Channels Analysis

The New HP and PC Retail in EMEA: One Brand Too Many

Abstract: The new HP has retained both HP and Compaq brands for consumer deskbound PCs in a bid to maintain market share. As the challenge of maintaining two brands becomes clearer, expect one to be discontinued.

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Strategic Planning Assumptions

- The new HP will discontinue either the Compaq Presario or the HP Pavilion PC brand for deskbound PCs in Europe, the Middle East and Africa (EMEA) by the end of 2003 (0.7 probability).
- Through 2003, the new HP's initiatives to build market share in Western Europe's consumer-PC market will focus on high-volume retail promotions (0.7 probability).

Recommendations

- Retailers stocking both the Presario and Pavilion brands should demand improved availability of both brands, and logistics support from the new HP, in return for any adjustments to retail margins.
- Retailers present in multiple countries should request preferential terms and conditions from the new HP in return for negotiating centralized contracts.
- The new HP should formalize its relationship with Medion to minimize retail overlap and so place boundaries around the market presence of this fast-expanding vendor.
- Other PC vendors should exploit the integration of HP's and Compaq's consumer-PC operations to win additional orders from retailers that currently stock both the Compaq Presario and HP Pavilion brands. These opportunities will likely be greatest during 4Q02.
Introduction

The new HP inherits a leading position in the consumer-PC market in EMEA — Compaq and HP were the third-and fourth-ranked vendors in EMEA’s consumer-PC market during 2001, with a combined market share of 15 percent.

Although sufficient to establish a five-point lead over its nearest competitor, this market share does not give the new HP more ability to influence the market. Unlike the commercial segment, where the new HP’s presence in distribution is expected to drive channel consolidation (see “The New HP’s Channel Strategy for EMEA,” HARD-WW-DP-0300), the overall impact of this new market leader on PC retailing in EMEA is likely to be minimal.

In acquiring Compaq, HP has not only gained additional market presence and better retail representation, but also taken on new challenges. The decision to continue with both the HP and the Compaq brands took many by surprise and will add much complexity to the new HP’s integration process.

The decision to retain both brands was motivated by the need to preserve market share and by differences in market coverage — Compaq’s consumer PCs were available throughout most of EMEA, but HP’s availability was restricted to only 10 countries. It is expected that both brands will be retained throughout the integration of HP’s and Compaq’s consumer-PC operations, but, once this process is complete, the life expectancy of one of the brands in retail is likely to be short.

Similar Products, Different Operations

The Compaq Presario and HP Pavilion product ranges on sale in EMEA are broadly similar. Both offer deskbound PCs based on Advanced Micro Devices (AMD) and Intel microprocessors and a limited, but growing, range of mobile PCs. The products offered under the two brands are a subset of those available in the U.S. market.

Despite this similarity, the market performances of the two brands in EMEA were very different during 2001: shipments of Compaq Presarios fell by 30 percent to approximately 957,000; shipments of HP Pavilions grew by 77 percent to approximately 678,000.

Market Presence

Of the two product lines, the Compaq Presario is the more established, and has widespread coverage across EMEA. When the HP/Compaq deal was finalized on 7 May 2002, Compaq Presarios were available across all of Western Europe, as well as in countries of Eastern Europe and the Middle East and Africa (MEA). Despite the extent of availability, shipment volumes in smaller Western European countries and most of Eastern Europe were low.

Although it was first launched in Europe in 1997, HP’s Pavilion range is still in its rollout phase across much of Western Europe. Initially offered in only the United Kingdom and France, HP began extending the availability of the Pavilion range during 1999, and has added two to three countries per year since then. By 7 May 2002, HP’s Pavilion PCs were present in 10 Western European countries, but not in Eastern Europe or MEA.

During 2001, both HP and Compaq moved to take advantage of growing demand for mobile PCs through retail: Compaq extended its Presario range, and HP introduced its first Pavilion mobile PCs in the United Kingdom and France.
Supply Chain

The supply chains for Presario and Pavilion PCs in EMEA are similar in organization, but were managed quite differently.

Manufacture of all Presario and Pavilion deskbound PCs is outsourced, mostly using a scheduled production strategy: Presarios were built by First International Computer (FIC) in the Czech Republic and by Ingram Micro Frameworks (IMF) in the Netherlands. Pavilion PCs are also built by FIC in the Czech Republic, by Tatung in the Netherlands and by Medion in Germany. Mobile PCs for both brands are supplied by Asian-based original design manufacturers (ODMs) and configured in Europe.

