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Hewlett-Packard Slows Pace After Fast Start in Consulting

By Damon Darlin

PALO ALTO, Calif. — Hewlett-Packard made a splashy entrance into the big leagues of business consulting when it landed a $3 billion outsourcing contract in 2003 to run all of Procter & Gamble's information technology.

But it has not made many waves since Mark V. Hurd became the chief executive more than a year ago.

"It was like the dog who finally caught the bus," said Julie Giera, a vice president with Forrester Research who tracks the information technology consulting business. "Now what?"

For the last half year, HP Services, the company's $16 billion consulting and services business, has answered that question with declining revenue. The division has been one of the company's few laggards, while the divisions that sell printers and computers have reported strong increases in revenue and profit.

The reason for the slowdown, said Steve Smith, the company's senior vice president for services, is pretty simple and totally intentional. "All the Tinkertoys we had in the company were not being leveraged," he said.

Mr. Hurd told Mr. Smith and his lieutenants to throttle back growth until they could start bringing in more profitable revenue. How they are doing that says a lot about how Mr. Hurd is changing the giant technology company and how he intends to get more growth out of it.

Mr. Hurd wants Hewlett-Packard, which reported $86.7 billion in revenue last year but only $2.4 billion in net profit, to grow three ways, which it can do even faster with the help of the company's business consultants.

First, he wants Hewlett-Packard to sell more notebook and hand-held computers to corporate customers. That is an easy one for its team of consultants, who analyze how a customer uses technology and how Hewlett-Packard could potentially improve things.

Second, he wants to sell more printers and printing services. The imaging and printing division has been doing well in those areas as it extends Hewlett-Packard's reach into copiers and commercial printing.

The company could sell even more by winning contracts to manage a company's printing just as it manages computers or data storage. Because printing is distributed around a workplace, the costs are huge, hidden and largely unmanaged. Companies spend as much as 3 percent of their revenue on printing, faxing and imaging, said Hewlett-Packard executives, but rarely realize that they are doing so.

In this new area, Hewlett-Packard faces Xerox, a reborn and strong competitor, and Dell, its longtime rival in the PC business, which recently won a major printing services contract from Boeing.

Mr. Hurd's third engine of growth is a new one: the next-generation data center. It is a computer room running with few workers because Hewlett-Packard software on the company's machines automates most of the process. The company's consultants would design, sell and run these centers.

The clients would save money because the data centers are efficient, using less power and fewer people, Hewlett-Packard says. And it is betting that those companies will spend some of their savings on new equipment — like the computers, servers, storage devices and printers that it makes.

For all this to work, it needs to win invitations from major companies to fix their technology infrastructure. It has to get bigger or act bigger. Hewlett-Packard's services business is in fourth place, behind I.B.M., which has revenue of $46.4 billion; Electronic Data Systems, with $20.1 billion; and Accenture, with $16.1 billion.

The ranking inflates Hewlett-Packard's strength because it includes what are called "break-fix" deals — maintaining equipment and running help desks. The company does well in that segment, but lags where the high-profit revenue is made, in consulting and outsourcing.

Pulling out all the stops to win the Procter & Gamble contract made sense for HP Services. "They aren't that big, and they struggled to put themselves on the map," said A. M. Sacconaghi Jr., a senior research analyst who follows Hewlett-Packard for Sanford C. Bernstein & Company.

It got on the map, but at what price? "Big deals are hard to manage," Mr. Sacconaghi said, and digesting a large number of deals can hurt earnings. "They were overly aggressive on the top-line growth at the expense of profitability."

Company executives would not discuss the profitability of individual deals, though they pointed out that multiyear contracts were rarely profitable in the early stages as the vendor learned where the problems were and invented solutions.

Ann M. Livermore, the executive vice president for Technology Solutions Group, which includes HP Services, said, "I would absolutely do that deal again."

Procter & Gamble said it was going well. "We've had our challenges," said Linda Clement-Holmes, the company's general manager of infrastructure services and governance. "We suspected we would. It's been a learning curve for both of us." (One result of the relationship: P.& G. puts printing on its Pringles potato chips with Hewlett-Packard's printing technology.)

Ms. Livermore says she thinks the unit is on the right track. "While we are not satisfied with the performance of our unit, we are satisfied with the progress," she said. "The challenge is how to price the projects to win them and still generate returns."

Rather than chasing everything, Ms. Livermore and Mr. Smith are looking at smaller deals. That allows HP Services to use the skills it has setting up data centers around the world and automating the management of software used by its clients. It is focusing on global companies doing business in Asia, where analysts estimate the services division already has about a third of its personnel. That way, the company estimates, as it adds another dollar of new business, it does not have to add 60 cents of cost, but maybe 30 cents or 40 cents.

The mistake the company made, Mr. Smith said, was in taking on too many large, unique projects. "To get cost-efficient, we have to do 75 percent standard and 25 percent custom," said Mr. Smith, a former executive at Electronic Data Systems. "Before, we were doing too many one-offs. We wanted to slow it down."

HP Services focused on technology infrastructure, data centers, printing and business processes for finance and administration. When customers complained that they were seeing too many Hewlett-Packard sales representatives and consultants, the company made sure a designated team made the visits each time.

Focusing on the smaller deals could be a winning strategy. The research firm IDC estimates that consultants will be bidding on $127 billion in large information technology deals in 2007 and 2008. Unlike the first generation of outsourcing and consulting contracts, these will most likely be shared by a number of vendors as the companies try to maintain the balance of power.

One recent example of this trend was the contracts awarded by General Motors in February. Over all, the contract was large, $5.1 billion. E.D.S., the incumbent, retained 85 percent of its business, but Hewlett-Packard got $700 million for networking G.M. dealers and providing technology for the product development and manufacturing quality operations.

“We are really pleased with what we got,” Ms. Livermore said. “We like when it is segmented.”

Ms. Livermore said she was looking for revenue growth of 4 percent to 6 percent a year for HP Services, and operating profit of 8 percent to 10 percent. While revenue for the unit was down in the quarter that ended April 30, the operating profit margin almost hit 9 percent as profits rose 18 percent.

For now, analysts are waiting to see the result of Hewlett’s changes. “We see HP Services clearly as a work in progress,” said Robert Welch, an industry analyst at IDC. “I don’t see the roster of players shifting at the top, and I don’t see anyone dropping off the list.”

Cindy Shaw, a securities analyst with Moors & Cabot, said: “They need to keep doing what they are doing. They have the right plan.”