



Michael Dell Remarks Harvard Business School

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MODERATOR: We've got about 140 of the members of the Harvard Business School class of 2004 here, and on their behalf I want to welcome today's guest and thank you for spending time with us this morning. During the past week we spent some time studying Dell's strategy and looking especially at the efforts of Dell's competitors to cope with Dell's success. We've been struck by how difficult it is for the competitors to mount an effective response to what Dell has done. And we've got lots of questions for you, but I wanted to give you a chance upfront to say a few words about your thoughts about why has it been so hard for competitors to respond effectively to Dell.

MICHAEL DELL: There are a number of possible reasons for this. Some of the things that come to mind first are the fact that we established our business with a whole different value chain, a whole different basis to our competitors. We focused on the end customer as opposed to the dealer. And we actually focused on customers as opposed to products.

What I mean by that is if you look at the organizations of technology companies from their origin, basically they originated from engineers who believed that the products were almighty and that really we have this wonderful product and if you're lucky enough to buy one, we'll sell it to you.

That changed in the '80s and '90s as the customer and standards played a much bigger role and I think these companies fundamentally had a case of mistaken identity in terms of who the real customer was, and it was very, very hard to change their whole business models.

We're not designing our eighth generation of servers. I forgot what generation we're on, on desktops and notebooks, but it's probably 20 or 25 or something like that. The point of that is that as you go through those generations, there's a massive amount of learning that comes from the input and relationships we have with our customers.

Another factor is that our competitors have for many, many cycles either not really understood what we were doing or underestimated the impact of it. If you go back in time, you can see countless examples of competitors trying to either explain or rationalize why what Dell was doing would not succeed in one form or another, one market, one type of customer, one type of product, one type of technology, only to be disappointed that their hopes and wishes didn't come to pass.

And I think there also are cultural elements here, because the factors I mentioned earlier wouldn't necessarily be enough to explain the whole thing. I think our culture plays a big role in the difference in our success versus other companies.



And there are some unique aspects of the culture. One is that we are not an amalgamation of other companies. The company was created in an organic sense and has very clear focus and very clear values and direction and with regard to customers and what we're trying to accomplish. That certainly makes our jobs a lot more straightforward.

MODERATOR: Michael, we've got lots of questions from students here and the questions tend to fall into three categories, questions about Dell's past and the competitors' past, which you've started discussing already; questions about Dell's present and questions about Dell's future. Let's start with Dell's past.

QUESTION: In light of the barriers you've just mentioned, if you had been the CEO of HP or IBM in 1996, how would you have responded to the threat that Dell presented?

MICHAEL DELL: By 1996 we were already a pretty substantial company. Certainly in the United States we were coming up on the No. 1 position, I think by '97 we had captured No. 1 in the United States market. And by far and away we were the most profitable company in this sector in personal computers. We hadn't yet achieved that in servers.

It's an interesting question. I think IBM certainly fared better than Compaq did in terms of the competitive balance, but IBM's small computer systems business doesn't make any money. They fared better because they had other businesses that they've been able to transition customers to and rely on as a source of profit.

What might they have done? Well, they might have tried to abandon their old methods and it's not often you'll see examples of companies who have made dramatic transitions from one distribution channel to another.

I think also the underlying problem, if you look at the cost structures of an IBM or an HP, they're just massively different than Dell. It's a bit like Saks 5th Avenue trying to compete with Wal-Mart; it just doesn't work.

There are areas they can go where there's higher ground and that's what IBM has done with services. And their positioning in computer systems is more of a defensive measure than an area of growth and profit. So I would say their strategy has been probably the best, even though it hasn't worked that well in competing with us.

I think Compaq made a massive error in the positioning of the company by essentially creating a huge price umbrella in servers and subsidizing losses in desktops and notebooks.

