

February 11, 2003

\$60 Billion Dollar Question: How to Fill the Strategic-Planning Gap

Dell Computer Corporation, founded by Michael Dell in 1984, is a direct provider of desktop, notebook and other business computing products and it would like to double its revenue from \$31.88 billion to \$60 billion over the next five years. Dell needs to establish a Strategic Marketing Plan (SMP) in order to achieve such growth because baseline sales alone will not, in all likelihood, reach \$60 billion by 2007. Dell can use three types of growth to fill its strategic-planning gap: Intensive, Integrative and Diversification. These three sources of potential growth make up the difference from Dell's baseline sales and its target sales. The following analysis will attempt to estimate the different types of growth available to Dell and the target markets from which that growth will come from.

A SMP, which attempts to define target markets, assists a company in developing products desired by the marketplace. The marketing concept prescribes an approach in which companies must know the customers' needs, wants and desires in order to be effective in offering the most beneficial products to each market segment. In the past, Dell's SMP has been to target markets that have an established demand for a specific product with low cost, high quality products:

The Dell Direct Model was the engine of Dell's success. Easy to describe, but difficult to duplicate, the Dell Direct model was about low cost, direct customer relationships and virtual integration. It was a high velocity, efficient distribution system characterized by build-to-order

manufacturing, and products and services targeted at specific market segments.¹

If Dell were to continue to pursue this model without modifying its SMP, sales growth would be stagnant because the company would not be meeting the ever-changing demands of the customer. Dell's five-year baseline growth, which is outlined in Appendix A, is estimated at \$16.46 billion, which leaves a strategic-planning gap of nearly \$12 billion.

Intensive growth, which maintains the current SMP while intensifying efforts, holds a lot of promise for Dell and its revenue growth goal. While the PC market in the United States is, by many accounts, saturated,² the international market is loaded with billions of potential customers who have not yet experienced the benefits that PCs can bring to small businesses or to their personal lives. This market has room for expansion in PCs, Workstations, Servers and Storage. Therefore, Dell can grow through intensification of its efforts in the international market and, if it can execute its low cost, high quality direct model, it seems probable that it will soon come to dominate the international market:

As we look at the international markets, we need to consider the markets that are key to unlocking the region: Germany in Europe, China in Asia, and Brazil in South America. We need to look at these markets, understand how they work, and set our direct model to work.³

When Dell states that it must understand how foreign markets work, it is referring to the market research that it must do in each market in order to offer effective, desirable and cost-efficient solutions to its target customers. For instance, due to crowded living conditions, the urban Chinese market may require a compact PC whereas the German

¹ Dell—New Horizons, pg. 5

² Dell—New Horizons, pg. 2

³ Dell—New Horizons, pg. 17

market, due to a high level of technological competency, may demand a high-performance PC with only the highest-quality components. In either case, Dell must determine what each target market within each region requires and then it must fill that want with an appropriate product. A high foreign PC revenue growth rate will only come about with an increase in intensity, which includes targeting markets with market-specific products, more advertising and increased local, on-site support.

As Kevin Rollins puts it, Dell needs to be relevant in the international markets:

What we've seen in the international markets is that if you can get to the number one or number two in the market, you can grow at a much faster rate than the rest of the pack. It is a question of relevance. If you are relevant in the market, you can get the growth you need.⁴

Unfortunately for Dell, it is not number one or two in any of its target international markets of W. Europe, Asia/Pacific, Japan and Latin America. In W. Europe, Dell is a close number three to Fujitsu Siemens,⁵ which suggests that it may be able to overtake the number two position in a short period of time. While Dell is not currently meeting its international goals, it has huge resources to advertise and build up brand strength and relevance in foreign markets. This suggests that it will be able to battle competitors for market share in each market over a number of years. Dell's fiscal 2000 international revenue amounted to \$7.4 billion, so, assuming a reasonable growth rate of 15% over the next five years,⁶ Dell's 2007 incremental international revenue is equal to \$7.69 billion. This is, of course, in addition to baseline sales; Otherwise, the same sales would be counted in both baseline growth and intensive growth.

⁴ Dell—New Horizons, pg. 16

⁵ Dell—New Horizons, pg. 23

⁶ Dell—New Horizons, pg. 23. Dell's market shares in each one of its international markets have been increasing dramatically over the last four years' worth of data, which makes 15% a reasonable estimate.

