

Explaining Dell's Success from a Strategic Management Perspective

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Dell Computer is arguably the most successful business among those established within the last twenty years (Microsoft just misses qualifying under this timeframe). As I have stated recently in different venues, I believe that this company provides a classic example of how the principles of strategic management have been used to translate an innovative vision into a successful and sustainable enterprise.

Dell Computer has also realized tremendous benefits from its application of information technology. IT has been used not only to create competitive advantages at the operational level, but also to introduce an unprecedented type of strategic information management. As a result, I am pleased to accept the invitation from the Stockholm School of Economics to review the success of Dell Computer, and to explain it from a strategic management perspective.

Michael Dell founded Dell Computer in 1984. At the time he was only 19 years old, and in his first year of studies at the University of Texas in Austin. Michael Dell had a simple but powerful vision: that personal computers could be built to order and sold directly to customers. This followed from his belief that the PC, made up of little more than software from Microsoft and chips from Intel, was rapidly becoming a commodity product.

Dell's new approach to the PC business had two advantages: (1) bypassing distributors and retail dealers reduced marketing and sales costs by eliminating the markups of resellers, and (2) building to order greatly reduced the costs and risks associated with carrying large volumes of both and finished goods.

Michael Dell started his company with only US\$ 1,000 of capital. Dell Computer experienced its share of difficulties in the first few years, to the point where some family members and friends wondered whether it had been wise for Michael to drop out of university. Several times it had to refine its strategy even as it was implementing it. The company started off by using the direct sales model for upgraded versions of IBM-compatible PCs. However, within a year it was selling its own brands of PCs. Most of Dell's customers in the 1980s were hobbyists and experienced PC consumers.

By 1990, Dell had captured a significant share of the corporate PC market. The direct sales model was particularly appealing to IS/MIS departments in large organizations that rarely needed the various services provided by corporate resellers. In the early 1990s, Dell briefly augmented its direct sales by using a retail channel for marketing and distribution, but this was abandoned after a business downturn.

Despite its evolution (with some trials and errors) over the years, Dell has faced the constant challenge of creating and continuously upgrading of a world-class

manufacturing infrastructure while simultaneously developing a good reputation in the marketplace against bigger and better-known rivals.

Significantly though, Dell did not have to compete directly against the more established PC manufacturers. They continued to concentrate on product design and after-sales service even as Dell's energy went into providing an affordable product and reliable delivery. Both of these goals would be achieved by cutting out the intermediaries between the manufacturer and the consumer. Initially, Dell's direct from the factory approach relied on telephone sales.

With the emergence of the Internet, Dell Computer could extend the reach and scope of the direct sales model at a relatively low marginal cost. The company was ideally positioned to take advantage of the Internet because of its distinctive supply chain. Unlike its major rivals, Dell did not face any channel conflict with resellers or distributors by going online. Moreover, with a build-to-order manufacturing process already in place, customers could easily configure their own products online, just like they were already doing over the telephone.

Not surprisingly, Dell Computer was an early and enthusiastic convert to the Internet. It gained a first-mover advantage by setting up its first Web site in 1994, a year in which its total revenues were US\$ 3.5 billion. By 1998, its Internet sales accounted for more than half of the firm's total revenues, which by then had surged to more than US\$ 20 billion. At that point, Michael Dell had joined Bill Gates of Microsoft and Larry Ellison of Oracle among those who had become high-technology billionaires after dropping out of university. (Despite their success, I would encourage business students to complete their studies.)

Dell's build-to-order and sell-direct approach attracted growing numbers of customers, not only in the United States, but all over the world. As envisioned by Michael Dell, the supply chain compression resulting from the direct-to-customer model gave his company a substantial unit cost advantage over everyone else. With an inventory turnover rate of about 60 times per year, Dell has minimized the rapid depreciation and inventory write-off costs that have chronically plagued the PC industry. It has also greatly reduced its working capital requirements by operating on negative cash conversion cycle - receiving payment from its customers *before* it pays its suppliers for components.

Many of the major players in the PC industry have continued to manufacture their products in bulk and keep their distributors and retailers stocked with ample inventories. As a result, Dell has sustained a comparative advantage as a result of its lower overhead costs. For example, Dell's overhead costs (selling, general and administrative expenses) in both 1999 and 2000 were less than 10% of its total revenues versus industry norms of 15-17 percent.

The direct sales model also enables closer customer integration. Dell has built strong and stable relationships with both the large corporations and smaller enterprises that are its core customers. Unlike its rivals, who depend on indirect sales, Dell possesses a great deal of information about its customers. By logging all of its interactions with customers, Dell knows their purchasing behaviour, demand patterns, and satisfaction levels. With a little bit of data

mining, Dell managers can determine how customers buy computers, what motivates different types of buyers, and thereby accurately forecast demand in various market segments.

Dell also collects timely information about the performance of its products. This enables it to respond quickly to emerging problems and, in some cases, avoid costly refunds and service calls. For example, Dell responded rapidly when Intel shipped faulty Pentium chips to PC makers in the mid 1990s. Dell knew exactly where the problem chips were and could easily help customers to replace them. Most of its rivals did not have this capability. They had to stop their production and ask their channel partners to find the problem chips that had already been sold or distributed. Dell's quick and efficient response attracted many new customers. These customers were able to receive timely shipments of PCs with faultless chips from Dell's just-in-time inventory model.

More generally, Dell Computer knows who each end user is, what equipment they have bought, where it was shipped, and how much the customer has spent. This information helps Dell to provide high levels of customised service; to offer complementary products and services; to coordinate maintenance and technical support; and even to forecast (if not encourage) PC replacements and upgrades. Some of its corporate customers have even outsourced their entire range of PC inventory activities, from purchase to disposition, to Dell.

