

April 6, 2004

PAGE ONE

After Landing Huge Navy Pact, EDS Finds It's In Over Its Head

Mired in Big Computer Job, Company Loses \$1.6 Billion; Jordan Tries a Turnaround

Plea for Staff to Ask for Help

By **GARY MCWILLIAMS**

Staff Reporter of THE WALL STREET JOURNAL

April 6, 2004; Page A1

PLANO, Texas -- Michael H. Jordan, chairman of **Electronic Data Systems Corp.**, was in his office when he received a call from a company consultant last November.

"You're not going to believe where I am and what I'm looking at," the consultant said.

He was inside a warehouse at a U.S. Navy base in San Diego. Towering over him were 1,500 personal computers that EDS employees had laboriously assembled. But because EDS had never installed the computers it hadn't been paid for the work. Some had been collecting dust for as long as nine months.

The giant project to set up a computer network connecting 4,000 Navy locations has turned into a quagmire for EDS, which already has lost \$1.6 billion on the assignment. The troubled project also presents a daunting challenge to Mr. Jordan, a veteran CEO, who was lured out of retirement by EDS directors a year ago to turn around the pioneering computer-services company.




Michael H. Jordan

So far, Mr. Jordan has discovered that EDS executives vastly underestimated the scope of the project, relied on incorrect information from the military and failed to coordinate their efforts. That resulted in lots of unfinished and unbilled work.

The Navy job is both EDS's biggest problem and brightest prospect. The project, the richest in the computer-outsourcing world when it was awarded in 2000, is valued at as much as \$8.8 billion in total revenue. If Mr. Jordan succeeds, his turnaround of EDS would cap a career which already includes CEO posts at Westinghouse and CBS Corp. If Mr. Jordan can't fix it, EDS executives worry he may have to consider breaking up EDS, much as he split his former company, Westinghouse Electric, into defense and media concerns. Mr. Jordan says he has no plans to break up the company.

DOW JONES REPRINTS

 This copy is for your personal, non-commercial use only. To order presentation-ready copies for distribution to your colleagues, clients or customers, use the Order Reprints tool at the bottom of any article or visit: www.djreprints.com.

- [See a sample reprint in PDF format.](#)
- [Order a reprint of this article now .](#)

FURTHER READING

- [EDS Posts Loss Amid Charges](#)¹
02/06/04
- [SEC Asks EDS About Navy Deal](#)²
05/15/03

The military hired EDS to design and install a single, hacker-proof network linking 345,000 computers at 4,000 Navy and Marine Corps locations from Norfolk, Va., east to Iceland and west to Japan. EDS, which operates computer systems for large corporations, was also to manage the computer network and provide technical support.

But EDS projects losing a further \$400 million this year on the assignment, which may last up to six more years. The U.S. Securities and Exchange Commission is investigating EDS, in part over the contract losses, as well as its past financing of a stock-option program. Credit-rating companies, including Moody's Investors Service, have cited cash drains from the Navy contract as a reason to review EDS's ratings. Moody's decision is expected this month.

EDS executives say the company's problems with the Navy are affecting how other customers perceive EDS. Sears, Roebuck & Co. and McDonald's Corp. recently dropped EDS from their short lists of vendors they were considering to manage their computer systems.

EDS was founded to do computer work for large corporations in 1962 by two-time presidential candidate H. Ross Perot, who carted early clients' computer tapes in the trunk of his car. The business expanded to writing software, networking, and advising clients on technology. In 1984, Mr. Perot sold EDS to General Motors Corp., which then spun it off 12 years later .

Four years ago, the company's then-CEO Richard H. Brown negotiated the military contract, with the hope that the megadeal would give EDS a quick boost in growth. Despite its lack of military outsourcing experience, EDS impressed the military by pledging to bring the Navy up to corporate computer standards.

The Navy contract grew in importance to EDS. Its big clients US Airways Group, AMR Corp.'s American Airlines and MCI, the former Worldcom Inc., negotiated lower payments to EDS because of their financial problems. While EDS's former parent, GM, is still its largest client, that work is shrinking. The Navy could surpass GM on EDS's client roster in a few years.

The Navy project ran into trouble almost from its start in 2000. Congress held up work for 18 months while it asked EDS for new network-performance tests. EDS was required to pass 200 technical hurdles, such as the speed at which an e-mail message could travel, says Mr. Jordan. The demands were very unlike requests from EDS's corporate clients, who focus on services such as the time it takes to respond to a call for computer help.