The retail distribution strategies of HP and Compaq were different. Compaq typically used distributors to supply most retailers, whereas HP preferred to "drop ship" PCs directly to key retail partners, avoiding intermediary distribution wherever possible. Compaq’s two-tier approach required less administration and offered more flexibility for increasing coverage with new retail partners. HP’s approach provided greater control and significantly reduced risks of building up channel inventory.

Order and production management systems were also dissimilar. HP centrally managed its Pavilion inventories with resellers and retailers on a weekly basis, using the feedback to drive production planning. Compaq, with its increased reliance on two-tier distribution, had less control of Presario sell-through and was generally more prone to inventory build-up — when the HP/Compaq deal was finalized, Presario inventories in some European countries were approaching nine weeks.

The New HP’s Retail Strategy

The new HP is organized into four line-of-business units: the Personal Systems Group (PSG), Enterprise Systems Group (ESG), Imaging and Printing Group (IPG) and HP Services. The new HP has three "go-to-market" strategies, each "hosted" by one of the above product business units — direct sales by ESG, channel sales by PSG and retail sales by IPG — with a team dedicated to managing and implementing each strategy.

Although part of IPG, the new HP’s retail team is responsible for sales and marketing of Pavilion and Presario consumer PCs, and draws on part of PSG to support this. In EMEA, the managers of both the IPG and the PSG consumer-PC team were formerly part of the HP consumer organization.

Managing, marketing and selling both brands in EMEA will require the new HP to make some decisions. Supply chain and logistical preferences have already been decided, generally in favor of the established HP practices. Deskbound-PC production will continue with FIC, Tatung and Medion, but the relationship with IMF has already been discontinued. However, many key marketing and sales questions have yet to be answered.

Brand and Coverage

The main challenge facing the new HP’s consumer-PC team in EMEA is to market and sell two parallel consumer-PC brands that were formerly direct competitors. Faced with different geographical coverage — some countries having both brands, and some only the Presario — two strategies were immediately required.
For those countries in which both PC brands are available, the new HP must seek to create meaningful differentiation between them. Without this, retailers will have no incentive to maintain both brands once unified contracts are introduced in late 2002. The new HP has yet to announce specific details of how it intends to differentiate the brands, but indications from the global PSG suggest that they will be repositioned to appeal to different types of user.

If this approach is adopted, Gartner Dataquest expects the Pavilion brand to be the mainstream product line for deskbound PCs, targeting "family" purchases. This would provide maximum leverage for the established HP brand in bundled offers that include printers and other consumer peripherals marketed by IPG. The Presario brand will most likely be positioned to appeal to more-performance-sensitive users, such as gaming enthusiasts, and to users who want custom configurations.

The strategy adopted for mobile PCs is expected to be different, with Presario providing the mainstream product line, and the Pavilion brand restricted to lower price points and retail promotions. There may be less bundling of peripherals with these product lines than with the deskbound-PC ranges. This approach would reflect the current market presence of the two brands, and be consistent with the perception of many retailers that there is less scope for bundling peripherals with mobile PCs.

In countries where only the Presario is available, the new HP has no option regarding brand repositioning. PC market conditions are not conducive to major investment, so increased coverage for the Pavilion brand cannot be expected before late 2003. For these markets, which offer smaller-volume opportunities, the retail strategy is effectively one of "maintenance."

**Business Models**

The main business model for the new HP's consumer PCs will be based on that formerly used by the HP Pavilion organization. PC production and assembly will still be outsourced, with planning based on the IPG order management system. Compaq's two-tier distribution method will be generally phased out, and HP's "drop shipping" approach adopted wherever possible.

The main business model will be used to support the standard product lines in retail stores, but the new HP will also continue to develop other channels for its consumer PCs. The new HP has already established a partnership with France Telecom to sell bundled broadband solutions, and other deals with national fixed-line operators can be expected as broadband availability increases. Employee purchase programs and special promotional offers will also be targeted, supported by the new HP's existing agreement with Medion, Europe's leading exponent of PC promotions.

The new HP's relationship with Medion is unusual because it implies an agreement of noncompetition. Medion is Europe's leading "local" assembler and has established its position through high-volume promotions with general retailers, particularly Aldi (see "Local Vendor Business Models: Focus, Opportunism and Imagination Drive Success," HARD-WW-DP-0291). Medion acts as more than an outsource manufacturer for the new HP — it is an ODM. The new HP defines the product's "look and feel" (mainly in terms of the case, price and top-level features), but leaves Medion to handle all procurement and assembly details.
Prices, Terms and Conditions
The new HP intends to adopt Internet list pricing for its consumer PCs (as with its commercial-PC operation). However, few retail agreements are organized on a Pan-European basis, so price harmonization across the region is not a strategic priority. Consumers generally buy at specific price points, so pricing is already relatively transparent.

