

A teaching case on strategic and tactical decision-making at Hewlett-Packard Co.

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ABSTRACT

This teaching case requires students to explore the financial, strategic, nonfinancial quantitative, and qualitative underpinnings of publicly-announced decisions and decision-reversals made by Hewlett-Packard Company (HP) in 2011. This was an eventful year for HP and is rich in material for a teaching case. In particular, management/cost accounting concepts should be included in the case discussion, such as the long-run and short-run costs that are relevant (or irrelevant) to the strategic and tactical decisions explored in the case. On July 1, 2011, HP launched the TouchPad tablet and 48 days later announced that it was both stopping production and significantly reducing the price of its Touchpad. Because of surging tablet sales (precipitated by the drastically reduced selling price), HP later temporarily reversed this decision. On August 18, 2011, HP also announced ongoing discussions to spin-off its personal computer division into a separate company but this possibility was squashed 70 days later. The case was class tested in two MBA management accounting classes and an advanced cost accounting class.

Keywords: strategic decisions; tactical decisions; financial factors; nonfinancial factors; teaching case.

INTRODUCTION

This teaching case requires students to explore the financial and other underpinnings of publicly-announced decisions and decision reversals made by Hewlett-Packard Company (HP) during 2011. This was an eventful year for HP and is rich in material for a teaching case. Students are expected to identify strategic, financial, nonfinancial quantitative, and qualitative factors that are relevant to various strategic and tactical decisions made by HP in 2011. In particular, factors pertinent to management/cost accounting need to be included in the case discussion, such as the long-run and short-run costs that are relevant (or irrelevant) to the strategic and tactical decisions explored in the case. Strategic decisions have significant long-run impact whereas tactical decisions have mainly short-run impact but need to be consistent with the organization's strategic objectives.

Strategy has been defined as specifying "how an organization matches its own capabilities with the opportunities in the marketplace to accomplish its objectives" (Horngren et al 2015, p. 473). Also, organizations of all types want to maximize their strengths and minimize the impact of their weaknesses. In general, organizations adopt a product differentiation strategy with premium selling prices or a cost leadership strategy with lower selling prices (Horngren et al 2015, p. 474), although different divisions of a decentralized organization may adopt different strategies (e.g., Cadillac adopting a product differentiation strategy and Chevrolet adopting a cost leadership strategy).

It is important for accounting students to learn that management accountants are strategic partners with other managers in organizational strategic decision-making. The emerging strategic role of management accountants is embodied in the latest definition of management accounting of the Institute of Management Accountants (IMA):

Management accounting is a profession that involves partnering in management decision making, devising planning and performance management systems, and providing expertise in financial reporting and control to assist management in the formulation and implementation of an organization's strategy (IMA 2008, p. 1).

The IMA further explained the management accountant's expanding strategic business partnership responsibility in an organization in the following way:

The role for management accountants has therefore shifted in two respects with regard to the information value chain: Management accountants (1) provide the conceptual framework for converting data into information and (2) fulfill the role of enabler and strategic business partner along the entire information value chain (IMA 2008, p. 2).

This case allows students to consider both strategic decisions and more familiar tactical decisions made in a real-world company and the important role of both financial and nonfinancial information in these decisions. For example, students need to identify costs that are relevant for long-strategic decisions from costs that are relevant for short-run tactical decisions. Horngren, et al (2015, 4) include "measuring, analyzing, and reporting financial and nonfinancial information" in their definition of both management accounting and cost accounting. This means management accountants need to be skillful in identifying both financial and nonfinancial information relevant for various strategic and tactical decisions.

As a foundation, first, the new strategic direction adopted by HP in March 2011 will be outlined. Second, selected publicly-announced decisions and decision reversals made by HP in later months during 2011 will be considered.

A NEW STRATEGIC DIRECTION FOR HEWLETT-PACKARD

On March 14, 2011, HP issued a press release to outline the company's new vision and strategy presented by its CEO and President, Léo Apotheker (HP 2011a).¹ HP recognized the steady information technology migration from onsite proprietary computer networks to extensive and flexible cloud computing resources. HP wanted to maintain its market leadership in the continually evolving information technology (IT) landscape and Léo Apotheker presented the following four-pronged strategy to continue HP's leadership in the IT marketplace:²

- extending its leadership in managing and optimizing today's traditional environments;
- leveraging HP's core strength in cloud [technology] to build and manage next-generation cloud-based architectures;
- being the trusted partner to customers by enabling the seamless transition to hybrid computing models [i.e.: "In HP's view, a hybrid environment that combines the best of traditional environments with private and public clouds will be the prevailing model for many large enterprises for a long time."];
- defining and delivering the connected world from the consumer to the enterprise (HP 2011a).

