

Pricing at Dell

Revised: November 17, 2003

In a time of crisis in the personal computer industry, Dell is taking a hit. In the first months of 2001, its net margin dropped to less than six percent of sales. However, among the top six US PC manufacturers, Dell was the only to report a profit during the first quarter of 2001.

Dell's relative success can be attributed to many factors. Its business model is quite different from those of its rivals: Dell builds machines to order and sells them directly to the customer, rather than through independent dealers. Another distinctive characteristic is the company's almost obsessive concern with cost cutting. It is estimated that Dell's overhead amounts to 11.5 cents of every sales dollar, compared to 16 cents at Gateway, 21 cents at Compaq and 22.5 cents at Hewlett-Packard. Recent staff reductions are likely to make Dell's number even lower.

But low overhead is only part of the story. Dell has a system of "real time" cost information that it uses in pricing decisions. Information collected from suppliers and from Dell's own factories is used to create a "cost package." Based on this package, one can estimate fairly accurately how much it would cost to supply a given model today or a month from today (taking into account, for example, predicted changes in the price of memory chips or of an Intel microprocessor).

Dell's representatives have access to this information and are given significant flexibility in their pricing decisions. They are expected to take into account variables such as the buyer's willingness to pay, how much competition there is, the proposed delivery dates – and, of course, cost. For example, representatives may offer a special discount if the buyer is willing to order in advance, stagger its purchases, or simply delay them, depending on which would imply a lower cost for Dell.

By contrast, other PC manufacturers tend to follow a system of estimating sales, drafting a corresponding production plan, and negotiating long-term component purchases. Some rivals have attempted to embrace Dell's practices, but only to a limited degree. They have, however, responded to Dell's aggressive pricing. Gateway now has a database system to monitor rivals' prices, primarily Dell's. Compaq, IBM, and Hewlett-Packard are instructing dealers to match any Dell quote, regardless of their own costs. "They'll do anything, anything they can, if it's within reason to keep Dell from getting the deal," says one dealer.

Questions for Analysis

- (a) Why has Dell be successful?
- (b) Contrast the competitive advantages that come from having low costs vs having a good knowledge about costs. Which one is more difficult for Dell's competitors to mimitate?
- (c) How would you comment on the following quote: "By matching Dell's prices, we are getting the benefits from flexible prices without incurring the costs of setting up a detailed cost information system."

Additional Information Sources

Dell's online shopping web site: <http://www.dell.com/us/en/gen/default.htm>

Online chat about Dell's logistics:

<http://logistics.about.com/industry/logistics/library/bllogisticsatdellchat1.htm>

<http://logistics.about.com/industry/logistics/library/bllogisticsatdellcomputerschat2.htm>

Article on Dell's logistics: <http://www.mnstate.edu/peschke/Articles/dell.htm>

Some articles on computer price wars: <http://www.newsfactor.com/perl/story/9402.html>

<http://www.zdnet.com/eweek/stories/general/0,11011,2713688,00.html>

<http://www.pakistaneconomist.com/page/issue20/etc3.htm>

University of Florida online Dell case:

http://web.uflib.ufl.edu/cm/business/cases/dell_computer.htm

Notes

This case is partly based on the article "Lean Machine: How Dell Fine-Tunes Its PC Pricing to Gain Edge in a Slow Market," The Wall Street Journal, June 8, 2001. It was prepared by David Backus and Luis Cabral for the purpose of class discussion rather than to illustrate either effective or ineffective handling of an administrative situation. © 2001 David Backus and Luis Cabral.