# HP and Yahoo!'s curious competition

Recent decisions taken by the boards of HP and Yahoo! have both had tangibly negative affects on the companies' stock performance

By **Nir Kossovsky**

Talk about dramatic job exits. In August 2010, Jet Blue flight attendant Steve Slater set a new and seemingly unbeatable record. After a dispute with a passenger, Slater let loose a string of invective over the public address system, pulled the lever that activated the emergency evacuation chute and, on his way out, paused to grab a beer from the beverage cart. It was big. It was bold. And it was inconceivable that his record would be shattered only one year later.

Fast forward to early September 2011. Rather than accepting her over-the-phone dismissal quietly, fired Yahoo! Inc CEO Carol Bartz hours later laid into the board of her former employer in an interview with *Fortune* magazine. "These people f**ked me over," Bartz – whose reputation for salty language is widely appreciated – told her interviewer. She further raised the spectre of the board's 2008 rejection of a US$44.6 billion bid by Microsoft: "The board was so spooked by being cast as the worst board in the country. Now they're trying to show that they're not the doofuses that they are."

Noting that the company was on its fourth CEO in four years, the Associated Press quoted Darren Chervitz, co-manager of the Jacob Internet Fund and longtime Yahoo! shareholder: "This board has presided over some of the worst decisions made by any company in recent history." In defence of Yahoo!'s board, BGP Financial Partners Colin Gillis opined that this dubious honour in fact belonged to Hewlett-Packard Co's (HP) board, which has snooped into people's phone records and, 13 months ago, switched CEOs – again.

In this article, we present the sordid facts and let you, the reader, decide whether this race is one worth risking in your own world (Figure 1). More importantly, while you reflect on the impact of the above on the reputations of the corporations and individuals involved, consider this: according to a survey of corporate boards taken earlier this year by accounting firm Eisner Amper, their number one concern in 2011 is an intangible: reputation.

**Hewlett-Packard Company**

HP, with a September 2011 market capitalisation of just under US$50 billion, is a provider of products, technologies, software, solutions and services to individual consumers, small and medium-sized enterprises and large enterprises, including customers in the government, health and education sectors.

Stanford University graduates Bill Hewlett and Dave Packard started the company in a garage in Palo Alto in 1939 with an initial capital investment of US$538. HP incorporated on 18th August 1947 and went public on 6th November 1957, growing uneventfully until a series of ethical scandals rocked the firm in the early part of the 21st century.

As part of its recovery from those issues, it hired Mark Hurd, who as CEO continued to restructure older operations and grow the firm through acquisitions. In April 2010, the company completed its acquisition of 3Com Corporation. In July 2010, the company completed the acquisition of Palm Inc. In September 2010, it acquired Fortify Software. In September

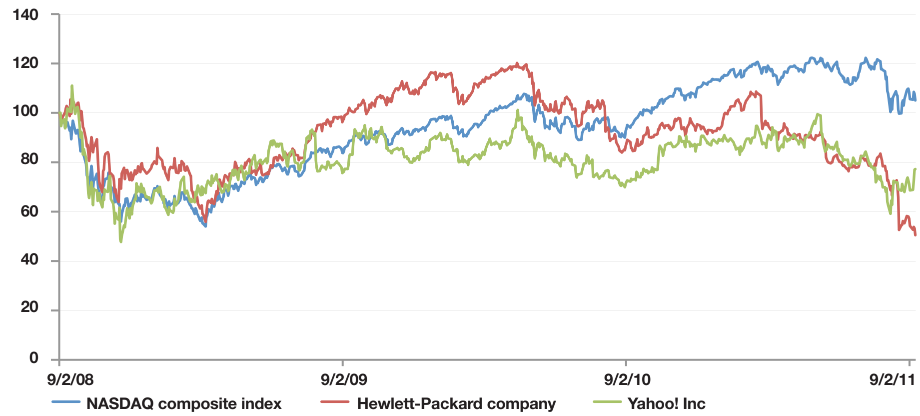
**Definitions**

***Doofus***
1. Someone stupid…
2. A foolish, incompetent or stupid person

***Doofuses***
3. Plural of Doofus. People who think their ignorance is something to be proud of.

Source: UrbanDictionary.com

Figure 1. **Three-year equity returns for Hewlett-Packard Company (NYSE:HPQ), Yahoo! Inc (NASDAQ:YHOO) and the benchmark technology-heavy Nasdaq Composite Index. (2nd September 2008 =100.) Like war, reputational loss has no winners – only survivors**




Data source: **Yahoo! Finance**

2010, it acquired 3PAR Inc, a global provider of utility storage. In October 2010, it acquired ArcSight, Inc, a security and compliance management company. Amid all this acquisition, in August 2010, the board of directors fired Hurd.

