



Aberdeen Group
Business Success Case Study

Hewlett-Packard

*Successfully Playing on Both Sides
of Total Cost Management*

August 2004

Executive Summary

Hewlett-Packard (HP), the second largest information technology company in the world, recognized that it could leverage advances in Total Cost Management strategies, processes, and technology as both a buyer and seller to improve its overall financial performance. Over a five-year period (Figure 1), the company has put together an impressive record of cost savings, transforming its Indirect Procurement function into a strategic asset for the company. In addition, it built an impressive business channel by selling more than \$1 billion through the Ariba Supplier Network.

Figure 1: HP's Total Cost Management Performance

	Q2 FY02	Q1 FY04	Exit FY06
Supplier Spend	\$8B	\$13B	\$16B
Negotiated Cost Savings	\$250M 2 years	\$377M 1.5 years	\$1B 3 years
Supply Base	125K	65K	50K
Number of Systems	122	51	<10
OPEX % of Spend	0.95%	0.65%	0.60%

Source: Hewlett-Packard, August 2004

The significant cost reduction results came from an evolution and maturation of HP's Total Cost Management – also called Spend Management, strategies, processes, and technologies as the company itself evolved. Like many companies, HP started with the traditional spend consolidation and price negotiations strategies of the late '90s. With the Compaq merger, HP had both a challenge and opportunity to advance its Total Cost Management strategies. Going forward, the role of HP's Indirect Procurement has evolved to a broader perspective as a strategic asset in driving down the total cost of procurement to achieve world-class cost structures.

HP knew that companies like itself were leveraging new spend management tools to drive procurement decisions and wanted to take advantage of the new selling channel to increase revenue. With a strategy of being an early supporter of the Ariba Supplier Network and working to make it easy for customers to integrate and do business with HP, it has been able to generate \$1 billion in revenue, making it the largest IT supplier to Total Cost Management customers using the Ariba Supplier Network.



This business success case study is broken into two sections — Section 1: The Evolution of HP's Total Cost Management Strategy and Section 2: Building a Sales Channel Through the Ariba Supplier Network.

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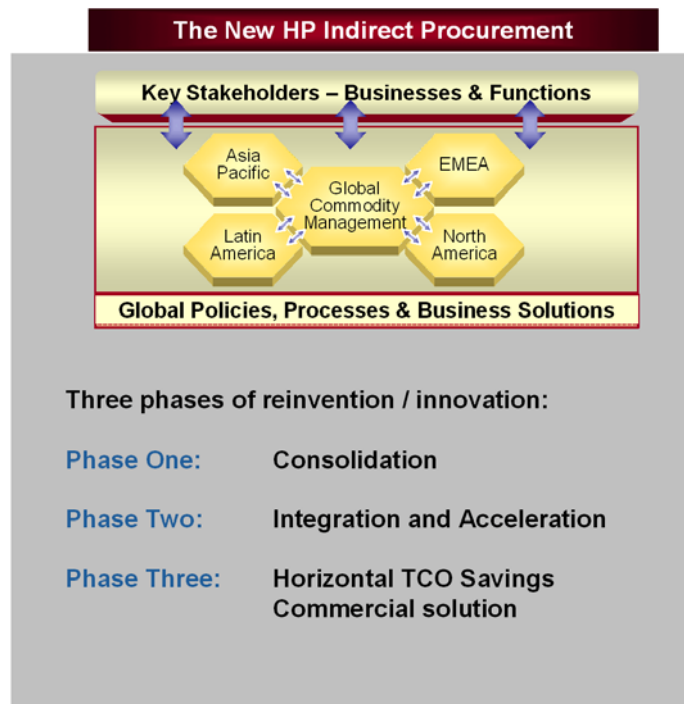
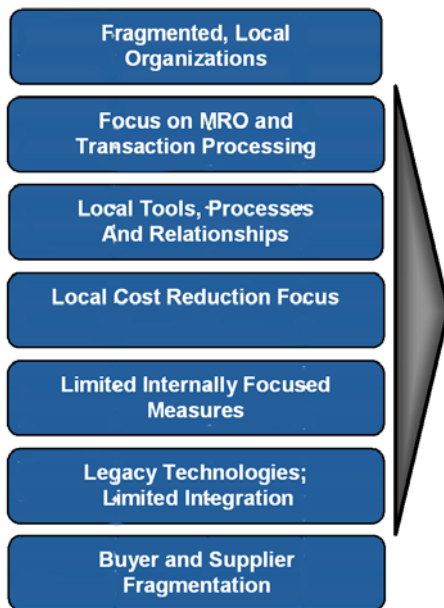
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Chapter One: The Evolution of HP's Total Cost Management Strategy