The press release stated that HP's new "strategy lays a foundation for the company to move from delivering world-class information technology, to world class information experiences." It presented the new strategic priorities of HP in three areas: cloud, connectivity, and software. First, HP planned to create a "full cloud stack" (i.e., "a portfolio of cloud services from infrastructure to platform services") and to assist its customers migrate to "hybrid cloud environments" that combine traditional onsite computing with cloud computing resources. HP also planned to expand "its higher-value services that offer greater strategic value," which indicates HP's premium pricing strategy. Second, HP stated its intention to be a connectivity leader leveraging its extensive global reach. Third, using "a build, buy and partner approach, HP intends to continue to enhance its leading management and software portfolio" (HP 2011a), which indicates three ways to achieve its strategic objectives: *build* its own systems, *buy* innovative companies (e.g., its anticipated purchase of Vertica Systems mentioned in the press release), and *partner* with other innovative companies.

The press release also reported HP's strategy to "build webOS into a leading connectivity platform," and to take advantage of its scale as the world's leading PC and printer manufacturer "to deliver 100 million webOS-enabled devices a year into the marketplace" (HP 2011a). One of these webOS enabled-devices was the ill-fated TouchPad Tablet that will be discussed next.

¹ Not long before, Léo Apotheker had been appointed CEO and President of HP effective November 1, 2010 (HP 2010c). He succeeded Chairman, CEO, and President Mark Hurd who resigned August 6, 2010, after an internal investigation found he had violated "HP's Standards of Business Conduct" (HP 2010b).

² Bulleted statements were not used in the press release. Also the word and sentence added in squared parentheses were taken from elsewhere in HP (2011a).

TOUCH-PAD TABLET

On July 1, 2011, HP launched the TouchPad tablet in the U.S. (HP 2011b). The 16GB TouchPad was priced at \$499.99 and the 32GB option was priced at \$599.99. The press release reported the statement by Jon Rubenstein, senior vice president and general manager of Palm Global Business Unit, that TouchPad should be highly competitive because of the unparalleled features and flexibility of its webOS operating system.

Despite the optimism expressed in the press release, only 48 days later (on August 18, 2011) HP announced that it was stopping production of TouchPad tablets and also webOS phones because these products had failed to achieve “internal milestones and financial targets” (HP 2011c). The HP press release also stated that “strategic alternatives” were being explored for webOS software.

Two days later (on August 20), HP reduced the price of unsold 16GB TouchPad tablets to \$99 from \$399 (having earlier reduced the retail price from \$499.99 to \$399) that resulted in much online buzz and a huge demand for the tablet with long lines at retail outlets (Sherr 2011). Eleven days after announcing cessation of tablet production HP announced, in response to this surging demand, that it was restarting manufacturing the 16GB TouchPad for a temporary period (Sherr 2011). Some analysts wondered why HP temporarily reversed its decision as each tablet would be sold at a \$207 loss just based on the direct materials cost of \$306 estimated by the research organization IHS iSuppli and assuming continuation of the \$99 selling price (Sherr 2011). In a video recording Sherr and Fried (2011) with others discussed the temporary resurrection of 16GB TouchPad and other related matters. Table 1 (Appendix) presents a breakdown of the direct materials costs of the 16GB TouchPad and 32GB TouchPad reported by Hesseldahl (2011a), as estimated by IHS iSuppli (based on its teardown of the TouchPad).³

On October 31, 2011, it was reported in another video recording that BestBuy was bundling the 32GB HP TouchPad for \$149 with the purchase of any HP or Compaq PC (Hesseldahl 2011b). The TouchPad could also be purchased separately for \$599. Selling the 32GB TouchPad when bundled with a HP or Compaq PC at \$149 is \$179.65 less than the estimated direct materials cost of \$328.65 presented in Table 1 (Appendix).