In 2001, Dell Computer was the PC market leader in the United States, with a nearly 18 percent share, about three percent ahead of second-place Compaq. Gateway was third with 9 percent, followed by Hewlett-Packard with 8 percent and IBM with 7 percent. Dell overtook Compaq as the U.S. sales leader in the third quarter of 1999 after moving past IBM into second place during 1998.

Remarkably, Dell has been able to replicate its direct sales approach in dozens of other countries. During 2001, Dell Computer was almost equal with Compaq in terms of global PC sales (each had about 12 percent of the market). IBM ranks third worldwide, with an 8 percent share that has steadily declined over the last few years. Since 1995, Dell had been gaining market share quickly in all of the world's markets, growing about three times the 16% average annual rate of global PC sales.

Dell's sales at its website (www.dell.com) surpassed \$50 million a day in early 2002, up from \$5 million daily in early 1998 and \$25 million daily in early 2000. In its fiscal year ending January 31, 2002, Dell Computer posted revenues of over \$31 billion, up from \$ 3 billion in 1994 -- a compound average growth rate of about 50 percent. Over the same time period, profits were up from \$150 million to \$2 billion-a 65 percent compound average growth rate.

Since its initial public offering of common stock in June 1988 at \$8.50 per share, the company has seen its stock price split seven times and increase 40,000 percent! Dell Computer was one of the top ten best-performing stocks on the NYSE and the NASDAQ during the 1990s. In recent years, Dell's annual return on invested capital had exceeded 150 percent. However, it has been hit hard by an overall slowdown in PC sales that begin in the second half of 2000. The

result has been a sharp fall in Dell's stock price and a reminder that Dell is not immune to the cyclical demand and brutal price competition that has characterized the PC industry since the 1980s.

Michael Dell believes that his biggest challenge now is to have his company's direct business model as widely accepted outside the United States as it is across Dell's home market. He sees a need for aggressive marketing activities to develop customer trust and some modification of the basic model to account for institutional weaknesses and cultural differences in places like China and India.

Another challenge is to find enough talented people to help the company capitalise on the opportunities available in overseas markets. Dell was active in recruiting foreign nationals graduating from U.S. business schools. Most of those who joined Dell were sent to Austin, Texas, for a couple of years to learn about Dell and its business model and to work in various parts of the company's operations. They were then given assignments to help in Dell's global expansion effort. Michael Dell believed that he needed the expertise of foreigners who not only knew his company from the inside out but also understand different cultures and could respond in a sensitive manner to local customs and behaviors.

Michael Dell does not seem to be particularly concerned about the efforts of competitors to duplicate his build-to-order business model: He is quoted as saying "The competition started copying us seven years ago. That's when we were a \$1 billion business. Now we're doing \$35 billion a year. And they haven't made much progress to be honest with you. The learning curve for them is difficult. It's like going from baseball to soccer...We're more challenged by new technologies on the market, some new computing model, something we haven't anticipated." It seems that even Michael Dell is worried more about potential substitutes (the hardest of Michael Porter's five forces to analyse) than his current rivals.

Michael Dell's near term goal is for the company to reach \$50 billion in annual sales by 2005. This is to be achieved using a three-pronged strategy: 1) growing the overall U.S. market and aggressively taking share in the consumer and small business segments, 2) increasing Dell's revenues beyond the United States by stepping up its efforts in Eastern Europe, Latin America, China and India, and 3) selling more powerful and more expensive servers to corporate customers.

Dell is also laying a solid foundation for the longer term. Its ability to combine a focus on the customer with just-in-time mass customization has been the key to its business success. Although Dell has no plans to give up its control of the relationship with the end user, it is relying increasingly on supply chain partners to provide many of the capabilities need to build, distribute and support its PCs. Although Dell has outsourced most of its components, pre-assembly, and logistics, it has continued to develop its core competency in final assembly and its superior ability to manage the overall supply chain. These leading-edge capabilities are partly the result of the millions of dollars that the company

spends annually on research and development. Its aim of providing the best value-for-money IT products is reflected in a strong commitment to both product and process innovation.

Dell also appears well positioned to extend its brand name beyond mainstream computer products by leveraging its reputation as an e-commerce leader. In the year 2000, Dell began to redefine itself as the company that "knows how E works". It has shared its online sales expertise with a few large customers as they developed their own e-commerce capabilities.

More recently, Dell has prepared a plan to aggressively enter the computer services business. The first part of this plan is to be implemented by the end of 2002. Other forms of concentric diversification can be expected to emerge as part of Dell's corporate strategy. Although the company is trying to develop a business network that can offer a wide range of software and service capabilities, it will be interesting to see whether it retains its primary concentration on computer hardware.

Michael Dell is spending a lot of his time these days thinking about Asia. He recognizes that the large developing economies in Asia (such as China, India and Indonesia) offer the greatest IT market potential in the 21st century. Remarkably, Dell has acknowledged that he fears (and presumably respects) the Legend Group in China more than any other current or potential rival.

Dell would like to make his company the market leader in many of the most attractive IT segments in the world's major developing economies. With this long-term goal in mind, he must evaluate the alternative ways that his company could compete against Legend in China and a number of significant rivals, both domestic and foreign, in countries like India and Indonesia.

While we watch these and other rivalries emerge, it is useful to sharpen our own strategic thinking, and contemplate the strategies that Dell could and should use as it seeks to sustain its remarkable business success.