Over the last five years, HP has rolled out its Total Cost/Spend Management strategy through three significant phases of indirect procurement reinvention and innovation that it calls: Consolidation, Integration and Acceleration, and Horizontal Total Cost of Ownership (Figure 2).

Figure 2: HP's Indirect Procurement Strategy 2000

Key Factors Driving Reinvention



Source: Hewlett-Packard, August 2004

Phase I: Consolidation

Priorities

By 1999 HP's revenue had grown to \$42 billion as a product-driven company that was highly decentralized. The CEO at the time, Lew Platt, realized that increased top- and bottom-line growth would be very hard if the company did not restructure to take advantage of its economy of scale.



Actions

HP decided that indirect procurement was a good candidate for centralization, as the existing decentralized model with fragmented local organizations provided little leverage. In early 2000, the Indirect Procurement function (IP) was created with direct line management of all indirect procurement spend.

IP was given responsibility for managing nonproduction spend categories: information technology, human resources, marketing, travel, real estate and workplace solutions, finance, and labor. IP's scope was to manage the strategic, tactical, and operational aspects of procurement, including global and regional sourcing, local buying and order fulfillment, and deployment of e-procurement programs. The newly created organization reported to HP's CFO, significantly enhancing its ability to consolidate the resources and effect operational changes to capture the benefits. In early 2000, IP was able to identify \$7 billion of indirect spend and was given a savings target of \$250 million over the next two years.

HP identified a three-phased strategy to consolidate local operations from around the world into the new organization:

Phase I: Initial consolidation of local procurement operations, bringing all the assets into one organization under one cost envelope:

- Find the people
- Identify the systems and processes

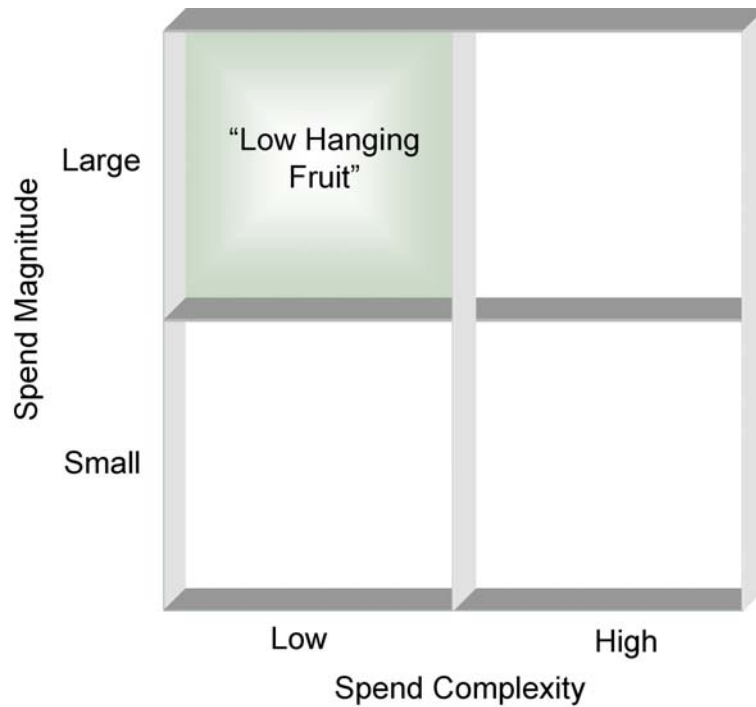
Phase II: Standardization

- Deploy a standardized purchasing platform, Ariba, to reduce cost of transactions
- Develop and implement new policies, practices, and standards

Phase III: Realization of the cost savings made possible by the initial consolidation

- Identify the “low-hanging fruit” in a centralized model (Figure 3)

Figure 3: IP Commodity Analysis Strategy



Source: Aberdeen Group, August 2004

Capabilities

IP broke down its procurement function into three major categories with the intent of standardizing the policies, processes, and supporting IT systems for each (Table 1).