Another target market that Dell can focus a product line on is low-income families in the United States who do not have a PC or families that have a PC and are looking to add a cheap second PC. Both of these markets have not been significantly penetrated in the United States⁷ and they can be served simultaneously with a similar product offering. Essentially, market research must be conducted on this market segment to determine the features that are desired, the level of service/support that is desired and the price that can be paid. In addition, Dell must evaluate the market environment in terms of potential competitors and the state of the economy. As the current market environment is one of recession, the market potential is therefore limited and, for the purposes of this estimation, the incremental sales for new budget computing offerings will be a conservative \$500 million.

Dell is certainly capable of integrative growth because of its resources, but it seems very unlikely that Dell will engage in any purchases or takeovers of suppliers or distributors. Dell does not have a history of takeovers because they do not fit with its business model:

By 1999, Dell was the leading seller of PCs in the United States, having surpassed early leaders IBM and Compaq. The company had developed a reputation for effectively entering a product market where core proprietary elements had become standardized and undercutting existing players based on price. Michael Dell had coined the phrase “virtual integration” to express Dell’s strategy of choosing best in class providers like Intel and Microsoft, for each component, and leveraging their scale investment in R&D.⁸

In the past, Dell has shied away from actual production of components and it is inconceivable that it would consider taking over a disk-maker, software company or any one of its suppliers. Another compelling reason why Dell would not take over a supplier

⁷ Kotler, pg. 147. PC penetration is estimated at only 54%, leaving a large amount of room to grow to the level of TVs, at 98%.

⁸ Dell—New Horizons, pg. 5

is the strain that it would create in its relationships with the remaining suppliers. The other end of integrative growth is taking over distributors, which would be difficult for Dell to do considering that it sell products directly to the customer and does not have any distributors that it would or could conceivably take over.⁹ Dell will not have any incremental sales growth from 2002 to 2007 as a result of integrative growth.

Dell has a lot of room to grow through diversification growth, with a particular focus on new product offerings to both consumers. Dell has already entered the consumer electronics market by offering digital cameras, PDAs and mp3 players. It is sensible to believe that Dell will continue its foray into this arena, especially in light of Gateway's celebrated introduction of a low-price plasma HDTV.¹⁰ The reason that this seems like a likely proposition is that Dell's consumer customers are classified as "transactional" customers,¹¹ which essentially means that they are loyal to price and performance. In addition, it can be reasonably assumed that the same customers who buy PCs are likely to consider buying what some consider "toys," such as HDTV. Dell can leverage its brand strength and sizable purchasing power to enter the consumer electronics market as a low-cost, high-reliability competitor that will immediately attract sales. This low-cost strategy is one of Michael Porter's generic strategies for a business to achieve its goals.¹² The advantage that Dell has is that it can simply re-brand reliable products with the Dell name in the same manner as it currently does to Dell-branded computer monitors. This allows Dell to once again enter a market where "core

⁹ While Sears does have some Dell sales stations (See WSJ.com article), it is impossible to believe that Dell would try to take over Sears.

¹⁰ <http://news.com.com/2100-1040-964156.html>

¹¹ Dell—New Horizons, pg. 8

¹² Kotler, pg. 106

proprietary components are standardized,”¹³ as it has done in the past. In addition, Kevin Rollins offers a statement that hints towards Dell’s future expansion:

The beauty of our model is that commodities fall right into our sweet spot. Industry gross margins have dropped from about 50% in the early 1990s to about 25% today and at that level the business is not profitable for many of our competitors, yet we continue to show profit growth. We just need to continue to catch products as they move to the commodity phase and apply our low-cost direct model.¹⁴

This is about as definitive a statement as one will hear a corporate executive make about future strategies. However, as these product lines for the most part do not currently exist, one has to estimate the approximate revenue added through this type of diversification. This analysis will consider the five-year growth of consumer electronics to be a \$5 billion addition to Dell’s revenue.

Therefore, Dell is able to boost total revenues to \$61.53 billion mainly through intensification of international efforts while also intensifying domestic budget PCs offerings and expanding its product line to included consumer electronics. While the task of doubling the revenue of a large company may seem daunting at first, it is certainly possible for Dell to achieve its revenue goal of \$60 billion by 2007. The key for Dell, as it has been in the past, is one of execution. If it can continue to properly execute its direct, low-cost model in the future, it will continue to prosper as a company.

¹³ See pg. 4

¹⁴ Dell—New Horizons, pg. 3