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## Building a Competitive Advantage in an Internet Economy

Michael Dell's Address to the Detroit Economic Club

**Detroit, November 1, 1999**

Thank you for joining me this afternoon. I'd like to talk about the Internet and the effects that it has had on our business, and the implications that I believe it has for the broader economy. There are a number of issues that companies should consider when they address how the Internet impacts their business, and how they can use it to their advantage. The Internet is bringing about the demise of many traditional business models and creating tremendous changes.

To illustrate these changes, let's compare the market valuations of some well-known companies. If you look at the market valuations of Dell, Schwab, Cisco, Coca-Cola and Exxon in 1994, you'll note that Coke and Exxon had market valuations that were much larger than the other three companies. In fact, either one of them would have been larger than those three combined. Looking at those valuations today, you find significant changes. They've all had relatively good returns -- notably Dell growing at 7,600% and Cisco growing at 2,600% during that period. But today the market valuations of Dell and Cisco exceed that of Coca-Cola and Exxon combined. Clearly the market is betting on the Internet and new technologies.

The changes taking place are not limited to .com companies or technology companies. The changes are happening across literally all Fortune 500 companies. Only two percent of companies in the Fortune 500 today don't have a web site. There has also been a dramatic uptake in online commerce and the interaction abilities that exist on these web sites, growing from about 11 percent in 1997 to 42 percent in 1999. And many companies have already begun to adopt the Internet as the core element to their strategy; these companies are achieving what's known as a "first mover" advantage in a very rapidly changing marketplace.

Consider the market valuation of Yahoo, which is about six times greater of that of the New York Times. This is a company that has no physical distribution system, can update information real time around the clock, and is quickly changing the rules about how information is disseminated around the world. You can argue whether these valuations make any sense, but that's not my purpose here today. The market is moving in this direction, and whether or not the specific companies I used as examples succeed, there's no question that the world will be changed forever by the Internet as a phenomenon.

### The Value of Information

The Internet is clearly provoking a massive revolution in business, causing companies to reflect on how they can change their infrastructure. We're increasingly being asked by our customers to use our experiences to help them address their IT challenges. There are, of course, many examples here in Detroit of companies that are analyzing the Internet; every few days there seems to be a story about the Big Three and their efforts to use the Internet to change their business.

I believe a fundamental shift in the definition of value is occurring. There used to be value around inventory; now there's value around information. Dell operates with about six days of inventory, whereas our competitors have about 60 days. Not only does that allow us to provide the latest technology to our customers faster, but because the value of components declines over time, we can provide a cost reduction to our customers.

I believe there's an inverse correlation between the quality of the information you have and the amount of inventory you need. Most businesses tie up a tremendous amount of assets anticipating things that may not actually happen. If they had a system that was customer

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demand driven, they would be much more efficient in their assets. In other words, physical assets are being replaced by intellectual assets. Closed business systems are giving way to collaboration.

The Internet is also decreasing the cost of interactions. For instance, instead of making printer circuit boards, Dell has a supplier that does it, whom we treat as part of our company and with whom we exchange information at very little cost and at very high speeds. The Internet is shrinking time and distance, allowing us to bring our customers and our suppliers inside our business, and creating shared efficiencies and greater loyalty. Companies that recognize this can take advantage of it; those that don't will end up as road kill on the information super highway.

## **Establishing Direct Connections**

At Dell, we have integrated virtually our entire business with the Internet. We currently take about 40 percent of our orders online through dell.com, which saves money for both our customers and Dell. It increases customer satisfaction and customer loyalty by reducing support costs. And many routine service kinds of inquiries that would normally occur over the phone can now happen on the Internet. For instance, order status calls, which can cost up to \$13 a call, can be handled over the Internet for essentially no cost at all. And of course, turning our inventory faster allows us to save cost, and it gives our suppliers a direct view into our demand trend so that they can tune their output to meet our exact requirements.

Companies need to consider the implications of leveraging the Internet for their business. Simply establishing a web site-putting a web front-end on top of your company-is not going to create the efficiencies you need. You must re-think how you're going to use information more efficiently, and drive inefficiencies out of the system.

In the traditional physical world, the field of consideration was limited to a geographic area that you could travel in. But now, of course, all that's changed. The field of consideration is the world. We have pricing transparency. We don't buy things only from companies that are physically close to us. And those companies that are physically close to us, with expensive assets like real estate and inventory and buildings, are carrying a lot of additional cost which may or may not be necessary.

I'm not suggesting that all physical businesses are doomed for disaster. But consider the example of two extremes. One extreme is a café where you go for some social interaction and a cup of coffee. You're not going to replace this kind of experience online. The other extreme is purchasing something at a drug store. How many of you like to go to the drug store to stand in line while people are buying embarrassing things? This is not a highly differentiated, experiential sort of thing. My point is that every physical experience now has to be held to a higher standard. If you're in a physical business, you've got to deliver something that is more valuable than can be delivered online.

