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CORPORATE FINANCE PRACTICE

## Thinking longer term during a crisis: An interview with HP's CFO

**Cathie Lesjak reflects on the company's response to the recent global financial crisis—and the long-term effects it will have on performance.**

Paul Roche



**What CFO didn't face a baptism by fire** during the economic crisis? Wild swings in currency rates, dramatic shifts in supply and demand, and the virtual freezing of the financial markets tested the mettle of even the most veteran CFO.

Hewlett-Packard's Cathie Lesjak was no exception. She ascended to the CFO role in January 2007, after nearly two decades in the treasury and other finance leadership positions at the company. As the global financial crisis escalated during the second half of 2008, the company was integrating its \$13.9 billion acquisition of Electronic Data Systems (now known as HP Enterprise Services). When the crisis peaked, Lesjak was suddenly faced with severe cost-cutting measures, unprecedented uncertainty, and the full spectrum of crisis-related management challenges. Yet, a little more than a year later, the company announced its \$2.7 billion acquisition of 3Com, signaling its intention to continue investing in future growth even during the challenging economic environment.

Lesjak recently sat down with McKinsey's Paul Roche, a partner in the Silicon Valley office, to recall the steps she took to ensure that HP could continue to meet its commitments to the market and to look ahead at the company's strategy. The interview took place in Lesjak's office at the company's headquarters, in Palo Alto, California.

**McKinsey on Finance:** *What was your immediate response when the financial crisis hit?*

**Cathie Lesjak:** Our business began to decline in late November of 2008, and by early December we were looking at a lot of different scenarios. The first thing we did was try to ascertain how bad the economy might get and how it would affect our financial performance.

The challenge was to pull together a big picture of all the moving parts, put in place additional measures, and, frankly, get everyone more focused on the tough environment. We started modeling more "what if" scenarios of what we thought could happen and what types of actions we would need to take. By mid-February, we had announced several initiatives. Some were short-term actions, such as cutting travel by almost 90 percent in all but our revenue-generating activities. It's interesting to note that a lot of that travel is never going to come back, even as things are getting better, because people have gotten more comfortable using our Halo video-conferencing solutions. So some things have changed culturally as a result of tough times.

In addition, most of our employees took a pay cut, which gave us an additional cushion. And what we ultimately did, which I think is a little unique, is we converted that pay cut to a bonus opportunity. At the end of the year, when it turned out that we didn't need the extra cushion, we paid bonuses that in the aggregate exceeded the total amount of the pay cuts.

**McKinsey on Finance:** *How did the mix of HP's business portfolio play out, in products as well as services?*

**Cathie Lesjak:** Service businesses have recurring revenue, which makes them very resilient. In this respect, the EDS acquisition couldn't have come at a better time, because it gave us stability just when it was most needed. And our technology services business, for example, continued to do well through the first half of 2009 and only started to feel the impact of the downturn in the second half of the year. The printer supplies business is also very resilient, and in fact, if you look at the mix of hardware versus supplies in 2009, we had 60 to 65 percent of our revenue coming from supplies. Those are very high margin businesses, which also provides a certain amount of resiliency.

On the other hand, our PC, server, and storage businesses require a lot of operating leverage, so their operating profit was down almost twice as much as their revenue was in 2009. Obviously, the good news is that in 2010 we have an opportunity for that profit to come back as the economy picks up.

**McKinsey on Finance:** *You mentioned some of the modeling that you did. What have you done to the planning and budgeting process itself to build in new capabilities or new ways of looking at, for example, scenarios? Did you change that, or was this more of a crisis, in that you responded and moved on?*

**Cathie Lesjak:** There was a real demand placed on the finance function throughout 2009. The challenge wasn't just the recessionary environment; it was also the currency volatility. The late November–December 2008 period was very challenging because we'd get new forecasts showing massive moves in revenue, and obviously therefore in profit. Even through mid-2009, there were still some pretty big month-to-month jumps from a forecasting perspective. Revising the annual plan multiple times to get a sense of what was happening from a currency perspective wasn't something we could put the organization through as often as we wanted, so we spent a lot of time coming up with new models to understand how the different businesses within HP would respond under different sets of circumstances. We were in a position to help senior management really understand the dynamics that were going on—which gave finance a bigger voice at the table.

It was a great learning experience for the business folks as well, because the finance people couldn't do it by themselves. They had to go and talk to people, and by asking the types of questions that the finance function asks they got the business guys thinking as well. So it became a much more collaborative effort to deliver the new models and the new understanding of how businesses would respond under a variety of economic conditions.

**McKinsey on Finance:** *Can you give some examples of that?*

**Cathie Lesjak:** If you go back to some of the modeling that I talked about, finance people were saying, “Okay, what happened in the past, when the dollar has either dramatically strengthened or weakened? How quickly did you either raise or lower prices?” Having those types of discussions brings a heightened awareness to everybody about how long it has taken to pass increased costs or savings through to customers in the form of higher or lower prices.

When we first started asking these questions, it wasn’t like somebody said, “Oh, you know, for industry standard servers, it’s three to four months. For PCs, it’s a week.” People didn’t have those frames of reference. Now, after really thinking it through, there is a better understanding of what the “puts and takes” are for a business, as well as for the P&L. This is helpful to the business folks too.