Table 1: IP’s Procurement Processes and Supporting Technology

	Strategic Sourcing	Tactical Operations	Transaction Processing
User	Procurement professional (indirect and services)	Consumer (end-user doing the purchasing)	Finance
Solution strategy	Custom and purchased	Smart Buy (Ariba Buyer)	Ariba/SAP

Source: Aberdeen Group, August 2004

Enablers

Prior to the Consolidation phase, HP wanted to eliminate competing and obsolescent systems and needed a common platform. In late 1998, because Ariba was the emerging leader in automating indirect procurement, HP selected Ariba Buyer as the technology platform to manage indirect procurement spend. Over the next two years HP integrated



the Ariba Buyer product into HP’s systems architecture and implemented Ariba Buyer as the standardized indirect procurement transaction system throughout the U.S. Pilot implementations were completed in Europe and Asia.

IP decided to implement its own strategic sourcing and contract management solution, which is a combination of purchased and HP-developed solutions. IP recognized that sourcing and contracting practices varied widely across the company, with no leverage of spend or sharing of best practices. IP set a goal for its e-procurement solution, called the Workbench, to promote best practices in sourcing and contracting as well as centralize all leverageable opportunities (e.g. multiple contracts from the same company).

To effectively and quickly roll out the new policies, processes, and supporting IP systems, HP created a holistic approach to delivering the Workbench solutions, including training, virtual tours, and town hall meetings to educate 400 to 500 users prior to launch. In the meantime and over the span of a year, IP strategic sourcing teams prepped for the conversion by scanning contracts, doing the associated data-mining exercises, and developing global standards and nomenclature. With everything in place, IP was able to “go live” with the Workbench in 47 countries in one day. Today, this solution is used by more than 1,500 procurement and finance professionals.

A key component of the Workbench is the e-sourcing module, which provides online RFX’s and reverse auctions. This module allowed IP to negotiate with suppliers of key commodities in “real time.” Using this Internet-based solution reduced the time involved in sourcing and negotiating for goods and services. Time reductions were as much as 60%, whereas negotiated savings averaged 10%–15%.

Table 2: Results in Q2 FY02

	Q2 FY02
Supplier spend	\$8 billion
Negotiated cost savings	\$250 million
Elapsed time	Two years
Supply base	125,000
Number of systems	122
OPEX % of spend	0.95%

Source: Aberdeen Group, August 2004

Lessons Learned

- IP started its rollout of the consolidated procurement strategy with a “top-down” management strategy, but it met resistance with business units as their business needs were not necessarily being taken into account. As a result, it changed its approach, moving from a global sourcing focus to a global commodity management model. Using this more collaborative model, IP engaged the business units early in the strategic procurement process to build strategies in alignment with their business objectives.

By proving value, they began to build the partnerships necessary for demand and compliance management.

- The bulk of the savings came from the commodity teams' ability to identify the "low-hanging fruit."
- The Workbench was a great tool for helping IP's procurement management because it gave visibility to projects and leveraged opportunities across regions.
- To make it easier for IP to attack spend, it worked to educate suppliers on how to optimize the new e-sourcing processes to gain a greater share of HP's indirect spend.
- Use of computer-based training (CBT) was key to getting thousands of end-users, both employees and suppliers, proficient with the solutions.