**August 2010**
It would be difficult to top the language of the Silicon Valley *Mercury News*: "In a stunning plot twist in the long-running Silicon Valley soap opera that is Hewlett-Packard (NYSE:HPQ), Mark Hurd resigned as CEO of the Palo Alto tech giant after an investigation into a sexual-harassment claim." While a company investigation determined there was no violation of HP's sexual harassment policy, the probe concluded that Hurd filed false expenses reports to conceal his relationship with the woman. Blame it on whatever is in the water cooler servicing the C-suite.

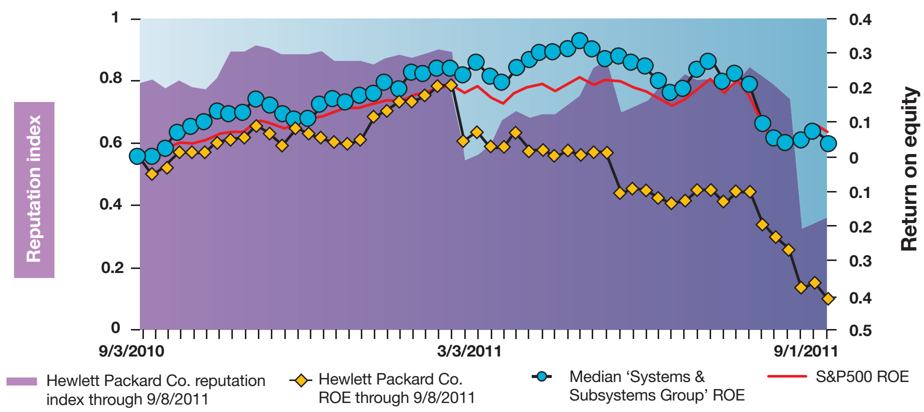
At the time, the Steel City Re Corporate Reputation Index indicated that the event was material. To quote an HP employee website: "The performance of a leader must be measured – and rewarded – based on more than the numbers. Integrity matters. Trust matters." We're talking about "violations of HP's Standards of Business Conduct" by the man who held ultimate responsibility for corporate conduct.

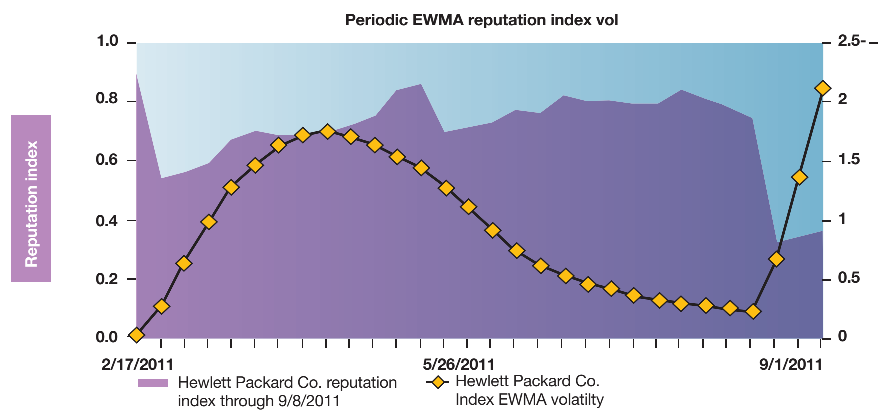
HP began the period with a reputation ranking in the 95th percentile and exhibited little volatility of 1.4% until the events of the recent past. In August 2010, the company's reputation index ranking had drifted down to the 84th percentile, to the benefit of both Fujitsu Ltd and Lenovo Group Ltd, and further distancing itself from the 22-company computer processing hardware sector leader, Apple Inc. The Intangible Asset Finance Society's Mission:Intangible blog noted then that "HP's reputation slippage at this juncture does not bode well for the company's future economic returns" (Figure 2).