And what should they have done? Well, they should have done everything possible to ensure that they were earning a profit in desktops and notebooks, cutting the channel, doing whatever they had to do in



terms of customer relationships. They had a great position but I think they relied on this subsidization strategy for too long and when you do that you just leave yourself incredibly vulnerable. In fact, in 1996 we had about 2 percent of the server market and now we have No. 1 share in the U.S. in servers. And when the profit pool of the server market collapsed, a ton of market share came along with it for us in desktops and notebooks because Compaq could no longer under-price their desktops and notebooks because they didn't have that profit from the server.

We're seeing the very same thing begin to play out now in printing with HP, so I think there is a perfect analogy to what happened in the server market in the mid '90s with the imaging and printing market today, along with all of the nay saying that it won't work for us or we don't have the technology. Go back to the mid-90s and you heard the same arguments about our entry into the server business.

QUESTION: Was your attack on the computer industry a carefully constructed intentional plan or was it more of a series of discrete, small decisions you made over time?

MICHAEL DELL: This business is a pretty dynamic one. I would say that the strategy and the tactics get mixed together. We certainly did not have a master plan that we could look out and say here we've got it all figured out, we're just going to execute to this.

It's a dynamically evolving plan where we looked at the situation and the opportunities, how we were executing, what our organization could digest at any given time in terms of new challenges and new markets to conquer. Sometimes we had to pull back from things because we weren't making enough progress on all the fronts that we had started. But by no means was there a master plan that we plotted out.

I was actually tremendously surprised for a very, very long time, for over ten years, that our competitors did not come and try to do what we were doing. I remember in 1987 being absolutely terrified that IBM was going to try to do what we were doing and they had more technology, they had more money. We were just a little, tiny company. But they didn't do that. And actually when they did do it, they didn't really understand what we were doing. They thought we were taking orders on the phone and selling things, which is a very simplistic understanding of what our company does.

QUESTION: What do you think were your most important decisions that really solidified your future growth?

MICHAEL DELL: When we started the company, fairly early on we concluded that we needed to go after large business customers. And I think that was quite important because it broadened the brand and the appeal of the company to a much broader context and set the stage for us to expand into adjacent markets like servers and storage and services.

We made the decision very early on to expand outside the United States, which is a big part of our growth and if you want to serve global companies you have to do that.



We made a bad decision to go into the retail market and when we pulled back from that it was an amazing, galvanizing event in terms of the company's strategy and focus. That was key for us.

Our entrance into the server market was absolutely pivotal in terms of broadening the company, as was our embrace of the Internet early on. We were really the first computer company to have a Web site. It sounds strange now because everybody has a Web site. It was a totally foreign idea at the time, but we saw that the Internet would be an incredible way to work with our customers and we jumped all over it.

QUESTION: What's the error you made that you regret the most?

MICHAEL DELL: We've made a lot of mistakes. I think one mistake was that we were so focused on the business market that we let Gateway develop and do very well in the consumer market. That's not a problem right now, because I think we have that one under control, but I think that was a mistake that we made.

Another mistake was in the software and peripheral business. There are some companies that are thriving in that area. We're also thriving in that area, but we probably could have started that a bit earlier and we'd be a bit larger.

You have to be realistic, though, about how many things you could realistically execute. I don't really know if we could have, but I certainly look at that as a missed opportunity.

QUESTION: As the industry leader, do many companies, many of your competitors, look to you for strategic direction and try to learn from your model of success? And clearly many of your competitors have tried to copy and have failed at copying certain parts of your business model. Whose success models do you learn from and where do you look for inspiration or expression, whether it be inside or outside your industry, past or present?

MICHAEL DELL: We try to learn from everywhere, everyone we can. We probably learn the most from our customers, as simple as that sounds, but it works extremely well for us. So we spend a lot of time with customers of all types and sizes to understand what their needs are, how we can serve them better. We ask a lot of questions. We're very curious.

We have a process inside Dell called Best of Breed and we actually find that when we go to other companies, like GE or Wal-Mart, we're comparing notes on how do you do things and what can we learn from each other.