Phase II: Integration and Acceleration (HP/Compaq Merger)

Priorities

In 2002, HP acquired Compaq in the largest merger in the history of the technology industry. The companies' combined revenues totaled \$70 billion. IP was given a goal of another \$250 million in cost savings from the "synergy" opportunities of the merger. It was also tasked with reducing its cost of operations from 0.95% to the Hackett Group benchmark of 0.73% of indirect procurement spend. The magnitude of operations cost reduction was significant because the IP budget was fully loaded to include systems, real estate, and legal.

Actions

To capture the merger synergy benefits and gain control of spend as quickly as possible, the combined HP/Compaq indirect procurement function chose to continue with HP IP's strategy and solutions because they were further along the centralized and consolidated operations path. Compaq had strong capabilities, but it looked similar to HP before Compaq started its consolidation efforts — assets everywhere and independently run.

IP began to transition its procurement strategy from a purchase price focus to total cost of ownership (TCO) and customer-directed value. IP recognized that there were different purchasing goals for different organizations. For example, marketing spend management is more about getting the most from the available funds than reducing the overall spend.

IP took the collaboration lessons from the Consolidation phase to heart as it expanded its reach to nontraditional indirect procurement areas, such as marketing. For example, having proved its value in reducing spend while meeting business needs, the IP Marketing Commodity Team was asked to lead a worldwide vendor consolidation team to significantly rationalize and leverage the marketing supply base in each of the marketing disciplines.

Capabilities

Although a significant percentage of HP's indirect spend was already being channeled through the Ariba Buyer product, the merger of HP and Compaq created a significant new consolidation need/opportunity. To maximize the speed and efficiency of migrating remaining HP countries and all Compaq countries onto a single standard expenditure cy-



cle system architecture, IP and HP’s Finance Organization worked closely together to develop coordinated “stop-and-go” deployment plans that converted a patchwork of legacy expenditure cycle systems across multiple countries to the single standard architecture.

Enablers

For the merger, IP adopted the “stop-and-go” strategy to accelerate rollout of standardized systems and processes. The “stop-and-go” strategy has three basic principles: stabilize, standardize, and optimize. All improvement work was put on hold in the beginning. First-year objectives were to stabilize and standardize. IP spent six months identifying spend opportunities. From a systems investment perspective, as long as basic requirements were met, resources focused on scalability and internationalization to speed rollout instead of adding more product features.

An important part of the strategy was to turn off legacy systems. To achieve this objective, HP initiated a Sunset Program that catalogs legacy systems, determines obsolescence strategies/dates, manages system retirements, and ensures capture/distribution of savings. To date, IP has retired 84 procurement transaction systems.

In addition, IP set an objective to minimize the complexity and customization of the Ariba Buyer software application and implemented a single version of Ariba Buyer code that is managed across three instances. Staying with standard systems as much as possible, IP partnered with Ariba to reverse engineer out customizations done in advance of Ariba Buyer’s functional build-out by working with Ariba to include them in subsequent releases.

Table 3: Results in Q1 FY04

	Q1 FY04
Supplier spend	\$13 billion
Negotiated cost savings	\$377 million
Elapsed time	1.5 years
Supply base	65,000
Number of systems	51
OPEX (% of spend)	0.65%

Source: Aberdeen Group, August 2004

Lessons learned

- Early alignment with finance operations is critical to deliver an integrated horizontal systems flow. This alignment enables full obsolescence of legacy systems.
- Investment in change management for end-user consumers will significantly increase adoption and reduce maverick spend.

Phase III: Horizontal TCO Savings

Priorities

With the merger successfully completed by mid 2003, HP embarked on another transformation of IP, taking it from a recipient of the company's strategic planning decisions to being part of them. Now reporting to the CIO and Executive Vice President of Global Operations, just one step removed from the president, IP has the visibility and authority to operate as a strategic asset for HP. Indirect procurement is no longer considered an adjunct function, but a competitive core function, adding increased overall value for the global business units and functions.

Going forward, IP took a three-year view of its strategy and adopted metrics that focus on strategic contribution — profit and cash generation. Because of increased outsourcing and broadened responsibilities, IP's indirect spend had climbed to \$13 billion in fiscal year 2004 and is expected to grow by \$3 billion by fiscal year 2006. The new goal is another \$1 billion in savings from the projected \$16 billion budget by the end of fiscal year 2006 with a continued reduction in OPEX.

