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Dell's World Isn't What It Used to Be

By [DAMON DARLIN](#)

Dell is sharply reducing prices on its computers.

The tactic is classic, straight out of the playbook that made the company the world's largest computer maker. **As overall demand for personal computers slows, lower your prices. Profit margins will take a temporary hit, but the move would hurt competitors worse as you take market share and enjoy revenue growth for years to come.**

Dell did it in 2000 and it worked beautifully. But after Dell rolled out the plan last month, knocking as much as \$700 off a \$1,200 Inspiron and \$500 off a \$1,079 Dimension desktop, many of the securities analysts who follow the company, based in Round Rock, Tex., said that this time around it could be folly.

"They had had a much better cost advantage over the competition when they tried this before," said Cindy Shaw, an analyst with Moors & Cabot Capital Markets.

What changed? Nearly everything, it seems, except Dell's closely studied, widely praised and frequently imitated business model of selling directly to the **buyer. The growth market, for one, is no longer in the United States, but in China, India and Eastern Europe, where it is harder to reach a mass market online.** Retail sales of desktop PC's now outpace laptops, which consumers are more likely to want to test the heft of before they buy.

More than anything else, Dell's competitors have changed. In particular, [Hewlett-Packard](#) is no longer the bloated and slow-moving company it was six years ago. Mark V. Hurd, Hewlett's chief executive hired in early 2005, has cut costs and focused his company on profitability while speeding its growth in printing and corporate data centers as well as personal computers, which in 2002 lost the company \$400 million. **Last year, it made \$660 million selling PC's.**

The most telling evidence of the new landscape for PC's was seen in statistics on worldwide shipments. While the industry grew 12.9 percent in the first three months of the year, according to IDC, Dell's shipments grew 10.2 percent. It was the first time since analysts began tracking Dell that its shipments

grew more slowly than the industry's. Hewlett's shipments, meanwhile, grew 22.2 percent.

Neither company would allow interviews with top executives before fiscal first-quarter earnings are released. Dell announces its earnings for the quarter ended in April on Tuesday and Hewlett follows on Thursday.

Kevin B. Rollins, Dell's chief executive, is expected to say that the company has finished its eighth consecutive quarter of decelerating revenue growth. Mr. Rollins, who succeeded Michael S. Dell in July 2004, has lowered Wall Street expectations of growth, but he also has had to announce earnings shortfalls three times, most recently last week, which sent the company's stock down 6.75 percent.

"The days of Dell growing at two to three times the rate of the market," concluded Richard Gardner, a [Citigroup](#) global markets analyst, "are gone forever."

Since last July, shares of Dell have lost almost 42 percent of their value. Hewlett shares have gone up 34 percent in the period. Indeed, since Mr. Hurd's hiring was announced in February 2005, the shares are up 60 percent. Shares of Dell fell 49 cents yesterday, to \$24.02. Shares of Hewlett fell 40 cents, to \$32.13.

At the rate Hewlett is growing, not only is there a possibility that the company, based in Palo Alto, Calif., outgrew Dell last quarter, said Ms. Shaw, but its estimated revenue of \$91 billion could pass [I.B.M.](#) this year to make Hewlett the largest technology company based on sales.

The problem for Dell is that it is harder to maintain a strong cost advantage over rivals. Because it built computers to order, it kept inventories low, usually less than a few days while rivals typically had four weeks of supplies and another four to eight weeks of finished goods in distribution channels.

Hewlett, as well as [Lenovo](#) and Acer, have taken a lesson from Dell and tightened their supply chains to about two weeks. "We've got laptops that are going direct from factories in China to the customer supply chain," said Ted Clark, Hewlett's senior vice president and general manager for notebooks. Hewlett boasts a custom laptop can go door to door in three days.

With tight inventories, Dell could squeeze out more of a cost advantage as prices on components drop. But it is harder to get gains on a \$500 computer than on one that cost \$1,500. Compounding that, **the rate that PC components are dropping in price has slowed from 1 percent a week five years ago, to about a quarter of a percent a week.**

Despite its changing circumstances, Dell is hardly down and out. It still holds an operating profit margin

advantage over Hewlett of at least 5 percent, Mr. Gardner calculated, though that has shrunk from 20 percent at the beginning of the decade. Other analysts, like A. M. Sacconaghi Jr. of Sanford C. Bernstein & Company, say Hewlett will not try to match Dell's price cuts because Mr. Hurd is not ready to sacrifice profit for revenue unless the company starts losing significant market share.

Inside Hewlett, however, there is a feeling that it can beat Dell without resorting to price wars. Todd Bradley, the chief of the computer division, said, "The PC is not a commodity." The company has started an ambitious marketing campaign to make that point with ads that proclaim, "the computer is personal again."

The campaign, created by the Goodby, Silverstein & Partners agency famous for the "Got Milk?" ads, will feature celebrities and how they individualize their computers. The company's is focused on laptops, the fastest-growing segment of the market, and it wants people to know about it. It has added technology like QuickPlay, which lets a user view a DVD or listen to a CD without waiting for the laptop's operating system to boot up. The ads will say, "Don't boot. Play."

New models have glowing keys that respond with hardly any pressure, fingerprint security, 16 hours of battery time and a high-gloss plastic finish that can be imprinted with different patterns.

"Laptops are the real battleground in PC's," Mr. Clark said. "We have taken back a lot of the momentum."

Hewlett is not the only one trying to reverse the trend of commoditization. Dell recently bought Alienware, the leading maker of PC's for gamers. Although the company resembles Dell in selling direct, its volumes are small, about 6,000 units a month. Dell sells as many PC's in 90 minutes. Some analysts were perplexed that Dell, the master of the high-volume low-margin business, would buy a high-margin low-volume maker that would have little impact on profits.

"Could that money not have been better spent on improving customer care or incremental advertising spend?" asked Harry Blount, a [Lehman Brothers](#) analyst, in a report he issued after the deal was announced.

Dell is indeed spending more on customer service, which is a reason earnings have been damped. It is hiring more people for call centers in the United States and Canada. "The time to answer the phone has been cut in half in the last month," said Joe Marengi, senior vice president for Dell's Americas business. Staff members are being trained to resolve complaints before they escalate. "The amount of escalations were going way too high. You can go out and see on the blogs what is happening."

The company, once known for great service, has faced a rash of mistreated customers to the point, analysts said, that the problem was becoming part of consumers' perception of Dell. The blogger Jeff Jarvis complained about his problems on his BuzzMachine site. In another case, Dell was said to have sold an expensive server to a woman who merely wanted a device to connect two PC's. Dell resolved Mr. Jarvis's complaint, but it was never clear that the woman with the server was ever given the right product, a router.

Dell is now surveying each customer after he calls, according to Mr. Marengi. They have discovered on occasion that some "technicians should be working someplace else," he said.

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