But we actually find we learn just as much, if not more, when we compare our own operations around the world. Take an activity like sales or technical support or manufacturing and you compare seven or eight or 20 different facilities around the world who are all using the same metrics and all trying to



accomplish the same thing. And what you find is that Japan figures out a really great way to get more customers to buy online or the folks in Singapore have come up with a great way to solve problems more effectively on the phone the very first time the customer calls. Or the folks in Ireland have figured out how to optimize their manufacturing process and drive inventories down and improve the refresh of materials. We learn a lot from having many different versions of the same model at play in different markets and rapidly comparing those.

And also we set big targets for ourselves in terms of productivity improvement, stretch goals for improving the customer experience. We have a business process improvement initiative inside the company where literally any employee can get involved in improving things. And we make heroes out of the people that save money for our customers. At some technology companies you're a hero if you invent something that no one wants to buy. At Dell you're a hero if you save the customer money.

It's a relentless focus on improving everything there is. We learn from our customers, we learn from our own experience and we just keep setting the bar higher. We believe it's better to set the bar really, really high and almost get there or miss, than set it low and just jump right over it.

QUESTION: What process at Dell overall do you use to explore strategic options, for example, going into digital jukebox or introducing a service like the Dell home system across the Internet? And the second part of the question is within that process, how do you take into account and then actually test the impact of those strategic options you have on all the functions in your business, from marketing to manufacturing, to ensure that you're able to maintain an integrated coherence within the entire company?

MICHAEL DELL: We tend to follow the profit, that's just the basic instinct of the company. And sometimes you can create new sources of profit through efficiencies in the business. So we study the profit pools in the industry and how customer spending patterns are changing and how our process can introduce new profit opportunities for us.

We have a phase review process that any new product or service goes through that essentially is a all encompassing process that looks at the design, the supply base, the manufacturing, distribution, logistics, sales, service to understand and comprehend the whole lifecycle of activities involved in introducing new products. And, of course, we have P&Ls not only by the customer but we also have product P&Ls and service P&Ls, so we can go back and measure how we are doing.

We're relentless data junkies. I get a report every day at about 3:30 in the morning that tells me exactly what we sold by country, by customer, by product, margin, revenues, year-over-year, quarter-over-quarter, to plan, et cetera, so we know how we're doing on any given product.

And, of course, we divide and conquer. We have teams that are very focused on how are we going to sell millions and millions of printers and how are we going to sell the services for printers and the



cartridges for printers and the paper for printers, how are we going to open up new markets for printers, photo printers or color laser printers or all sorts of expansion in those areas.

When it comes to these teams, I would say there's a mixture of Dell knowledge in terms of how our process works and then some domain knowledge on that particular product or service, which sometimes is coming from outside the company, sometimes we're developing inside the company.

QUESTION: Do you use any calendar driven process where at a specific time of year you force the company to review where you are, where the opportunities are, if there are forks in the road? It sounds more like you just go through a dynamic process as things develop within the company, a grassroots effort to look and explore those options.

MICHAEL DELL: We have a regular calendar of operations reviews and product reviews. But we don't necessarily delay things so that they fit into the cycle either. If we see a new opportunity, well, we'll get together and we'll make a decision and we'll go for it.

We have a meeting about every six weeks where we evaluate new technologies, new opportunities, things that aren't on the product plan in the next 18 months. We usually look at about three or four of them and it takes about four hours to go through these. Invariably, with maybe one or two of them we'll say, all right, this looks pretty interesting, go off and investigate it some more and come back with a plan on how you would turn this into a real product.

With others we might say, well, this just isn't ready, the market's not big enough, or it's going to be too hard to sell, or the technology is not mature enough. Or it may be great information but we're not going to do that now because we're too busy doing other things.

There's a regular roadmap or radar screen of things that we're looking at, new markets that we would enter and small teams that look at these things all the time to see what are we going to do next.

QUESTION: You alluded earlier to how by the time Compaq and IBM were starting to react to the Dell model it was too late. What does Dell have as far as processes or procedures in place to identify emerging threats that could be competitive or disruptive?