Actions

As part of its transformation IP has adopted HP's balanced scorecard approach to measuring its performance. The organization is evaluating itself across four areas: End-User Consumer Experience, Operational Efficiency, Realized Savings and Culture and Behavior.

End User Consumer Experience

IP recognizes that improving the end-user consumer experience is critical to getting tens of thousands of employees to use the processes and supporting systems that would capture the savings. IP's strategy is to make the end-user consumer experience as easy and repeatable as possible by standardizing the procure-to-pay workflow, purchasing channels and supporting IT systems. It also provides extensive training, both Web-based and virtual "live" instructor-led, and online and call center help desks.

Goal: Improve end-user consumer experience feedback by 33%

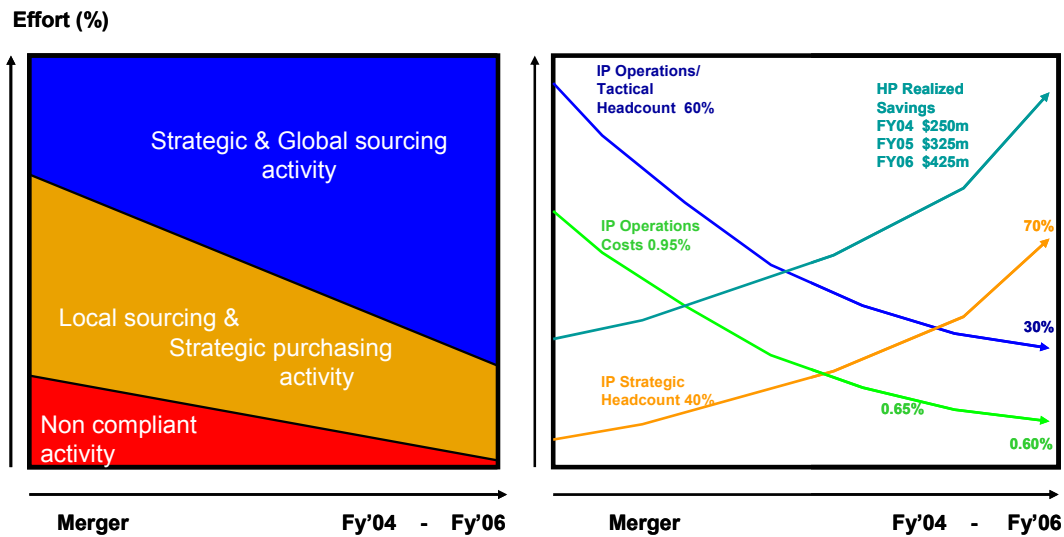
Operational Efficiency

IP is focused on exceeding Hackett Group "world-class" metrics. It believes that there are significant opportunities to reduce the costs of tactical procurement and transaction processing and that through technology-enabled processes and outsourcing, it can focus more of its resources on high-value strategic procurement strategies (Figure 5). "Right" shoring is part of IP's strategy for reducing operating costs as it continues to regionalize or centralize tactical operations and outsource transaction processing to HP's business process outsourcing group. In addition, IP continues to drive down IT-systems-related costs as it moves the entire company to a single platform and drives basic procurement transactions to procurement cards and catalogs.

Goal: Reduce operating expense to 0.6% of purchases



Figure 4: IP's Organizational Focus and Operating Cost Model



Source: Hewlett-Packard, August 2004

Realized Savings

Even though IP has saved more than \$600 million in three years, it believes that significant savings opportunities are still possible as it more broadly and deeply rolls out its Total Cost Management capabilities. Coming into the last phase, IP feels it has strong tactical operations and execution and has transitioned its focus to gaining a better understanding of spend and supply market information. Extending its reach into other areas to address spend not already under management is a key strategy. IP believes that it is in a unique position within the company to work across business units and geographies to drive down the total cost of ownership by attacking spend across such horizontal commodities as print supply chains, labor, and software.