**September 2010**
Oracle (NASDAQ:ORCL) subsequently hired Hurd. HP sued Hurd in a California court just one day later, arguing that Hurd would be unable to do his job at Oracle without spilling HP's trade secrets. Countering, Oracle CEO Larry Ellison shared his opinion of the HP board in a memorable letter sent to the *New York Times*: "The H-P Board just made the worst personnel decision since the idiots on the Apple board fired Steve Jobs many years ago. That decision nearly destroyed Apple and would have if Steve hadn't come back and saved them. H-P had a long list of failed CEOs until they hired Mark who has spent the last five years doing a brilliant job reviving H-P to its former greatness. In losing Mark Hurd, the H-P board failed to act in the best interest of H-P's employees, shareholders, customers and partners."

HP took its revenge. Not only did HP name Ray Lane, former Oracle president and chief operating officer, as non-executive chairman of HP's board, it turns out that Leo Apotheker, HP's newly hired CEO, had been in charge of SAP (NYSE:SAP) at a time when it is alleged to have been stealing Oracle's software. The ensuing litigation is scheduled for trial soon.

Figure 2. **HP reputation metrics. Over the trailing 12 months to 8th September 2011, the company's reputation ranking dropped from the 79th to the 36th percentile among the 208 companies comprising the systems and subsystems technology sector. The exponentially weighted moving average reputation index volatility has itself been highly volatile, reaching a value in excess of 200% as of 8th September**




**January 2011**

The boardroom drama continued. With HP having just released its last CEO for ethical issues, the *Denver Business Journal* raised concerns about the close business ties between the ostensibly independent directors and the new CEO.

The *Journal* (26th January, Schubarth) cited the concerns of several corporate governance experts that HP recently recruited executives to its board of directors who all have business ties to CEO Apotheker and whose independence is therefore potentially compromised.

Dominique Senequier, for instance, managed an investment buy-out arm of French insurer AXA SA, where Apotheker is on an advisory board. Three other new directors – former General Electric Co Chief Information Officer Gary Reiner, former Alcatel-Lucent CEO Patricia Russo and ex-eBay Inc CEO Meg Whitman – all did business with SAP AG while Apotheker was on staff.

Charles Elson, director of the Weinberg Center for Corporate Governance at the University of Delaware, commented: "If directors have significant relationships with the CEO or other directors of a company on whose board they sit, it's harder for them to be objective. Directors are supposed to be representing shareholders, not the CEO or one another, and that's why companies typically try to recruit directors who are independent of one another and management."

It is an interesting problem, and one that could confront any CEO whose business (or prior business) has a large global footprint. After all, it could be argued that anyone coming from a firm that did not work with, or use, SAP products is coming from a business still operating in the dark ages. And while there was no measurable

Table 1. **Reputation is an epiphenomenon. There are six key business processes (intellectual properties) that seek to achieve specific reputationally relevant goals and underpin reputation value**

| | |
|---|---|
| **Create an ethical work environment** | Ethics are the moral principles by which a company operates; integrity is the act of adhering to those moral principles. Ethics are an integral part of governance that combine with integrity to affect the reputation value of all other intangible assets. Additionally, ethics are the keystone intangible asset because they form the basis for trust and confidence. |
| **Drive innovation** | Innovation is the design, invention, development and/or implementation of new or altered products, services, processes, systems, organisational structures or business models for the purpose of creating new value for customers and financial returns for the firm. |
| **Assure quality** | Quality is:<br>• The extent to which a product is free from defects or deficiencies.<br>• The extent to which a service meets or exceeds the expectations of customers or clients.<br>• The extent to which products and services conform to measurable and verifiable criteria. |
| **Uphold safety** | Safety is the state of being certain that a set of conditions will not accidentally cause adverse effects on the wellbeing of people or the environment. |
| **Promote sustainability** (aka corporate social responsibility) | Sustainability means making, using, offering for sale or selling products and services that meet the needs of the present without compromising the ability of future generations to meet their own needs. |
| **Provide security** (physical/and cyber threats) | Security is the degree of protection that a company offers against events undertaken by actors intentionally, criminally or maliciously, for purposes that adversely affect the firm. Because fear is the great disruptor of life and commerce, it is useful to think of security, the most ethereal of the intangible assets, as "absence of fear". |

Data source: ***Mission: Intangible. Managing risk and reputation to create enterprise value*** **(IAFS, 2010).**

impact on the Steel City Re Corporate Reputation Index metrics, it could merely be an indication that the risks of poor board judgement have long since been factored into stakeholders' intuitions about the firm.