MICHAEL DELL: We relentlessly look at our whole business in terms of what's the growth rate relative to the market, are we gaining share, are we losing share, are we growing our profit at the right rate, what new emerging competitors are out there, whether it's Legend or Medion or Acer. What they are doing, how are they doing it, why are we doing it, what works, what can we learn from there. And so we try to understand these things as rapidly as possible and incorporate any of the ideas that might be out there from others. Our belief is that these things are going to happen and we'd rather do them to ourselves before somebody else does them to us.



If you look at our operating cost structure, it's well below the average of the industry and we keep driving it down. And we think about your question all the time. What could come along that's better than what we do that could displace us or cause us big problems and how do we get better than that so that that doesn't happen? And that defines how you stay ahead in a business. So far we've done pretty well at that, but we worry about it all the time. There is no question that that's the challenge.

QUESTION: What would you see today as the greatest threats to Dell's competitive advantage and does the tightly integrated nature of your strategy give you the flexibility you need to address that?

MICHAEL DELL: There are any number of potential threats. There are competitors who either don't really have a profit motive or have profit pools that they're using to subsidize losses in the computer industry. And those kinds of threats have always been there.

I happen to like our position. I don't think that having a really high gross margin is a great measure of safety in the computer industry. It might be if you have a killer ingredient, like a Microsoft or perhaps an Intel, but for systems companies and others in a similar vein, the history of companies with high gross margins and proprietary ingredients in technology is not a particularly promising one.

And so our method of operation has probably the best chance for long-term survival and being able to thrive in this market, but we've got to watch out for subsidization, we've got to watch out for competitors with much, much lower profit motives. New technologies are always a risk. Things can come along and change the nature of the business and change the nature of demand. There's a risk that the capability of these machines keeps running way, way past what customers need. Prices keep coming down. That also causes massive growth in the emerging market, which is not all bad. And to the extent the prices come down, it opens up the enterprise market to us and wreaks havoc for competitors at the high end.

We have \$11 billion in cash, maybe a little more, and great customer relationships. If you assume that in the \$800 billion market for IT products and services somebody actually has to sell this stuff to the user, and whoever can deliver that with the greatest value and the highest level of service is likely to have a pretty good business. Well, that sounds like us.

I think we're very well positioned, given the threats that are out there, but we're very motivated by fear, our own fear, and we think about those kinds of things all the time.

QUESTION: Can you envision any changes in market circumstances that could theoretically undermine the superiority of the direct sales model, say in the next ten years?

MICHAEL DELL: All kinds of things could go wrong. We could fail to execute. We could expand too fast into new markets. We could have technology ingredients cause us trouble. We could have competitors have greater success with their subsidization pools. You could have competitors emerge in China and India who don't care about making any profit, have low costs and destroy the market in an



economic sense. A lot of things could go wrong. People talk about the networked computer or other new technologies emerging. You could have more value in the pipe as opposed to the device. We understand all those threats. I don't think any of them are particularly high likelihood but they're all possibilities. Do you have any others you had in mind? (Laughter)

QUESTION: It's a two-part question about sharing information and allowing a competitor to gain insight into the processes and culture of Dell. Are you at all worried about giving away too many secrets?

MICHAEL DELL: I think we have made it a bit easier by explaining what we're doing but we've also made it easier to understand how we deliver value to customers, which illustrates the fact that we're the low cost producer and that attracts more customers to us and so we're able to sell a lot more products that way, too.

I think the evidence so far is that our competitors have just not been able to close that gap. There have been countless stories written, there have been books written, there have been case studies, there have been plenty of employees that have left here, gone to other companies. It just hasn't happened. It may all of a sudden start happening but so far that hasn't been a problem. There's another factor here and that is that we are a moving target. We're not going to tell you our most secret new things that we did two or three years ago. We share basic concepts and ideas, but to be honest I don't think these are things that people couldn't figure out on their own just by looking at our financial statements and listening to analyst calls and talking to smart people who are associated with the company in one way or another.

