WHAT YOU DON'T KNOW ABOUT DELL A LOOK AT THE MANAGEMENT SECRETS OF THE BEST-RUN COMPANY IN TECHNOLOGY


In 2001, internal interviews at Dell revealed that subordinates thought CEO Michael S. Dell was impersonal and emotionally detached, while President Kevin B. Rollins was seen as autocratic and antagonistic. Fearing an exodus of talent, the two execs focused on the gripes. To some, the way Michael Dell handled sagging morale might seem like another tale of feel-good management. But to those inside the company, it epitomizes how this computer maker has transformed itself from a no-name PC player into a powerhouse brand. The combination of reaching for the heights of perfection while burrowing down into every last data point has not been imitated by rivals. For Michael Dell, inventing the Next Big Thing is not the goal. His mission is to build the Current Big Thing better than anyone else. Rollins is the day-to-day general. He and Dell sit in adjoining offices separated by only a glass wall.

Copyright 2003 The McGraw-Hill Companies, Inc.
Fearing an exodus of talent, the two execs focused on the gripes. Within a week, Dell faced his top 20 managers and offered a frank self-critique, acknowledging that he is hugely shy and that it sometimes made him seem aloof and unapproachable. He vowed to forge tighter bonds with his team. Some in the room were shocked. They knew personality tests given to key execs had repeatedly shown Dell to be an "off-the-charts introvert," and such an admission from him had to have been painful. "It was powerful stuff," says Brian Wood, the head of public-sector sales for the Americas. "You could tell it wasn't easy for him."

Michael Dell didn't stop there. Days later, they began showing a videotape of his talk to every manager in the company -- several thousand people. Then Dell and Rollins adopted desktop props to help them do what didn't come naturally. A plastic bulldozer cautioned Dell not to ram through ideas without including others, and a Curious George doll encouraged Rollins to listen to his team before making up his mind.

WALKING DATABASES

TO SOME, THE WAY MICHAEL DELL handled sagging morale might seem like another tale of feel-good management. But to those inside the company, it epitomizes how this Round Rock (Tex.) computer maker has transformed itself from a no-name PC player into a powerhouse brand. Sure, Dell is the master at selling direct, bypassing middlemen to deliver PCs cheaper than any of its rivals. And few would quarrel that it's the model of efficiency, with a far-flung supply chain knitted together so tightly that it's like one electrical wire, humming 24/7. Yet all this has been true for more than a decade. And although the entire computer industry has tried to replicate Dell's tactics, none can hold a candle to the company's results. Today, Dell's stock is valued at a price-earnings multiple of 40, loftier than IBM, Microsoft, Wal-Mart Stores, or General Electric.

As it turns out, it's how Michael Dell manages the company that has elevated it far above its sell-direct business model. What's Dell's secret? At its heart is his belief that the status quo is never good enough, even if it means painful changes for the man with his name on the door. When success is achieved, it's greeted with five seconds of praise followed by five hours of postmortem on what could have been done better. Says Michael Dell: "Celebrate for a nanosecond. Then move on." After the outfit opened its first Asian factory, in Malaysia, the CEO sent the manager heading the job one of his old running shoes to congratulate him. The message: This is only the first step in a marathon.

Just as crucial is Michael Dell's belief that once a problem is uncovered, it should be dealt with quickly and directly, without excuses. "There's no 'The dog ate my homework' here," says Dell. No, indeedy. After Randall D. Groves, then head of the server business, delivered 16% higher sales last year, he was demoted. Never mind that none of its rivals came close to that. It could have been better, say two former Dell executives. Groves referred calls to a Dell spokesman, who says Groves's job change was part of a broader reorganization.

Above all, Michael Dell expects everyone to watch each dime -- and turn it into at least a quarter. Unlike most tech bosses, Dell believes every product should be profitable from Day One. To ensure that, he expects his managers to be walking databases, able to cough up information on everything from top-line growth to the average number of times a part has to be replaced in the first 30 days after a computer is sold.

But there's one number he cares about most: operating margin. To Dell, it's not enough to rack up profits or grow fast. Execs must do both to maximize long-term profitability. That means products need to be priced low enough to induce shoppers to buy, but not so low that they cut unnecessarily into profits. When Dell's top managers in Europe lost out on profits in 1999 because they hadn't cut costs far enough, they were replaced. "There are some organizations where people think they're a hero if they invent a new thing," says Rollins. "Being a hero at Dell means saving money."

It's this combination -- reaching for the heights of perfection while burrowing down into every last data point -- that no rival has been able to imitate. "It's like watching Michael Jordan stuff the basketball," says Merrill Lynch & Co. technology strategist Steven Milunovich. "I see it. I understand it. But I can't do it."