**Yahoo! Inc**

Yahoo!, at half the size of HP with a September 2011 market capitalisation of less than US$19 billion, is a digital media company. Its business model, like that of AOL in past years, is built on advertising revenue and it attracts an audience for those advertisements through various online properties and services. During the year ended 31st December 2010, it acquired Dapper, a technology platform, and Citizen Sports. During 2010, it acquired Koprol, Indonesia's location-based social network.

Stanford University graduates Jerry Yang and David Filo founded Yahoo! in 1994. The company was incorporated in 1995 and went public in April 1996 with a total of 49 employees. The company grew rapidly as a pathway into online content and became briefly the most visited internet property.

**2008**

However, nothing seems to have gone right for the once-dominant portal over the past few years. In 2008, with decreasing revenues and users, Microsoft made an unsolicited bid for the company at a valuation of US$44.6 billion, or US$33 per share. Co-founder and then-CEO Yang sloppily rebuffed the offer, arguing that it "massively" undervalued the company. That was one of the worst decisions in the media industry since Time Warner's board agreed to sell itself to America Online in 2000. Yang stepped down 11 months later. Bartz was hired three months after that.

**June 2011**

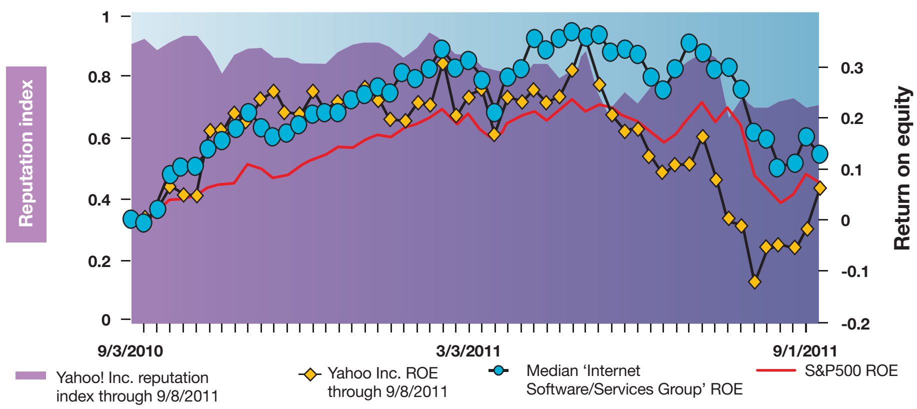
Yang's competence as a director of Yahoo!'s Chinese investee company, Alibaba Group, was questioned as news broke that Alibaba sold its stake in Alibaba's Alipay to a separate group controlled by Alibaba's founder, Jack Ma, on uncertain terms. At the company's annual meeting, shareholders expressed concern that Yahoo!'s more than 40% investment in Alibaba Group was being diluted. How concerned? Nearly 20% of Yahoo!'s shares were voted against the re-election to the board of the company's chairman, Roy Bostock, and CEO Bartz. Less than 10% of the shares were voted against re-electing the remainder of the board.

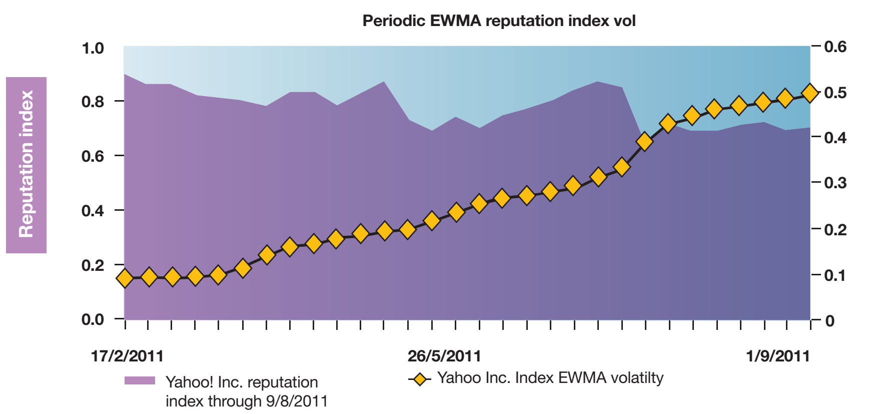
According to the *Financial Times* Bostock began the shareholder meeting by saying that Bartz was doing a good job on a long-running turnaround effort at Yahoo! and the board still backed her. "This board is very supportive of Carol and the management team," he said. But a shareholder speaking from the floor said that he believed the board should accelerate rumoured discussions with potential successors to Bartz and consider selling or restructuring the company. "The last thing Yahoo! needs right now is a lame-duck CEO," he said.