"This was a very difficult program, more complex than either of us thought," says Navy Secretary Gordon R. England. "We've both had some problems with the program."

According to the project design, military personnel would order customized computers from EDS. The computer-services firm would configure and install them.

But, under an unusual arrangement for EDS, the company would pay for the computers and bill the Navy after installing them. Typically, corporate clients pay EDS a monthly fee. As a result, EDS managers were under intense pressure to complete Navy computer installations.

In 2001, EDS installers, armed with new desktop computers, fanned out to bases, but they were

sometimes turned away because they lacked proper advance security clearance. Another problem: sailors and officers weren't always available because they were busy, sometimes overseas.

EDS soon discovered that the Navy had some 67,000 software programs to be transferred to the new PCs, not the 5,000 originally estimated. EDS says it didn't verify the number earlier so it had to eat the extra costs.

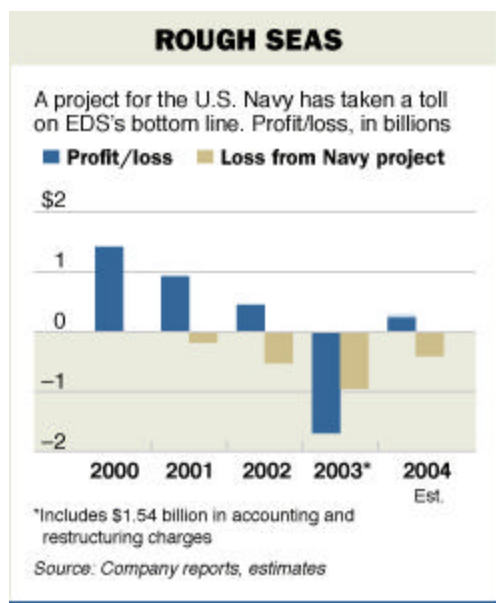
The company often had to revamp the old software before installing it on the new computers, so sailors and officers used both their old and new computers. This dramatically increased gear and technical support costs. In one case, EDS had to install two \$500,000 firewalls to provide security between old and new systems, says Vinnie Madsen, an EDS senior vice president.

Despite its problems, the Navy project wasn't the priority when Mr. Jordan arrived in late March 2003 to become EDS's third CEO in less than five years. The EDS board had ousted Mr. Brown, citing poor performance. EDS director and former PepsiCo Inc. CEO Roger Enrico, who knew Mr. Jordan, 66 years old, from their years as executives at PepsiCo, recruited him for the turnaround.

Initially, Mr. Jordan focused on EDS's finances. The company had just changed how it accounted for big contracts to comply with Financial Accounting Standards Board policy changes. As a result, it adopted stricter revenue-recognition rules and reported a loss of \$1.7 billion on \$21.5 billion in revenue last year.

The SEC began investigating EDS after the company disclosed a third-quarter 2002 earnings shortfall that sent its share price plummeting. The agency also has reviewed some customer contracts and documents related to its Navy contract.

In April, Mr. Jordan made a courtesy call to the Pentagon but says EDS wasn't then aware of the extent of the problems and that the Navy did not push for changes at the meeting. At the time, the problem with the Navy contract "was important, but quite frankly it wasn't the only fire we fought. I wish at this point, we had trooped in two to three months earlier," Mr. Jordan says now.



With little coordination among the EDS managers, some naval commanders cut side deals with individual EDS teams. At a base in New Orleans, EDS had planned to tailor a computer set-up for each of the 36 different jobs. Instead, frustrated at the slow pace of computer installations, Cmdr. David M. Wojda divided the jobs into five groups. Every employee in a group would get the same computer set-up.

He told other Navy managers of his approach, and some adopted it. Cmdr. Wojda reasoned the change wouldn't affect costs and would speed up installations.

EDS executives, however, say providing unnecessary software to all group members could increase its costs, even though the reduced variety made installations easier. While EDS can request additional compensation for the new

requests, it isn't guaranteed.

EDS managers assigned to the Navy project "kind of created our own tribe. We did everything ourselves. It was almost the mentality we didn't need help," says Mr. Madsen, the EDS senior vice president.

When Mr. Jordan quizzed EDS managers, they blamed difficult customers, he says. In a meeting with a small group of executives, Mr. Jordan noted that he had replaced 29 of 31 managers in his first year at Westinghouse. His comment stunned the room and quickly circulated through the company, say people who were there. The remark was intended to send a "signal that management was an issue," Mr. Jordan says.