Later it was reported that HP would continue to enhance webOS, retaining the 600 employees who work on it, and that it would provide the software free to anyone wishing to use it (HP 2011h; Worthen 2011c). The webOS operating system was acquired by HP in conjunction with its purchase of Palm Inc. for \$1.2 billion in 2010 (HP 2010a).

PERSONAL SYSTEMS GROUP

On August 18, 2011, HP also announced that its Board of Directors had approved exploration of strategic alternatives for its personal computer division, Personal Systems Group (PSG), which included spinning-off PSG into a separate company (HP 2011d). Krazit (2011) speculated that this announcement was similar to “putting a for-sale sign on the division.” This announcement surprised the stock market as HP was at the time the world-wide market leader in PC sales. This major announcement, along with the two other strategic announcements on the

³ Hesseldahl (2011a) also reported that other costs associated with the tablets were impossible to estimate.

same day that confirmed HP's discussions with Autonomy Corporation PLC to acquire the British company (HP 2011e) and its decision to cease operations of webOS devices, contributed to HP's 20 percent stock price decline (Worthen 2011a). In fact, HP's stock price was reported to be 36 percent less in late October 2011 than at the start of the year (Worthen 2011b). Some investors and customers expressed their disappointment with the announced decision to explore spinning-off the PC division as well as other recent strategic decisions and some customers stated that they were reconsidering planned purchases of HP products (Worthen 2011a).

On October 27, 2011, 70 days after the possible spinoff of PSG was publicly announced, HP announced its decision to retain the PC division following extensive strategic, financial, and operational analyses of the impact of separating PSG to establish it as a separate company (HP 2011g). The press release announcing this decision reported that the benefits of separation and creation of a standalone company were less than the costs that included recreating the division's significant contribution to "HP's solutions portfolio and overall brand value" in a standalone company (HP 2011g). It was reported that Meg Whitman, HP's recently appointed President and CEO (HP 2011f), had earlier stated her support for the investigation into a possible spinoff of PSG and other recently announced decisions that had not been well received by some of its corporate customers and the market in general (Worthen 2011b).

CASE ANALYSIS QUESTIONS⁴

To further aid addressing the case analysis questions, Exhibit 1 (Appendix) outlines the timeline of some of the significant HP announcements and appointments referenced above, while Table 2 (Appendix) shows HP's adjusted close stock price the day before, day of, and day after these announcements and events. In addressing the case analysis questions 1-6, consider whether the following four types of factors are relevant: strategic factors (e.g., long-term enhancement or damage to HP's brand), financial factors (e.g., increased or reduced monetary costs and/or revenue), nonfinancial quantitative factors (e.g., increased or decreased available capacity), and/or qualitative factors (e.g. positive or negative employee morale impact from a decision that can persist for the short-run or even the long-run if not reversed that may rise to the importance level of a strategic impact). In addressing the case questions 1-6, give examples of any of the four factors that are relevant to the decision and also specifically identify any of the four factors that you believe are not affected by the decision. Relevant concepts for the case questions that typically are discussed in management/cost accounting textbooks include the benefits of centralization versus decentralization, relevant costs and revenues, and long-run versus short-run pricing. Fully reference any articles or other sources of information that you use to address each of the following questions.

1. Discuss possible financial and other reasons for HP seriously considering spinning-off its PC division (PSG) into a separate company when it was the world's largest PC manufacturing company in terms of sales.

⁴ Faculty interested in using this case can send a request for a copy of the teaching notes to the following e-mail address: jmacarth@unf.edu.

2. Discuss likely financial and other reasons for HP later deciding to retain PSG within the company.⁵
3. Discuss possible financial and other reasons for HP deciding to stop production of Touchpad after only 7 weeks from its launch.
4. Discuss likely financial and other reasons for HP deciding to drop the price of its 16GB TouchPad from \$399 to \$99, and the price of its 32GB TouchPad when bundled with a HP or Compaq PC from \$599 to \$149. In both cases, the indicated sales price is lower than the estimated direct materials costs for the products presented in Table 1 (Appendix).
5. Discuss possible financial and other reasons for HP temporarily restarting production of the 16GB TouchPad 11 days after ceasing production.
6. Discuss likely financial and other reasons for HP deciding to continue developing webOS and to providing it free-of-charge to anyone wishing to use it.
7. Did you receive any practical help or insight from preparing the case analysis? For example, did preparing the case analysis help you better understand any cost concept? It is acceptable to indicate that no help or practical insight was received from preparing the case analysis but it will be helpful to the Instructor if reasons for this outcome are given.