**September 2011**

Bostock read a lawyer's prepared statement to fire Bartz by phone on 6th September while she was in New York for a Citigroup Inc technology conference, *Fortune* magazine reported. "I said, 'Roy, I think that's a

Figure 3. **Yahoo! reputation metrics. Over the trailing 12 months through 8th September 2011, the company's reputation ranking dropped from the 89th to the 70th percentile among the 104 companies comprising the Internet Software/Services technology sector. The exponentially weighted moving average reputation index volatility has been rising steadily reaching a value in of 49.4% as of 8th September**




Data source: Steel City Re

script,'" Bartz told *Fortune*. "Why don't you have the balls to tell me yourself?'"

**Board-level reputational issues**

Even without the extraordinary drama afflicting select companies founded by Stanford University graduates, pressures are increasing on board directors to attend to the reputations of the corporations they oversee. The most obvious pressures are the February 2010 risk oversight provisions of Securities and Exchange Commission Rule 33-9089 and growing fallout from the November 2006 Delaware Chancery Court findings in *Stone v Ritter* that board members may be held personally liable for losses from failing to oversee the assets that underpin reputation. Such losses now average 7% of market cap.

The losses in the two cases presented are above average, but so are the issues. Typically, reputational crises arise from an operational issue from one of six key processes: failure to foster an ethical work environment, drive innovation, uphold safety and promote sustainability (Table 1). These processes are visible to stakeholders and create a myriad of cumulative impressions and intuitions that drive stakeholder actions. Economically relevant actions involve encouraging customers to be less sensitive to pricing, reducing employee turnover and causing equity investors to bid higher prices and regulators to be less punitive.

Atypically, as in the cases presented herein, the reputational crises centre on the board of directors. "Dysfunctional boardroom dynamics will be reflected in both the quality of a board's decisions and in how those decisions are communicated," observes Dr Urmi Ashar, president of the Three Rivers chapter of the National

> That boards should be obsessed with reputation management and want to bridge the chasm between governance and leadership is not a question

Association of Corporate Directors. And if the governance process is broken, management's actions are likely to be erratic too. "The performance of Company boards and leadership are inextricably linked," says Ashar. "The chasm between the governance and operational leadership is a potential black hole into which operational controls, trust, accountability, and reputation can all disappear rapidly."

That boards should be obsessed with reputation management and want to bridge the chasm between governance and leadership is not a question. It is true that a board-level reputation management process would materially reduce risk under *Stone v Ritter*. However, more fundamentally, reputation is a core intangible asset comprising an umbrella term that speaks to value creation. As Warren Buffet, chairman of Berkshire Hathaway and an extremely successful investor, has affirmed for the past 25 years: "We can afford to lose money – even a lot of money. But we can't afford to lose reputation – even a shred of reputation."

**Board-level reputation management**

Boards with superior reputation management processes exhibit three features:

- Public disclosure of their awareness of reputational value.
- Authentic reputational value process controls.
- Compelling stakeholder signalling strategies.

**Public disclosure of awareness of reputational value**

An increasing number of boards are taking action and accepting the premise that reputational value is something to be increased, protected and, if needed, restored. For each of the five years prior to 2010, about 40 companies out of the S&P500 cited reputation as a material risk in their annual corporate regulatory documents. This past year, that number jumped to more than 160 companies. Notably, Limited Brands Inc (retail trade), State Street Corp (finance), SAIC Inc (commercial services) and Cognizant Technology Solutions Corp (technology services) referred to their reputation more than 15 times in Section 1A – Risk of their Form 10-K filings.

**Authentic reputational value oversight**

As an oversight body, the board of directors must influence operating executives with its reputational vision without crossing the great chasm that separates boards from management and oversight from operational control. Publicly disclosed solutions for bridging this chasm are not generally available publicly; nor is their success rate widely appreciated.

In prior issues of *IAM* magazine, case studies covering BP and Rolls Royce have looked at their disclosures of processes used to connect board intent with operational risk controls. As the case studies pointed out, the reputational outcomes of two process issues were radically different at these two companies. Therefore, as also suggested in prior issues of *IAM* magazine, there is an information and process management gap that speaks to opportunities for intangible asset experts such as those who read this magazine.