Goal: \$1 billion of additional savings

Culture and Behavior

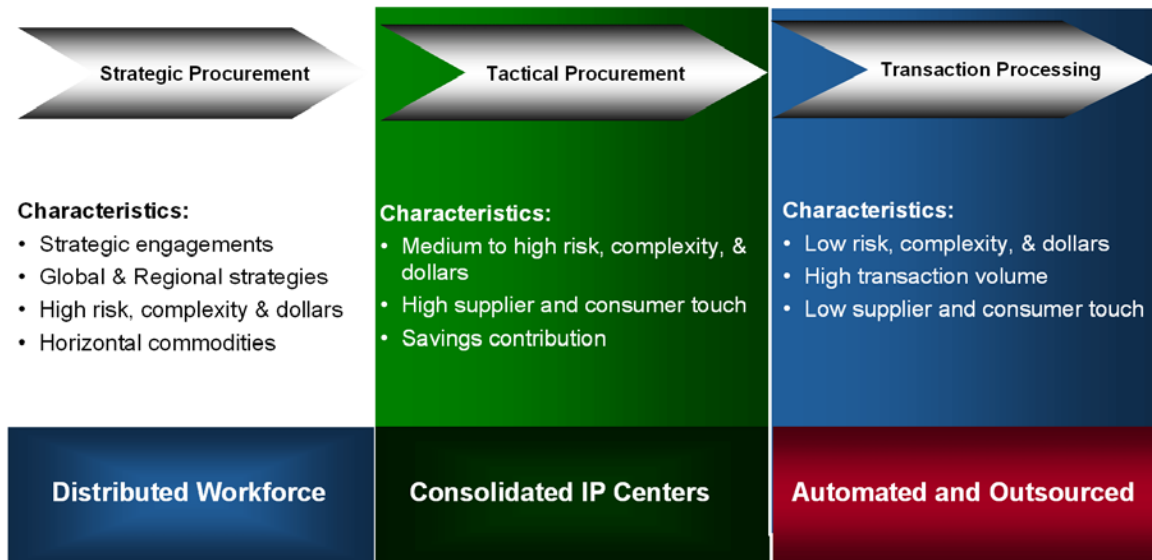
IP understands that key to its success in meeting financial and customer service goals are highly qualified and skilled resources. To that end, IP is focused on attracting strong talent through its “best-place-to-work” strategy that emphasizes trust, mutual respect, open communication, education, and personal accountability. In addition, because of the billions of dollars that transact through IP personnel, it is focused on ensuring that its operating practices meet regulatory guidelines and are consistent with company ethics.

Goal: Improve IP employee survey scores by 10 points

Capabilities

To deliver the results of its strategy, IP has employed a number of tactics that are an evolution of the previous two phases of its indirect procurement journey (Figure 5).

Figure 5: Core Indirect Procurement Business Process and Delivery Segmentation



Source: Hewlett-Packard, August 2004

Strategic procurement resources are located in 50 countries worldwide to be more closely aligned with stakeholder and end-user consumer needs.

Tactical procurement operations are centralized on a regional basis to take advantage of economy of scale while providing support to end-user consumers.

Transaction processing is being automated and outsourced to HP’s Business Process Outsourcing group to further take advantage of economies of scale and global labor costs. There is little interaction between IP’s end-user consumers and transaction processing because tactical procurement (Ariba) and the A/P systems (SAP) are integrated.

IP focuses heavily on understanding end-user consumer satisfaction as it recognizes that satisfied end-user consumers drive compliance and savings. Twice yearly, IP measures end-user consumer satisfaction and acts on the results. In particular, IP works on improving the ease of use of all of its solutions. The unstated goal is to have its procurement solutions be as intuitive as Amazon. IP also focuses on increasing awareness of policies and processes. Web-based resources continue to be a cornerstone of its strategy. The Procurement Central portal provides an easy-to-navigate Web site that has access to all purchasing tools, policies, processes, training, and contact information and a “how-to-buy” tool to better educate end-user consumers. The portal has raised end-user satisfaction and improved compliance and procurement effectiveness.