How did this Mike come by his management philosophy? It started 19 years ago, when he was ditching classes to sell homemade PCs out of his University of Texas dorm room. Dell was the scrappy underdog, fighting for his company's life against the likes of IBM and Compaq Computer Corp. with a direct-sales model that people thought was plain nuts. Now, Michael Dell is worth $17 billion, while his 40,000-employee company is about to top $40 billion in sales. Yet he continues to manage Dell with the urgency and determination of a college kid with his back to the wall. "I still think of us as a challenger," he says. "I still think of us attacking."
It's not that Michael Dell leads by force of personality. He's blessed with neither the tough-guy charisma of Jack Welch nor the folksy charm of the late Sam Walton. Once, after hearing about the exploit of flamboyant Oracle Corp. CEO Lawrence J. Ellison, he held up a piece of paper and deadpanned to an aide: "See this? It's vanilla and square, and so am I." This egotless demeanor permeates the company. Everyone is expected to sacrifice their own interests for the good of the business, and no one gets to be a star. If Michael Dell is willing to modify the personality traits he was born with, other top execs are expected to be just as self-sacrificing. Frequently, Dell pairs execs to run an important business, an approach called "two-in-a-box." That way, they work together, checking each others' weaknesses and sharing the blame when something goes wrong. One such executive calls Dell's senior leadership "the no-name management team."

All this has kept Dell on track as rivals have gone off the rails. Since 2000, the company has been adding market share at a faster pace than at any time in its history -- nearly three percentage points in 2002. A renewed effort to control costs sliced overhead expenses to just 9.6% of revenue in the most recent quarter and boosted productivity to nearly $1 million in revenue per employee. That's three times the revenue per employee at IBM and almost twice Hewlett-Packard Co.'s rate.

Still, for the restless Michael Dell, that's not nearly enough. He wants to make sure the company he has spent half his life building can endure after he's gone. So he and Rollins have sketched out an ambitious financial target: $60 billion in revenues by 2006. That's twice what the company did in 2001 and enough to put it in league with the largest, most powerful companies in the world. Getting there will require the same kind of success that the company achieved in PCs -- but in altogether new markets. Already, Michael Dell is moving the company into printers, networking, handheld computers, and tech services. His latest foray: Dell is entering the cutthroat $95 billion consumer-electronics market with a portable digital-music player, an online music store, and a flat-panel television set slated to go on sale Oct. 28.

Can Dell graduate from PC prodigy to corporate icon? Driving for nonstop growth will require grooming a new generation of leaders, which Rollins concedes is a major challenge given the company's pressure-cooker atmosphere. In the 1990s, after seasoned execs recruited from titans such as Intel and IBM quickly jumped ship, Dell learned that outsiders don't adapt easily to its demanding culture. And unlike in the past, Dell won't be able to count on stock options to make up for the discomfort. Some 32% of its outstanding options are priced above the current share price of $35, and the company has sliced grants to about 40 million shares this year, one-third the 2001 level. Little wonder that so far, Dell has achieved only a modest improvement in morale, according to its internal surveys. "They need to work a lot on appreciating people," says Kate Ludeman, an executive coach who has worked with Dell since 1995.

"ONE-TRICK PONY"

DELL ALSO FACES AN INNOVATION dilemma. Its penny-pinching ways leave little room for investments in product development and future technologies, especially compared with rivals. Even in the midst of the recession, IBM spent $4.75 billion, or 5.9% of its revenues, on research and development in 2002, while HP ponied up $3.3 billion, or 5.8% of revenues. And Dell? Just a paltry $455 million, or 1.3%. Rivals say that handicaps Dell's ability to move much beyond PCs, particularly in such promising markets as digital imaging and utility computing. "Dell is a great company, but they are a one-trick pony," says HP CEO Carleton S. Fiorina. What's more, Dell has shown little patience for the costs of entering new markets, killing off products -- like its high-end server -- when they didn't produce quick profits, rather than staying committed to a long-term investment. "They're the best in the world at what they do," says IBM server chief William M. Zeitler. "The question is, will they be best at the Next Big Thing?"

For Michael Dell, inventing the Next Big Thing is not the goal. His mission is to build the Current Big Thing better than anyone else. He doesn't plan on becoming IBM or HP. Rather, he wants to focus on his strength as a superefficient manufacturer and distributor. That's why Dell continues to hone the efficiency of its operations. The company has won 550 business-process patents, for everything from a method of using wireless networks in factories to a configuration of manufacturing stations that's four times as productive as a standard assembly line. "They're inventing business processes. It's an asset that Dell has that its competitors don't," says Erik Brynjolfsson, director of the Center for eBusiness at the Massachusetts Institute of Technology's Sloan School of Management.

