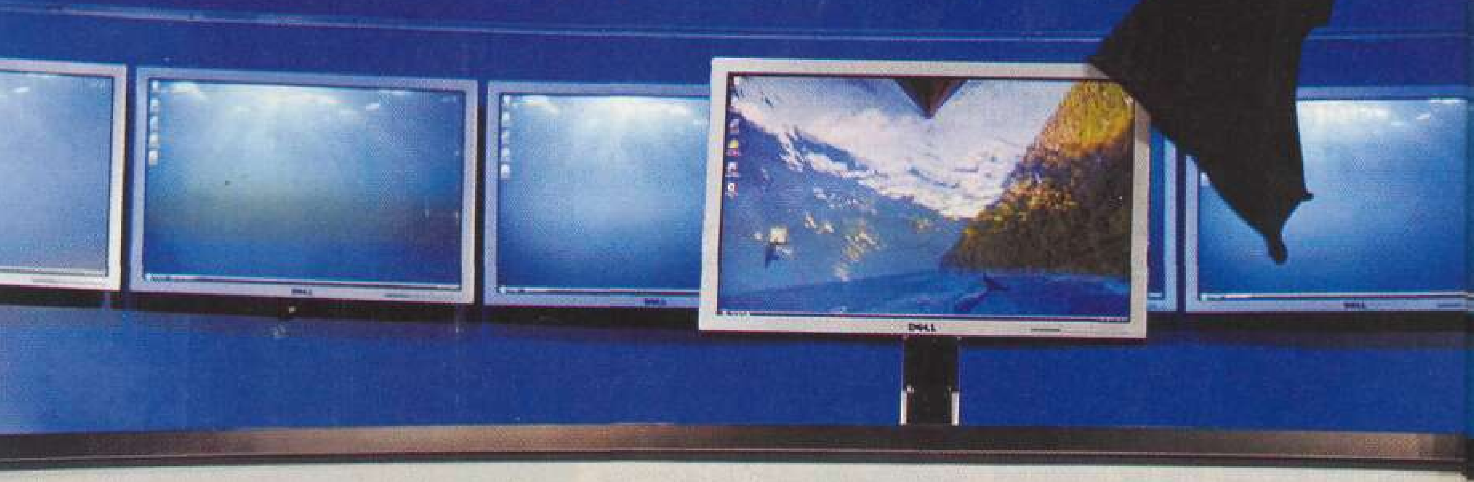
Where Dell Went Wrong

In a too-common mistake, it clung narrowly to its founding strategy instead of developing future sources of growth



BY NANETTE BYRNES AND PETER BURROWS

AT DELL, HOW IT ALL began is never forgotten. Even on Jan. 31, as founder Michael S. Dell returned to the role of CEO after 18 months of bad news and faltering financials, the press release trumpeted how, 23 years ago, Dell launched what would become a $56 billion business with just $1,000 and a simple idea. That stroke of genius—to bypass the middleman and sell custom-built computers directly to the customer—was one of the revolutionary business models of the late 20th century. Rivals from Hewlett-Packard Co. to IBM learned to fear its power. And once Dell began using the Internet to let customers configure their own PCs, no phone rep required, the company earned a place among other champions of the New Economy including Wal-Mart, Cisco, and Southwest Airlines.

Dell's storied beginnings have given way to another classic business tale, one far less happy. Like many long-forgotten former champions, Dell succumbed to complacency in the belief that its business model would always keep it far ahead of the pack. While Dell broadened its product line, it never dealt with the vast improvement in the competition or used its lead in direct sales and the cash generated to invest in new business lines, talent, or innovation that could provide another competitive edge. "Dell is a textbook example of single-formula growth: We make PCs cheap. This is what we do, and we do it a lot,'" says Jim Mackey, managing director at the Billion Dollar Growth Network, a research consortium focused on large-company growth. "You can grow very fast when you're on a single formula, but when you get to a certain point, you don't have the ability to create new growth."

Long-term success demands constant reinvention. Research done by Mackey and others shows that most fast-growing companies hit a point somewhere over $50 billion in revenue at which they falter. By then, growing apace demands billions of new sales every year. Rarely is the original, unchanged business model up to the job. The only way around the challenge: Nurture the next growth platform long before it's needed.

> Dell focused on giving Wall Street wnat it wants: The highest possible earnings

Most don't. Distracted by the demands of their current success, they are lulled into a false sense of security. "When ifs all you can do to keep up with the growth your current business model is providing, you just don't feel that urgency," says Harvard Business School professor Clayton Christensen. "It's hard to get worried." He visited Dell's Round Rock (Tex.) offices in 1998 and again in 2000, and warned Dell and then-CEO Kevin Rollins that they needed to focus on growth five to eight years out, on the model that would augment their built-to-order machines. A great admirer of both men's intellect, Christensen says he naively hoped they would take his advice. Instead, Dell pushed its model into new types of hardware, such as storage, printers, and TVs, in the hopes of making easy profits by selling products made by other companies. In some areas, like printers and TVs, the customization that made a Dell PC seem special isn't a factor. In others, like services, low-cost competitors had a head start.