By summer, Mr. Jordan says he was convinced that EDS culture was a problem. Employees looked only at their own narrow assignments and refused to seek outside help, he says. Under past EDS leadership, people on troubled contracts feared for their jobs so "people didn't want to go on a failing project," he says.

Mr. Jordan commissioned a survey of EDS employees on job responsibility. In some cases, several employees felt they were directly responsible for some jobs; in others, no one took responsibility, Mr. Jordan says.

Mr. Jordan also began recruiting executives from his past. He hired consultants from the Feld Group, a Dallas firm he had worked with at PepsiCo and CBS. To shore up executive talent, he personally persuaded EDS directors to buy the Feld firm after they questioned its hefty \$89 million price and Mr. Jordan's past ties to it.

Through the summer, computer installations increased. But by the fall, Mr. Jordan could see numbers falling again from the reports reaching his desk. Mr. Jordan dashed out an e-mail to employees urging them to look outside their units for help. "It's hard to trust others -- but that's what we've got to do," he wrote.

Mr. Jordan dispatched Feld consultant Michael Koehler to visit the big Navy base in San Diego. In a two-story warehouse by the water, Mr. Koehler saw computer boxes stacked 10- to 12-feet high. Each had a paper label with the name and location of the person for whom the computer had been ordered and customized. He grabbed one slip. It was dated February 2003. He pulled out his cellphone and called Mr. Jordan's office to report the backlog.

Armed with packing slips, Mr. Koehler followed the trail back to the original EDS workers who had prepared the computers and the military personnel who had ordered them to determine why they hadn't been installed. He made several key discoveries.

Some servicemen had ordered desktop computers and then decided they needed laptops instead. Since there were no penalties for changing, they never canceled their original orders, and EDS prepared two computers for one person, at EDS's expense.

EDS's order-processing systems couldn't complete an order without a serviceman's rank. EDS, however, hadn't told the Navy to provide rank. Incomplete orders resulted in boxed computers sitting in the warehouse, Mr. Koehler says.

EDS President Jeffrey M. Heller, 64, who still looks every bit the Marine Corps pilot he once was, took these findings to the Navy office, which oversees the project. It agreed to manage the computer installation schedule instead of allowing the bases to set the schedules.

Early last December, at a board meeting, EDS directors quizzed EDS's executives about their projected cash expenditures for the Navy project for 2004, Mr. Heller says. The board wasn't happy with the broad range of spending estimates for the project.

Mr. Heller hurriedly sought a meeting with the Navy head of procurement. He told the Navy that EDS had to slow the computer installations while it came up with a less costly approach to finishing the job.

The Navy was indignant at the prospect of the installations dragging on for another two years, says Mr. Koehler, who attended the meetings. Still, Mr. Heller insisted EDS had to make changes. In a separate, private meeting with John J. Young Jr., an assistant secretary of the Navy in charge of procurement, Mr. Heller explained that EDS needed a less costly approach to avoid falling short of the cash-flow targets management had promised Wall Street, he says.

"We do have a way ahead. I believe the way ahead is good for the Navy and good for EDS," says Navy Secretary England.

EDS now plans to install computers at the biggest Navy bases first, instead of trying to cover many bases simultaneously. It is reusing expensive hardware such as network firewalls. It has stopped individually customizing computers. Instead, it is providing the same computer setup to servicemen with similar jobs. And it plans to install computers from the warehouse before ordering new ones.

While waiting for the Navy to sign off on these new terms, EDS began implementing some of them in January anyway. "I made it very clear what we were doing. I didn't ask," Mr. Heller recalls.

Mr. Jordan says EDS can turn around the contract and reverse the cash drains by mid-2005. Once the Navy's secure network is in place, EDS says it hopes to bid for future contracts to provide the Navy with other services.

URL for this article:

<http://online.wsj.com/article/0,,SB108120038471074645,00.html>

Hyperlinks in this Article:

(1) <http://online.wsj.com/article/0,,SB107593245296720893,00.html>

(2) <http://online.wsj.com/article/0,,SB105301832612258700,00.html>

Copyright 2004 Dow Jones & Company, Inc. All Rights Reserved

This copy is for your personal, non-commercial use only. Distribution and use of this material are governed by our [Subscriber Agreement](#) and by copyright law. For non-personal use or to order multiple copies, please contact Dow Jones Reprints at 1-800-843-0008 or visit www.djreprints.com.