Compaq and HP used different terms and conditions (partly because of their different distribution focus), but alignment of these is not a significant issue. Retail contracts are not ongoing, so most are negotiated on a case-by-case basis. Compaq was generally more flexible on pricing and cash discounts, but the new HP will probably be less willing to give ground when single contracts are introduced in late 2002. The new HP will also try to steer retailer margins toward fixed-sum calculations, rather than set percentages.

Gartner Dataquest Perspective
The integration of HP's and Compaq's consumer-PC operations presents significantly less challenge in EMEA than its commercial-PC operations do. The lack of long-running contractual commitments, and the highly fragmented nature of PC retailing, give the new HP much flexibility in how, when and where its business with partners is combined.

The main integration issues will be internal. This is because legal constraints in some European countries delay the formal conclusion of the Compaq acquisition, obliging the company to maintain duplicate contracts with some retail partners. Only when these contracts are combined will the deal’s full impact on retail market share become apparent.

The disparate market presence of Presario and Pavilion PCs in EMEA and Asia/Pacific was probably a key factor in the decision to maintain both consumer brands. The need to respect existing contractual commitments with suppliers and outsource manufacturers was also a consideration. However, successful maintenance of both brands requires the new HP to overcome challenges that it currently seems poorly equipped to face effectively.

In contrast to the clear messages surrounding commercial-PC product road maps, communication regarding the relative positioning of the two consumer-PC brands has been confused. Moreover, there appears to be a degree of inconsistency between the three main-volume regions (the United States, EMEA and Asia/Pacific) as to how strategy will be adopted for deskbound PCs. This indicates that the new HP’s vision of consumer-PC brand positioning is still unclear. The different relative market positions of the Pavilion and Presario brands in the three main regions are no doubt a major complicating factor in the new HP’s bid to find a single, best solution.

However, Gartner Dataquest believes that the new HP’s delay in establishing its consumer-PC brand positioning strategy will prove decisive. With shareholders expecting to see early benefits from the acquisition of Compaq, and PC operations being an area where cost-savings must be achieved, the new HP cannot afford to spend marketing funds competing with itself. But unless the Presario and Pavilion brands are clearly differentiated, and unless the differentiation is effectively communicated to the new HP’s retail partners, that will be the adverse outcome.
The relative brand positioning currently suggested for deskbound PCs — which account for most consumer-PC sales — is incomplete. Although this positioning may provide a valid basis for the new HP’s consumer-PC brand strategy, Gartner Dataquest believes that such a strategy would still leave significant overlap in its consumer offering. Any such overlap would, if sustained, result in a reduction in retail presence, and so in market share.

Furthermore, differentiation may have additional implications for the business models that stand behind the two brands. For example, a focus on performance sensitivity for the Presario brand would increase the need for custom configurations, and so steer purchases away from retail and toward the new HP’s Web site. Current consumer-purchasing behavior suggests that this would significantly reduce sales for this brand.

Despite the stated intention to retain both the Presario and Pavilion brands, time to establish and communicate a strategy is running out. Given this, Gartner Dataquest expects the new HP to review its consumer-PC strategy, and then to rationalize its consumer brand presence for deskbound PCs as the additional cost of maintaining and managing the extra production and inventory become more visible.

The Pavilion brand, which is the more successful in the U.S. market, is the more likely to survive. However, Compaq was selected for commercial-PC branding, and the brand equity this implies for Presario must be weighed in any decision. Moreover, suppressing the Presario brand in Europe before the availability of Pavilion PCs is extended would effectively signal withdrawal from some markets. Before deciding when to discontinue one of these brands, the new HP should weigh the resulting losses against the potential savings of brand rationalization.

The new HP lacks the weight to drive change into the market: it has only a 15 percent share of Europe’s highly competitive and fragmented consumer-PC segment. PC retailing in Europe is undergoing two parallel changes: from specialist retailers to general retailers, and toward low-cost promotions. Both changes are symptoms of the consumer PC’s increasing “commodity” status and will dramatically change the long-term earnings prospects of this part of the market.

Given this, and the increased scrutiny that shareholders are likely to give the new HP’s PC market performance, the relationship with Medion looks to be the new HP’s most promising competitive advantage for gaining retail market share in EMEA. Medion is top of the “threat” list for most vendors targeting Europe’s PC consumers, so HP’s strategy is effectively a nonaggression pact with a leading competitor. Perhaps "sleeping with the enemy" will be the new HP’s best option — for now.

**Key Issues**

- Which channel strategies will prove most effective for each platform and market?
- What strategies are vendors implementing to succeed in this market?