Michael Dell maintains that his company's business model is still its key advantage. Dell, he says, has acquired too much middle-aged fat and lost the intense focus and drive that made it an icon. In his internal e-mail explaining the recent departure of CEO Rollins, Dell's

DELL He still sees his business model as a key advantage

founder promised that the company will fix customer support problems, boost its services business, and focus more on small and midsize outfits in addition to the megacorporations that bring in the bulk of sales. While he won't rule out big strategic shifts, such as a move into retail, Dell says: "I do think that Dell's core strengths historically will be its core strengths in the future."

Many critics say the problem is that the company didn't begin a more orderly evolution when times were better. For half a decade, it was the only major PC company that earned a profit. By cutting out the middleman and keeping research and development and inventory costs low, it often enjoyed profit margins 10 points higher than money-losing rivals. Rather than use that cushion to develop fresh capabilities, Dell gave its admirers on Wall Street and in the media what they want: the highest possible earnings.

Hubris crept in. In 1999, Dell bought a startup called ConvergeNet, which had a sophisticated storage product that turned out to be not ready for prime time. Dubbing rival EMC Corp. the "Excessive Margin Company," Dell seemed to expect storage to follow the same pattern PCs had, moving from pricey, feature-laden models into a standards-based commodity. Dell underestimated the competition and is an also-ran in the segment.

By 2005, PC rivals, particularly HP, which has taken the market-share lead from Dell, had closed the efficiency gap and were enjoying resurgent sales at retail stores.

PEOPLE-INTENSIVE

DELL'S LOYALTY to its business model could make it difficult to recapture growth. Dell has suggested a new offensive to enlarge its computer services business, which so far has focused largely on repair and upgrading of Dell's hardware. According to Bill Scheer, senior analyst at Kennedy Information Inc., which tracks information technology consulting, such "hardware" services are the slowest-growing segment of the $147 billion market, currently increasing an estimated 6.3% a year, vs. 7.6% for the market overall. Hardware repair profits can be good, but don't lead to the massive deals that help sell higher-end hardware and software to tie it together.

Consulting experts say Dell will have a hard time moving up the value chain. For one thing, it's a people-intensive business that doesn't benefit from the company's expertise in efficient manufacturing. And when Dell first started making PCs, it entered an industry with lots of built-in fat, namely reseller commissions and retailer markups. Lower-end consulting has already been made far lower-cost and more efficient by companies like Wipro Ltd. and Infosys Technologies Ltd., which sell programmers' time at $50 a hour that 10 years ago would've billed at $125 an hour or more.

Dell has struggled to find other growth areas large enough to matter. After a promising start in printers, moving quickly to No. 3, the most recent quarterly data from research firm IDC shows Dell's market share at 3.6%, down from 6.2% the previous year. Its once-promising move into networking gear has fizzled, and its share in the storage systems market is flat compared with a year ago.

And Dell's management bench doesn't seem as deep as it should be. When Dell ousted its chief financial officer on Dec. 19, the company ended up filling the spot with an outsider, board member Don Carty, the former CEO of AMR Corp., the parent of American Airlines. Industry sources say many of the recent management departures were not terminations but rather people burned out by an increasingly dismal turnaround effort. Dell spokesman Bob Pearson says the company has good bench strength and "we feel fortunate that [Carty] could do this."

These are the kinds of challenges Dell was protected from for years. How well its founder handles them will determine whether his legacy is building a great company that lasts—or having a great idea that ran out of steam. II

-With Louise Lee in San Mateo, Calif.

Second Thoughts

In the 1990s these companies rewrote the rules of business. But their big ideas have undergone a reassessment.

	WHAT WE THOUGHT THEN	WHAT WE THINK NOW
DELL	Merchandise sold directly by phone or the Internet would replace bricks-and-mortar stores.	People like live shopping, even for technology, and bad service makes them angry.
WAL-MART	The king of discounters had conquered supermarkets. Next, the world.	The Wal-Mart way hasn't translated well into all markets.
SOUTHWEST AIRLINES	The hub-and-spoke system was history, and discount airlines, hopping from airport to airport, would rule.	The Old Guard has risen from bankruptcy court, while Southwest's stock is in a holding pattern.
ENRON	"Asset-light" trading strategies can be applied to almost any market.	It's a far more limited idea than the Enron guys would've had you believe.
CITIGROUP	Sandy Weill had created a financial supermarket for the newly democratic world of investments.	Laser-focused traders and bankers at Goldman Sachs make out by sticking with lucrative investments.

Fonte: Business Week, n. 4022, p. 74-79, 19 Feb. 2007.