As far as the deep information on how our processes work, there's still a fair bit that's not totally well known. There's an example of this out there right now. There are analysts on Wall Street who are speculating that our profits in notebook computers are quite a bit lower than they actually are and they have their model of how we make notebook computers and they come up with their own profit estimates. We know they're wrong and we know what the facts are. And they don't totally understand what's going on and we don't necessarily feel compelled to explain all of the details of how we create value for customers.

QUESTION: (Off mike).

MICHAEL DELL: We're actually a little bit ahead of that \$60 billion plan. And if you think about any new product that we are introducing in the last year or will introduce in the next year or two, those products really won't have much of an impact at all on the \$60 billion. They'll have an impact three, four, five years out from now and ten years out from now, because the company is too large to for introductions to make an immediate impact. The vast majority of our growth will come from the product lines we're already in and you can see that in the most current results.



Some people remark about our move into consumer electronics. Probably a better way to describe it is the role of the PC is changing in the home. It's expanding. As you have a digital home, you have digital music, digital pictures, digital video, digital televisions and customers want these things to work together much more effectively than they have in the past. And so that not only provides an opportunity for the PC to be the center of that digital home, but for Dell also to sell all the other devices that go along with that PC. That's actually very different than saying we're going into the consumer electronics business, so we're expanding the role of the PC.

I should point out that the consumer market is about 15 percent of our revenues, growing very fast, but most of our business will continue to be businesses, institutions, governments and larger entities. But there are vast opportunities for us as the digital home comes into this standards orientation. We have huge scale with flat panel devices. And I think the PC has a pretty good shot at being the center of the entertainment experience.

QUESTION: If your model hadn't succeeded, what would you be doing today? (Off mike).

MICHAEL DELL: I didn't have the educational credentials that you all have or are about to have, so I'm not sure I would have been hired by Mackenzie. I was a biology major at the University of Texas, and I probably would have stayed in school and become a doctor. But it's not nearly as exciting a business and the failure rate is much higher.

QUESTION: Looking at today's competitive landscape and thinking about your new positioning going into printers and more consumer products, I was wondering how do you assess the threat of the HP-Compaq merger? Do you view that as a credible threat, given the fact that they are in a bundled PC, printer and services model?

MICHAEL DELL: You have to view it as a threat. Certainly, if you look in the last three years, our market share basically went up by about 50 percent, where HP and Compaq's went down. But now they've gotten through the merger and they're settled down and as far as the organization goes still not really making any money, certainly not more than the cost of capital bouncing up and down.

This is a company that's had about \$12 billion of non-recurring charges that just seem to just keep recurring. (Laughter.) In fact, it's interesting to think about these non-recurring charges because as far as I know, before 1980 there really was no such thing as a non-recurring charge. Now, every quarter they have these non-recurring recurring charges. It's the darnedest thing. I don't understand it. (Laughter.) But if you look at the cash flows, you see a very different story in terms of what the real results are.

You could justify the acquisition of Compaq simply on the basis of selling ink, which is really where HP makes all of its profits, where I think they're most vulnerable. They're clearly going to fight very, very hard and so it's going to be an interesting few years. I think ultimately it's going to be very hard to protect the ink franchise from disruption of new technology, new business models. There's a lot of



work going on in labs all across the U.S. and Japan and Asia in creating new forms of inkjet technology that are better and faster. And, of course, just about all those providers of technology see Dell as a perfect way to get that technology to the customers. They've got a fantastic ink subsidy, but long-term I think it will be very, very hard to have that hold up.

QUESTION: If I were you, I would probably retire and spend time with family and friends. Why are you staying on? What drives you to execute the mission?

MICHAEL DELL: I'm having a great time, it's a lot of fun. I take time off and I go on vacation with my family. I love both work and I love playing. But you can get bored sitting on a beach for weeks and weeks at a time. This is a fascinating business. When I think about the potential that our company has, this is a young company that will be 20-years old in a few months. We have enormous potential to keep growing. It provides lots of learning opportunity for me and it's fun to see how so many people, so many communities are affected in a positive way by what we're doing here. I love my job and I'm not giving it up. (Laughter.)

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