## **Internet Fuels Business Results**

The key benefits that can come from a system like this are tuning your business to exactly meet customers' needs, precisely in the way they want-an element of customization which provides a much better use of assets. We use a measure at Dell, called return on invested capital (ROIC), which allows us to measure the efficiency of the capital that we invest in our business. To show you the implications of the Internet on a traditional business, let's take an example of three large US companies who produce heavy machinery. A quick calculation of this group shows that today they have an ROIC of about 13.65 percent, which is probably about their cost of capital. So in strict economic terms, these companies are not really creating wealth.

Now, with the Internet we're able to link their suppliers and their end users together; their finished goods inventory is dramatically reduced; and they now have much better information about what their customers want to buy. The fixed assets are reduced as much as 50 percent as operations are streamlined and fixed infrastructure declines. For the sake of argument, let's assume that the traditional profit drops to the bottom line. This causes their ROIC to roughly double, freeing about \$8 billion of working capital to use for other projects-acquisitions, new investments, share re-purchase programs -- that could provide greater value to the shareholders.

It's interesting that broad schools of economists have now begun to recognize that information technology is a key part of what is driving the health of the overall economy in the United States. The question that's continually raised is, "Is this cyclical or is it structural?" I believe that it's structural. In fact, if you look at Dell's example over the last 15 years, you could only conclude that it's structural, and that these kinds of advantages are going to find their way to many other businesses.

Let me share some customer examples that have influenced my view. Shell Oil has told us that they're saving about 15 percent of their total purchasing cost by buying online, using systems built by Dell over the Internet. Business Week recently reported that Ford Motor has boosted its employee productivity by 25 percent from the use of the Internet. Recently we studied the impact of e-commerce on many of our largest customers, and the results are pretty impressive. One is a multi-billion dollar semi-conductor firm, which estimates that they're saving about \$10 million annually from increased productivity from better tracking of their IT assets and improved technical support. Another large, diversified multi-national tells us they're saving about \$5 million annually through reduced procurement costs. I believe these efficiencies are going to find their way into all industries, resulting in reductions in inventory, more working capital, shortened lead times, and increased flexibility in operations.

## **Building Your Internet Business**

So what are the steps for a company to harness the power of the Internet, and how can you take advantage of it for your business? I believe it starts with an intense focus on the customer experience. Research has shown that the loyalty of online shoppers is related much more to the customer experience than to traditional drivers such as price. The top two drivers of online loyalty are the quality of the customer experience and on-time delivery. I believe a company is vulnerable if this experience is not part of their differentiation.

At Dell, we continue to focus on differentiating ourselves through a positive customer experience by taking ownership of the customer relationship. Our goal is to provide an unparalleled level of service in our industry. To achieve this online, we focus on three areas: building rich content, growing our commerce capabilities, and establishing communities of suppliers and end users that share common interests.

The first stage of content means providing compelling information. This is how we started our online operations in 1993, when we put our technical databases online for customers to access. It was a relatively simple start, but it showed us the tremendous interest from our customers. Today Dell is a leader in online service and support. Our customers visit our technical database 400,000 times per week; we get more than 45,000 e-mail inquiries and 160,000 file downloads every week. Fundamentally, we've taken the same information that we had developed internally and turned it over to our customers.

The next stage is commerce, which should be thought of as all transactions, not just buying things over the web. In fact, our first activity in this area had nothing to do with purchasing. It was simply order status. Customers would call and say, "Where are my computers? I had 100 orders, and I'd like you to look up the status of 100 order numbers." Well, that was a very time consuming process. Now we have an order status tool that links customers right into our system. This was our first online application, and it had 5,000 hits per day the first week it went live. It proved to us that our customers were very interested in using the web. It also freed our people to become more productive and provide higher value-add activities. The savings to our business through avoided status calls, we estimate, have been more than \$21 million. This energized us to build an online system configurator that allows you to build your own PC, which formed the foundation of our online sales.

Our ultimate goal is to deepen relationships with customers by providing added convenience, efficiency, and cost savings, and a wider array of services. The Internet creates an opportunity to move these key transactions online and drive transaction cost to almost zero.

The final stage is developing an online community. At Dell, we've launched Dell.net, which is our ISP and portal service. We are building two-way relationships over the web with both our customers and our suppliers. For our small business customers we host Breakfast with Dell, an online forum to focus on unique issues such as Preparing Your Small Business for the Year 2000. We also have something called Dell Talk, a forum that brings users together to

talk about their IT issues. We currently have 100,000 registered users of Dell Talk. Finally, we collaborate closely with our suppliers through "valuechain.dell.com." This is a site for our top 50 suppliers that provides them exact information about our requirements and allows them to see their quality results in real time.

## Internet Changing Old Rules

In summary, the Internet is fueling huge opportunities and bringing new levels of efficiency to business operations. It has boosted both productivity and profitability. As you look to harness the power of the Internet in your own business, focus on these key areas: the online customer experience, which provides a strong and loyal base; rich content; high-value commerce that moves transactions to the web to reduce costs dramatically; and bringing communities together to create a network with shared interests. The changes that are driven by the Internet are having a profound impact on the global economy, which is why we continue to explore how we can use this technology to help our customers and to drive further improvements in our business as well.

Thank you very much for your attention.

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