Dell's expansion strategy is carefully calibrated to capitalize on that asset. The game plan is to move into commodity markets -- with standardized technology that's widely available -- where Dell can apply its skills in discipline, speed, and efficiency. Then Dell can drop prices faster than any other company and prompt demand to soar. In markets that Dell thinks are becoming commoditized but still require R&D, the company is taking on partners to get in the door. In the printer market, for example, Dell is slapping its own brand on products from...
Lexmark International Inc. And in storage, Dell has paired up with EMC Corp. to sell co-branded storage machines. Dell plans to take over manufacturing in segments of those markets as they become commoditized. It recently took on low-end storage production from EMC, cutting its cost of goods 25%.

Dell's track record suggests the CEO will meet his $60 billion revenue goal by 2006. Already, Dell has grabbed large chunks of the markets for inexpensive servers and data-storage gear. After just two quarters, its first handheld computer has captured 37% of the U.S. market for such devices. And Rollins says initial sales of Dell printers are double its internal targets. With the potential growth in PCs and new markets, few analysts doubt that Dell can generate the 15% annual growth needed to reach the mark. The company has averaged better than 19% growth over the past four quarters, and on Oct. 8 Rollins assured investors that everything was on track. "It's almost machine-like," says Goldman, Sachs & Co. analyst Laura Conigliaro. For the year, analysts expect Dell to boost revenues 16%, to $41 billion, and profits 24%, to $2.6 billion, according to a survey of Wall Street estimates by First Call.

What should help Dell as it plunges into so many new markets is the founder's level-headed realism. A student of business history, he has paid close attention to how some of tech's legendary figures lost their way by refusing to admit mistakes. He cites Digital Equipment Corp.'s Ken Olsen as one who stuck with his strategy until the market passed him by and hints that Sun Microsystems Inc.'s Scott G. McNealy could be next.

Dell, on the other hand, has reversed course so fast he's lucky he didn't get whiplash. In 2001, he scrapped a plan to enter the mobile-phone market six months after hiring a top exec from Motorola Inc. to head it up. He decided the prospects weren't bright enough to offset the costs of entry. The next year, Dell wrote off its only major acquisition, a storage-technology company bought in 1999 for $340 million. Dell backed out of the high-end storage business because it decided its technology wasn't ready for market. "It's amazing how a guy who was so young when he founded the company could evolve as he has," says Edward J. Zander, former president of Sun Microsystems. "Guys that have been in the saddle for 15 and 20 years tend to get too religious. He's the exception to the rule."

Michael Dell, in fact, has one of the longest tenures of any founder who remains CEO. At 19 years and counting, he's second in the tech industry only to Oracle's Ellison. "This sounds strange coming from me," says William H. Gates III, who was CEO of Microsoft Corp. for 25 years before giving it up to be chairman and chief software architect, "but very few business leaders go from the early stage of extremely hands-on stuff to have a leadership style and management process that works for a company that's an absolutely huge and superimportant company."

One way Dell has done it is through his power-sharing arrangement with Rollins, a la his "two-in-a-box" philosophy. Brought on as a consultant in 1993 to help plot the company's first long-range plan, Rollins helped it recover from a series of miscues, including the bungled launch of its notebook business and a disastrous go at trading currencies. Three years later, Dell hired Rollins away from Bain & Co. to run North American sales.

Now, Rollins is the day-to-day general. He and Dell sit in adjoining offices separated by only a glass wall. During a pivotal meeting in the fall of 2001, Dell proposed they agree not to make a major move without the other's approval. Working in tandem helps avoid mistakes that the more entrepreneurial Dell or the more rigid Rollins might make alone. Says Dell: "This company is much stronger when the two of us are doing it together." And there's no question that Rollins is the successor. "If I get hit by a truck, he's the CEO. Everyone knows that."

THE GAUNTLET

NOT THAT THE CURRENT CEO is letting up. He maintains pinpoint control over the company's vast operations by constantly monitoring sales information, production data, and his competitors' activities. He keeps a BlackBerry strapped to his hip at all times. In the office, he reserves an hour in the morning and one each afternoon to do nothing but read and respond to e-mail, according to one former executive. "Michael can be a visionary, and he can tell you how many units were shipped from Singapore yesterday," says General Electric Co. CEO Jeffrey R. a top Dell customer.

