Dell-Changing Rivalry in the Personal Computer Industry

In about the 1990s, the personal computer industry was good one to be in. New entry was limited by the brand loyalty and scale economies enjoyed by the established companies in the business. The most significant new entrant during the decade, Hewlett Packard, was able to enter because it already competed in the computer sector (it made midrange computers) and could leverage its brand loyalty and existing scale economies to reduce the costs of entry (something companies outside the computer sector could not do) into the personal computer market. Also, a robust supply of complementary products, including Microsoft's Office productivity suite, online service providers such as AOL and MSN, Internet browsers, email programs, personal finance software such as Quicken, digital imaging hardware and software, and PC games, helped to keep customer demand growing at 15 percent per annum compounded, giving all PC makes a chance to increase their revenues and profits. Nor were there any potential substitutes that might limit demand growth. In this growing industry, rivalry between companies, while vigorous, did not lead to major price wars, and this helped to keep industry profitably high.

This industry did have two strong suppliers that enjoyed substantial bargaining power: Intel, which provided the microprocessor for the majority of personal computers, and Microsoft, which provided the operating system. To sell their machines, personal computers companies had to include an Inter-compatible microprocessor and a Microsoft operating system. This enabled Intel and Microsoft to charge higher prices than would otherwise have been the case and thus reduced the profitability of the personal computer industry somewhat.
However, this negative was not enough to offset the positive growth fundamentals, which were strong. Moreover, the buyers in the industry-individual customers, corporations, and distributors such as CompUSA-did not exercise significant bargaining power.

All of this changed in 2000 as the Industry became consolidated. Dell now had a 14 percent share of world-wide PC shipments, Compaq 11 percent, Hewlett Packard 8 percent, IBM 6 percent, Fujitsu 5 percent, and Gateway 4 percent.

With almost half of the world market in the hands of just six companies, there was now a substantial level of interdependence among industry competitors. Moreover, these companies offered such similar products that analysts worried that PCs were fast becoming mere "commodities" like corn or wheat and that price would become be the main competitive weapon. Since differentiating products on non-price factors was becoming increasingly difficult, analysts postulated that it would be only a matter of time before one player cut prices, and the others would be forced to respond in kind in order to try to hold onto their market share, plunging the entire industry into a price war.

This scenario became more likely in 2001 when the growth rate in the industry began to slow to single digits. There were two reasons for the slowing growth. First, after two decades of robust growth, the market had become mature. By 2001, almost all businesses and 65 percent of homes in the United States had personal computers. Second, demand for personal computers was hurt by a lack of compelling complementary products that might persuade businesses and household customers to replace their existing equipments with more powerful machines. For the first time in two decades, worldwide unit shipments of personal computers fell to 130 million in 2000. In the large U.S. market, demand fell by 13 percent in 2001.

The combination of a consolidated industry, a product that was increasingly difficult to differentiate, and slowing demand set the scene for a marked change in the intensity of rivalry in the industry. Dell, which had the lowest cost structure in the industry launched a price war. Its rivals were forced to respond in kind in order to try to maintain their market share, and prices and profits in the industry plunged. During 2001, the average selling price in the industry fell from $1,850 a machine to $1,460. By late 2001, Dell was the only major personal computer company making money, and it was also gaining market share and increasing revenues. Industry observers believed that Dell's strategic goal was to drive some of its weaker competitors out of the market altogether, leading to a more consolidated industry in which Dell would be the dominant player.

By early 2002 it looked as if Dell might be getting closer to achieving this goal. Compaq and Hewlett Packard, the number two and three companies, had announced their intention to merge, partly in an attempt to rationalize their PC manufacturing operations, closing down some of their plants to take surplus capacity out of the industry. IBM announced its intention to exit the business of making PCs, selling its facilities to a contract manufacturer . Gateway was still hanging on, but its sales revenues had slumped by 35 percent during 2001 as prices plunged, and it was losing money. To many, it seemed as if Dell had analysed the structure of its industry in late 2000 and decided that the time was ripe to launch a price war in which it would be the major beneficiary.