Another opportunity that is indicated by the above is an affinity group-based solution to help board-level and C-suite executives to converse candidly and align reputational vision with operations. Such a solution would comprise smart content and a curated community that would provide members with tools, benchmarking metrics and peer support to create value from the greatest actionable business concern today: reputation.

Not that there has not been movement to exploit the emerging opportunity for reputation-linked solutions from a variety of professional niches. In recent years, as the impact of business processes on reputation has become clear and the value of reputation has become increasingly apparent, reputation metrics have emerged. Surveys are the most familiar, providing some basis for equity investment strategies. Investors can also turn to algorithmic equity strategies linked to reputational metrics, media-derived reputational sentiment and reputational-arbitrage indices. Reputation is also being factored into Standard & Poor's rating models and credit default swap pricing, and regulators are demanding that reputation be considered by financial institutions in their capital retention models. Last, a property and casualty insurer has developed index-linked reputational value insurances for corporations. Insurance availability is a notable development, since the underwriting process requires policy holders to demonstrate reputationally relevant process controls.

**Compelling stakeholder signalling strategies**

There are passive and proactive strategies through which boards can signal to stakeholders that they, and the companies whose management they oversee, are reputationally attuned with effective enterprise-wide controls. Passive strategies create value when stakeholders become aware of effective reputationally relevant processes in the aftermath of an event that might have spelled reputational disaster. A classical example is Johnson & Johnson's 1986 response to the second Tylenol product tampering event. Having already implemented triple seals and deployed sophisticated supply chain tracking tools, the company was able to localise the tampering to a single bottle in Brooklyn, New York. Equity investors rewarded the firm with a solid 30% market cap boost within days of the event.

A second example is Rolls Royce's 2010 response to the uncontained mid-air explosion of a Trent 900 engine. Having already implemented quality controls and other safety processes, Rolls Royce was quickly able to isolate the cause of the explosion and effect repairs in its engines. Equity investors rewarded the firm by restoring all value lost right after the explosion – 10% of market cap – when, eight weeks later, British Airways signalled confidence in the product by buying the engines for its new Airbus jumbo fleet.

Proactive signalling is more challenging, but potentially less traumatic. The key is obtaining meaningful third-party endorsement. One of the most expensive endorsements is an investment by Buffet. But it works. In 2011, Bank of America – taking a page from Goldman Sachs' 2010 playbook – boosted its reputation and its equity value by 9% by letting Buffet acquire a large equity stake on favourable terms.

If multibillionaire investors are in short supply or deemed to be too expensive, an alternative strategy involves the credit rating agencies. Ratings are widely recognised as signals of creditworthiness and, as noted above, reputation is increasingly being factored into these ratings. On the other hand, the fractional contributions of balance sheet, cash flows and non-monetary factors such as reputation to a single rating are not fully transparent. Witness the debate arising when Standard & Poor's downgraded the United States on the basis of the emerging reputation of the leadership's propensity to non-productive partisanship.

The last approach comprises qualifying for – and obtaining – reputational insurance. Unlike the ratings agencies, the insurance products speak authoritatively to a level of reputational risk control because the underwriter – unlike the rating agencies – is bearing real risk. A number of reputation-related insurance products have hit the market over the past few months. Some signal good risk by offering low premium rates for a large crisis communication indemnification package – basically, a catastrophe insurance product. Others signal good risk by being available only on the condition of an insured being in a state of control over reputational risks. In fairness, in part due to the increasingly sophisticated reputation measurement techniques available and in part due to market demand, reputational insurances are now beginning to proliferate. *iam*

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*This series is inspired by the book,* Mission: Intangible®, Managing risk and reputation to create enterprise value*, published by the Intangible Asset Finance Society. Visit the Society and its blog, Mission: Intangible, at www.iafinance.org.*

## Action plan

Boards with superior risk management processes exhibit three features:

- Public disclosure of their awareness of reputational value. Reputation, and its component drivers, are discussed in formal corporate documents as assets to be managed and value to be protected.
- Authentic reputational value process controls. Board-level processes transfer corporate culture and character to operations.
- Compelling stakeholder signalling strategies. Leadership and participation in appropriate reputationally relevant affinity groups; and third-party endorsements from iconic investors, rating agencies or insurers.