Enablers

IP continues to leverage the architecture that it created in the “Consolidation” phase (Table 4). Ariba has become central to automating IP’s tactical procurement strategy, allowing IP to ensure compliance and extend its operational reach across tens of thousands of end-users. As a result, IP can allocate more resources to more strategic procurement functions, such as identifying horizontal spend category opportunities.



Table 4: High-Level Indirect Procurement Architecture

	Strategic Procurement	Tactical Procurement	Transaction Processing
IP resources	Distributed globally	Consolidated IP centers	Consolidated and outsourced
Technology platform	Workbench (custom and purchased solutions)	Ariba	Ariba/SAP

Source: Aberdeen Group, August 2004

Working in partnership with the HP IT organization, it has been able to focus on scalability and reduce to three instances of Ariba for worldwide operations — all tied to a common SAP-based financial system that has been outsourced to HP’s Business Process Outsourcing Group, as previously noted.

Table 5: Anticipated Results in FY06

	Exit FY06
Supplier spend	\$16 billion
Negotiated cost savings	\$1 billion
Cost avoidance	Three years
Supply base	50,000
Number of systems	< 10
OPEX % of spend	0.60%

Source: Aberdeen Group, August 2004

Lessons Learned

- IP recognized that it needed to leverage its procurement domain expertise, but also understood that each customer organization had different buying needs and goals. IP commodity teams continue to partner with their stakeholders across the strategic procurement life cycle. Strong relationships and effective collaboration have been key to development of effective sourcing and supplier management strategies.
- To be considered best of the best, IP benchmarks itself versus indirect procurement standards produced by companies such as the Hackett Group and occasionally meets with peer organizations in companies of similar size to share lessons learned.

- Risk has become an important part of the sourcing strategy and evaluation of sourcing options. The California energy crisis of 2002 taught IP that the potential for service disruption and the need to ensure alternative sources are critical to ensuring reliable operations for its customers.
- To fully leverage TCO principles and meet IP's value commitment to HP, HP will need to make a technology investment that fully integrates strategic procurement through payment. This investment will strengthen HP's ability to "realize savings" through compliance, ensuring appropriate use of suppliers, contracts, and buying channels.



Chapter Two: Building a Sales Channel through the Ariba Supplier Network

Priorities

Concurrent with the start of HP's own indirect procurement journey, many of its leading customers were also deploying Ariba Buyer as part of their Total Cost Management strategies to manage their purchases from HP. In addition, these early adopter customers — large, influential customers — were looking at Total Cost Management in the same way as HP, choosing the Ariba Supplier Network as the vehicle to help automate and streamline the procurement process. HP could see that as part of their Total Cost Management strategies its customers were consolidating their supply base and enforcing compliance through solutions like Ariba. Customers with large Total Cost Management investments were moving away from unprepared suppliers, and IT was one of the first spend categories that was managed through this new method. HP decided to take advantage of the simultaneous trends of Ariba deployment and supplier consolidation by actively embracing the Ariba solutions as a supplier and aggressively working with customers to enable their Ariba solutions.

Actions

HP decided that the Ariba Supplier Network represented a new and significant selling channel because of the number and size of the companies that were deploying the Ariba solution. These companies all had high expectations of the potential benefits and supplier participation and were looking for suppliers that supported their Total Cost Management vision. HP also recognized that companies that made the decision to integrate and work through the Ariba Supplier Network tended to have closer relationships and commitment to making this new approach work with the chosen suppliers. HP's strategy to gain the greatest share of this emerging channel was to work with customers and Ariba to make the HP buying experience as easy and seamless as possible. Up-front integration costs for customers were absorbed as part of HP's operational costs (integration to the Ariba Supplier Network saves HP money as well), and the goal was to get the customer integrated as quickly as possible. Once these customers were connected, the strategy focused on operational excellence during the procurement life cycle by (1) providing accurate product information and pricing; (2) providing errorless order processing; (3) providing timely order status information; and (4) ensuring accurate billing. HP chose to be an early adopter of the new Ariba capabilities, such as PunchOut™ and order status and invoice, to provide customers with the greatest flexibility when doing business with HP.