**McKinsey on Finance:** *When you do budgeting in one of the businesses or in a function, do you have a process through the year where spending can be ratcheted up and down without having to do a complete replan?*

**Cathie Lesjak:** We absolutely do, although it’s not as if you start the year with a plan and build in the conditions up front. It really happens as the quarters evolve and the year unfolds that you start to think, “Okay, we’ve got room to make some additional investments that are going to be important to HP in the long term.” In 2009, our strategy

## Cathie Lesjak



### Vital statistics

Born in 1959

### Education

Graduated with a BA in biology in 1981 from Stanford University

Earned an MBA in finance in 1986 from the University of California, Berkeley

### Career highlights

#### Hewlett-Packard

CFO and executive vice president (2007–present)

Senior vice president and treasurer (2003–07)

Group controller, HP Software Solutions (2000–03)

Controller and credit manager, HP Commercial Customer Organization (1998–2000)

### Fast facts

Serves as a director of Neoware, a company HP acquired in October 2007

was to continue investing in sales coverage and R&D to put HP in a stronger position. We wanted to build in the confidence and the cushion so that we could make these investments and take advantage of the downturn, as opposed to being on our back foot the entire time.

**McKinsey on Finance:** *On another topic, did the financial crisis accelerate or change the way you viewed the shift of revenue and the shift of markets globally?*

**Cathie Lesjak:** Longer term, not really. For quite some time, we've been focused on the fact that emerging markets were going to be a good growth opportunity for us—and they have been. In 2009, for example, China actually ended up growing. The first quarter was a bit tough, and we were concerned, but if you look at our fourth quarter, China grew in excess of 40 percent in PCs and more than 20 percent for HP.

The rest of the BRIC<sup>1</sup> countries and the emerging markets definitely had a tougher time. But we still believe, in the long term, that emerging markets are where a lot of the growth will take place. For example, if you look at PC penetration rates in the emerging markets, they're a fraction of what they are in developed markets. So the opportunity is definitely there.

Now, no question, you've got to have the right products. We have set up R&D facilities in India, China, and other locations specifically to do development *in* local markets *for* local markets. We've got to design the right set of products, both in the premium and value markets, to make sure that we're targeting the overall market correctly.

**McKinsey on Finance:** *What does expected growth in China as well as in some of the other emerging markets imply for the size and staffing of the finance organization, the treasury organization, controlling, and so forth in those regions?*

**Cathie Lesjak:** Two or three years ago, we concluded that we would need to staff emerging markets differently. Some of them are small, but complex and growing rapidly. If we used our normal rule of thumb in terms of the level and amount of resources that we would place in those countries, we'd end up with less experience than we actually needed there. We realized we'd have to staff these markets as if they were bigger countries, because of the complexity and rapid growth. Folks who are less experienced are fine if a market is growing on a predictable, relatively slow basis. But when business grows exponentially, you need more skilled, experienced people who have seen a variety of things.

So we've decided to overhire, from our rule-of-thumb perspective, so that we're able to take advantage of what each market is going to be, rather than what it is today.

<sup>1</sup> Brazil, Russia, India, and China.

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**McKinsey on Finance:** *What effect has the financial crisis of 2009 had on the treasury department within HP?*

**Cathie Lesjak:** There was a whole revamping of our thought process, especially in late 2008 and early 2009. For example, we used to rely heavily on S&P and Moody’s and Fitch for their investment ratings, but now we need another layer of scrutiny.

Today, you want to look at a variety of indicators of credit strength, as opposed to just relying on a rating that comes out. Because, frankly, if you looked at asset-backed investments and money markets that invested heavily in asset-backed securities, the ratings in many instances—not in all—just didn’t hold up. I mean, things that we thought were AA and AAA, they certainly didn’t act like AA and AAA investments. And so, in addition to the ratings, we’re looking at other filters, such as the credit-default-swap spreads, to figure out what we want to do.

There have also been a number of changes in treasury as a result of the financial markets in terms of what the opportunities are, what the yields are, and how much risk we want to take. It doesn’t help that the yields are incredibly low right now. Almost no matter what you do—unless you go very risky—the yields are low, and I think that’s impacting a lot of companies. I get a lot of questions from treasury organizations on what we’re doing about the yields.

**McKinsey on Finance:** *What’s your sense about the balance that HP’s looking for between operating improvement and growth? Because clearly over the years, you’ve achieved some of each, but outsiders in the Valley would certainly look at HP and say, “Wow, the operational improvement has been tremendous.” What’s the right mix?*

**Cathie Lesjak:** Getting your cost structure right is the enabler to growth, so we’ll always be focused on both cost initiatives and growth. In 2010, we are definitely taking additional cost actions because we’re always going to do that, but we’re also making more significant investments to cover our total addressable market.

So the folks inside HP are going to hear a lot more about sales coverage in 2010 than they did in 2009. For example, we view the 3Com acquisition as more of a growth acquisition than a cost story, because while there are some synergies—the real long-term value of 3Com is to address more of the market, which includes both networking and data centers. Also, a good chunk of 3Com’s business is in China, including a strong R&D presence that we can build on for the future. ○