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⁵ If wished, a case question can be added regarding the strategic decision announced by HP in October 2014 to once again separate its businesses into two separate companies, one of which will focus on personal systems and printing (HP 2014).

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APPENDIX

Table 1

Estimated Breakdown of TouchPad's Direct Materials Costs per IHS iSuppli Estimates

Direct Materials	16GB	32GB
LG Electronics 9.7 inch display	\$69.00	\$69.00
6 Cypress Semiconductor Chips to control the touchscreen	11.75	11.75
Materials used to build the capacitive glass assembly that overlays the LCD display (\$63.50) plus other display components	144.25	144.25
Samsung 8GB system memory (DRAM)	26.00	26.00
Qualcomm main application processor chip	20.00	20.00
Qualcomm (Atheros subsidiary) Wi-Fi Chips	2.60	2.60
Qualcomm (Atheros subsidiary) two power management chips	5.00	5.00
Texas Instruments three power management chips and one display interface chip	4.50	4.50
SanDisk iNAND chips for storing data	23.00	45.00
Other (possibly rounding differences)	0.55	0.55
Total estimated direct materials costs	\$306.65	\$328.65

Source: The IHS iSuppli direct materials descriptions and cost estimates shown above were obtained from Hesseldahl 2011a.

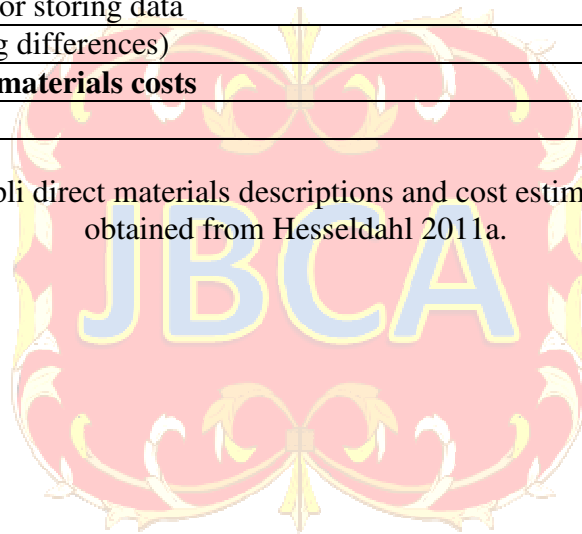


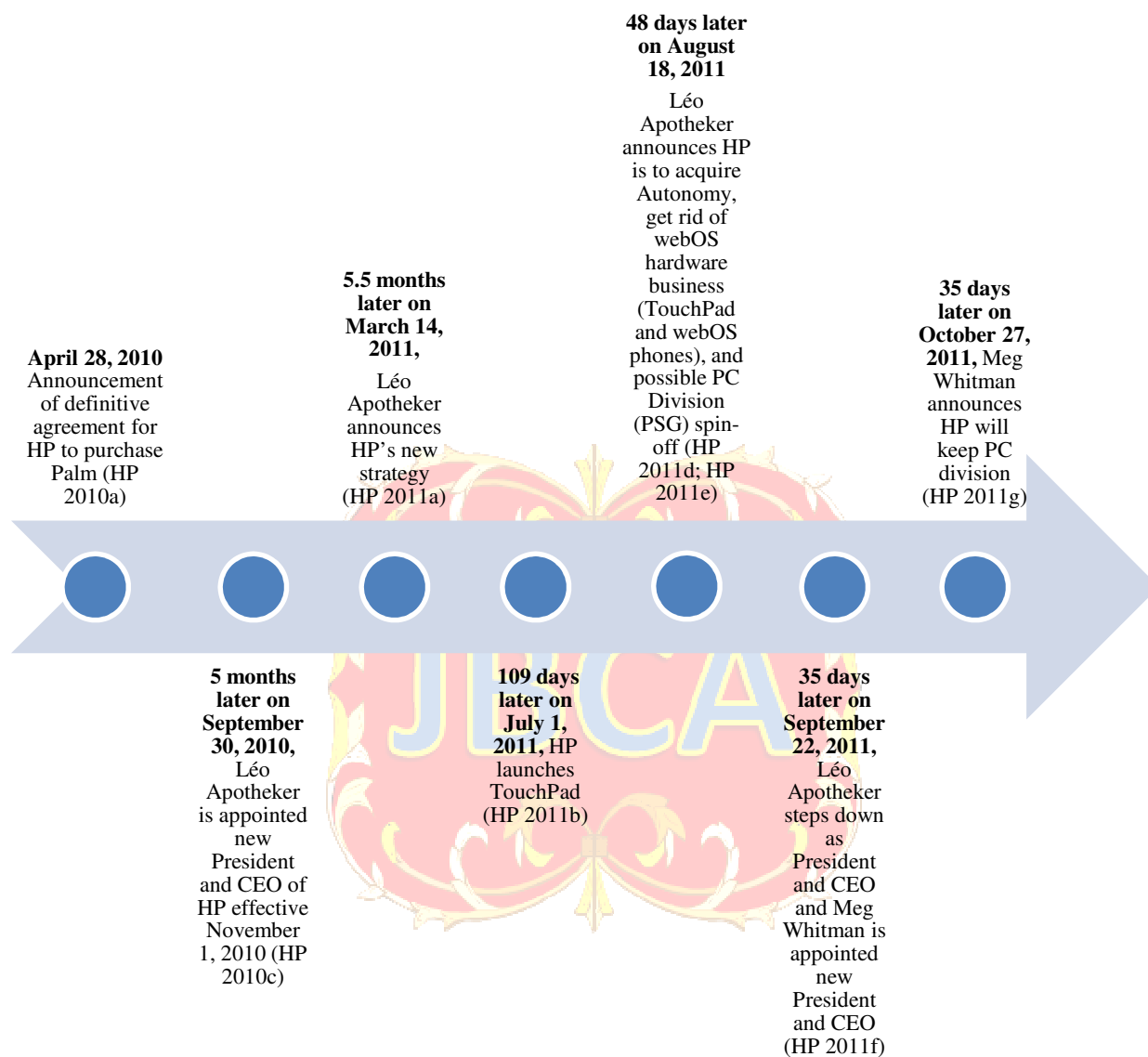
Exhibit 1**Timeline of Selected Hewlett-Packard Appointments and Announcements, 2010-2011**

Table 2
HP's Stock Price on Day before, Day of, and Day after Selected Strategic Announcements