Capabilities

To support its strategy of making business with HP straightforward through the Ariba Buyer and Ariba Supplier Network, HP worked closely with its customers to ensure that HP.com business-to-business integration fit into their procurement processes and met their requirements for catalog format and content. HP created customer qualification

checklists and deployment guides to make the deployment process go smoother. HP also recognized that the request for proposal (RFP) was a complex and time-consuming process, especially when there was a last-minute rush to HP to provide input for e-business questions. HP created RFP templates that have reduced these requests significantly. Equally important, because HP had internal operational experience, it knew that customers, especially global ones, need more than an “e-solution” to be successful; they need a total services solution that included human intervention. For example, HP built call centers to support the needs of customers in “low-tech” countries that did not have the infrastructure in place or skills base to either place orders directly into the network or effectively navigate use of the solution.

Enablers

HP leverages the Ariba Supplier Network to provide flexible deployment options for its customers and to allow it to concentrate on improvements in its own high-value customer services, including robust global order status, reporting, and product configuration. The Ariba Supplier Network provides the infrastructure to allow HP to adapt the level of integration provided, from completely manual or completely automated, to meet customer requirements. For example, the Ariba Supplier Network allows simultaneous support for multiple “standard” technologies, like EDI for payments and XML for orders.

Results

In addition to \$1 billion in revenue, the Ariba Supplier Network allowed HP to make its own operations more efficient and to leverage its scale. The Ariba Supplier Network enabled HP to make a single technical connection to the network and then serve all its Ariba-based customers. This capability enabled HP to readily connect its supply chain and financial systems, thus streamlining the quote-to-settlement process. The benefits to HP and its customers remain as follows:

- Shorter order lead times as orders are automatically validated, processed, and inserted into the fulfillment systems.
- Reduced order management costs owing to automation.
- Reduced “cash-to-cash” cycle time because invoice reconciliation is faster, easier, and less error prone.
- Better service because orders are released as soon as they are approved instead of being held for consolidation by the procurement organization, a process that creates “lumpy” demand.
- Improved forecasting because the customers adhere more closely to contracted terms and products.
- Tighter relationship with customers and better visibility into buying habits.

HP has worked closely with Ariba in evolving the Ariba Supplier Network to optimize the supplier interface. As a member of the Ariba Supplier Advisory Board, HP has had the opportunity to impact and provide input into product strategy and design considerations leading to an improved product.



Lessons Learned

Because HP IP was an early adopter of Ariba Buyer and Ariba Supplier Network as a customer, HP's electronic commerce group had the benefit of learning firsthand how its customers were deploying the solution, the challenges that they faced, and what would make the buying experience better. Some of the benefits were:

- Better understanding of the challenges of IT procurement in areas such as product configuration and asset management.
- Better testing of new capabilities with internal buyers before exposing customers.
- Regular training of the e-business staff within the regions, enabling them not only to learn about internal spend management capabilities but also to gain an increased understanding of their customers' needs.

Other Important Lessons Learned by HP

- IT and business team alignment is extremely important. Like IP, the e-business group that supported Ariba as a supplier evolved through several organizational structures before being incorporated into the global operations organization. This process brought the e-business group closer together with the core IT group and end-to-end supply chain and customer operations teams.
- Early on, HP recognized that the regions were heavily dependent on headquarters for customer setups as well as ongoing support. HP built tools to automate customer setups for field specialists within the countries and developed support mechanisms to drive expertise out into the countries, reducing headquarters involvement in 90% of the setup projects to single digits.
- In an effort to streamline processes and boost deployment numbers, HP examined all aspects of the customer deployment cycle.
- HP pays close attention to customers that outsourced procurement functions because the customer and outsourcing partner are not always in sync.
- To ensure that procurement functions during the customer transition process, HP discovered that it is appropriate to install parallel or even manual processes.

Aberdeen Group, Inc.

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This research study is the result of research performed by Aberdeen Group directly with Hewlett Packard and underwritten by Ariba.

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