new entity EDS, an HP company. Closing is scheduled for 2H08.

Analysis

This is a good financial deal for both companies, but this combination alone does not ensure HP and EDS can catch their closest competitors, IBM and Accenture.

This deal gives HP:

- Double total services revenue, to $38 billion
- A strong client base across a variety of industries, including new services clients in the public sector
- A modernized network data center infrastructure
- Means to fill some capability gaps, especially in application outsourcing
- 43,000 additional resources in low-cost labor locations

Consulting and system integration (C&SI) becomes a strategic growth opportunity for HP. But HP will have to fight stronger competitors, including Accenture, IBM and many niche and vertical providers that combine front-end C&SI services across a range of solutions, such as CRM and ERP. HP needs to aggressively set up a new C&SI business unit to maximize this opportunity, integrate consulting with solutions, and use HP's technology assets to their full services advantage. If this unit resides in an existing organization, it will struggle as it currently does in both organizations.

HP said there is little client overlap in services, and most of the deal's synergies will come from reducing costs. HP has many opportunities to cut costs, such as using its hardware maintenance organization to support third-party hardware, which EDS contracts out. Gartner also expects job cuts; cutting 10,000 to 15,000 jobs will boost EDS's gross margin and may take it to about 15%, up from 9.7% today.

This large integration will require careful stewardship, and the cultures of the two companies are quite different. The keys to success will be moderate revenue growth, aggressive cost cuts, and using the C&SI business to accelerate HP's growth and profitability.

RECOMMENDATIONS

HP and EDS clients:

- Determine where you are in the order of importance to each provider and understand their plan for you.
- Understand the timeline to transition and how the integration will affect your contract and service delivery operations.

- Examine your contracts for change of ownership clauses. If you are dissatisfied with current operations, this may be a way to get out of the deal or negotiate a better one.
- Understand how HP intends to leverage EDS's heritage and best practices for IT and application outsourcing methods, practices and procedures.
- If your EDS deal is producing subpar financials for either provider, be prepared to address these issues either during the transition or soon thereafter.

RECOMMENDED READING

- "Vendor Rating: EDS" — EDS continued its momentum in 2007, transitioning to a focus on growth. **By Dane Anderson and others**
- "Vendor Rating: HP" — HP is strongly focused on growth to complement profitability and consistent execution. **By Carl Claunch and others**

(You may need to sign in or be a Gartner client to access the documents referenced in this First Take.)

REGIONAL HEADQUARTERS

Corporate Headquarters
56 Top Gallant Road
Stamford, CT 06902-7700
U.S.A.
+1 203 964 0096

European Headquarters
Tamesis
The Glanty
Egham
Surrey, TW20 9AW
UNITED KINGDOM
+44 1784 431611

Asia/Pacific Headquarters
Gartner Australasia Pty. Ltd.
Level 9, 141 Walker Street
North Sydney
New South Wales 2060
AUSTRALIA
+61 2 9459 4600

Japan Headquarters
Gartner Japan Ltd.
Aobadai Hills, 6F
7-7, Aobadai, 4-chome
Meguro-ku, Tokyo 153-0042
JAPAN
+81 3 3481 3670

Latin America Headquarters
Gartner do Brazil
Av. das Nações Unidas, 12551
9° andar—World Trade Center
04578-903—São Paulo SP
BRAZIL
+55 11 3443 1509