Day	Date in 2011	Adjusted Close Price^{a, b}	Points Change	Percentage Increase/ Decrease
Day before announcing HP's new strategy	March 11	\$39.49		
Day of announcing HP's new strategy	March 14	\$39.34	-\$0.15	-0.4%
Day after announcing HP's new strategy	March 15	\$38.81	-\$0.53	-1.3%
Day before announcing exploration of strategic alternatives for PSG, confirmation of its discussions to acquire Autonomy Corporation PLC, and cessation of operations for webOS devices	August 17	\$29.86	-\$8.95	-23.1% ^c
Day of announcing exploration of strategic alternatives for PSG, confirmation of its discussions to acquire Autonomy Corporation PLC, and cessation of operations for webOS devices	August 18	\$28.08	-\$1.78	-6.0%
Day after announcing exploration of strategic alternatives for PSG, confirmation of its discussions to acquire Autonomy Corporation PLC, and cessation of operations for webOS devices	August 19	\$22.45	-\$5.63	-20.0%
Day before Whitman announces keeping PC Division within HP	October 26	\$24.63	2.18	9.7% ^d
Day of Whitman announcing keeping PC Division within HP	October 27	\$25.82	\$1.19	4.8%
Day after Whitman announces keeping PC Division within HP	October 28	\$26.72	\$0.90	3.5%

^a Source: Yahoo Finance,

<http://finance.yahoo.com/q/hp?s=HPQ&a=02&b=10&c=2011&d=09&e=29&f=2011&g=d>.

^b Close price adjusted for dividends and splits (extracted historical prices on July 15, 2013).

^c The percentage shown is the decrease from March 15, 2011.

^d The percentage shown is the increase from August 19, 2011.