Dell's penchant for tracking every last detail can land him in hot water. On Oct. 10, during the trial of former Credit Suisse First Boston tech banker Frank P. Quattrone for allegedly obstructing an investigation into the bank's handling of hot initial public offerings, prosecutors revealed e-mails between Dell and Quattrone. In one July, 2000, exchange, Dell requested 250,000 shares in Corvis Corp., a promising networking company that was preparing to go public, for his corporate venture-capital fund. Dell suggested the allocation "would certainly help" the relationship between his company and CSFB. Dell declined to comment. But his spokesperson says he was merely trying to
assist the fund and noted that the company did not do any investment-banking business with CSFB before or after the exchange. In a separate e-mail on which Michael Dell was copied, the manager of Dell's personal venture fund requested Corvis shares for the fund. A spokesperson for that fund says it had invested in Corvis in 1999 and there was nothing improper about the request.

Rollins has the same attention to detail as Michael Dell. He is overseeing a Six Sigma transformation of everything from manufacturing to marketing that is expected to help cut expenses $1.5 billion this year. The emphasis is on small surgical strikes on defects and waste, not massive restructurings. Consider a Six Sigma meeting one balmy July afternoon. Rollins listened to John Holland, a technician in Dell's server factory, describe how his team replaced the colored paper it used to print out parts lists with plain white paper, saving $23,000. "Where else do you get a supervisor making $40,000 a year presenting to the president of a $40 billion company?" says Americas Operations Vice-President Dick Hunter, Holland's boss.

The discipline in Michael Dell's management style is most apparent in how the company approaches new markets. Take Dell's plunge into the $50 billion printer business. Beginning in 2001, a team of Dell strategists spent more than a year researching the market. Dell only started serious planning after finding that nearly two-thirds of its customers said they would buy a Dell printer if they could get the same kind of service they got when they bought a PC or server. In the summer of 2002, Vice-President Tim Peters, a veteran of Dell's handheld launch, was tapped to lead the effort. But like any exec planning to put out a new product, he had to face the gauntlet of Dell and Rollins. After thinking up a strategy, he had to sit by while it was picked apart.

Nothing was left to chance. Dell prodded Peters to think about product features and the buying experience, while Rollins pushed him to keep costs low without sacrificing quality. Both bosses wanted to make sure the timing was right. That required intense discussions about how standardized printer technologies were and the state of the supply chain that Dell would use. One key challenge: ink. Customers typically buy replacement cartridges at a nearby retailer. It didn't seem likely that they would wait for days for an Internet order from Dell to arrive.

The toughest task in any product launch is the math. At Dell, a new line of PCs, which is good for $2 billion to $3 billion in annual revenue, costs roughly $10 million to launch. Any new idea must have a comparable return says G. Carl Everett, a Dell senior vice-president who retired in 2001, and turn a profit from the get-go. That's what Peters had to promise in printers. The rare exceptions occur only when Dell senses an opportunity that's critical to the company's future. Dell's server business, for instance, took 18 months to reach profitability, says former Vice-President Michael D. Lambert.

In the printer business, it took seven months for Peters to work everything out. The products debuted in March and were profitable immediately. Peters' proposed solution to the ink riddle: Every Dell printer comes loaded with software directing users to Dell.com, where they can order a new cartridge and have it delivered the next day. Still, Michael Dell never let up: The night before the launch, he sat up until 2 a.m. to watch the printers debut online and then zipped e-mails to Peters with suggestions for improvement. When initial sales came in at double the internal target, Peters' team got a very Dell-like reward: a quick trip to see Terminator 3.

That flick may turn out to have more than therapeutic value, considering that rival HP is determined to wipe out Dell's printer ambitions. HP's strategy is to leave Dell in the dust with a burst of innovation. It spends $1 billion a year on printer research -- more than twice Dell's entire R&D budget. HP is using that money to develop products like high-end photo ink, which will last 73 years, nearly 10 times as long as what Dell offers. "Dell is going to hit a wall," says Jeff Clarke, HP's executive vice-president for global operations. "We view them as low-tech and low-cost. They're the Kmart of the industry." And some experts say Dell won't threaten HP's 60% market share anytime soon. Gartner Inc. estimates that Dell claimed less than 1% of the printer market in the second quarter, mostly at the low end of the business.

ATTACKING FROM BELOW

IF PAST EXPERIENCE IS ANY GUIDE, Dell may struggle as it tries to move upmarket. With its bare-bones R&D budget, it had to kill off high-end servers that go head-to-head with fancy gear from Sun, saying the soft demand didn't merit its attention. And after two and a half years selling networking gear, Dell has failed to deliver products powerful enough to threaten Cisco Systems Inc.'s dominant market share. Yet Dell is betting that as technology improves, the low-end products it sells so deftly will become more than good enough for most customers, leaving rivals scrambling to find their next high-end innovation. "The history of the industry is [that] the attack from below works," says Merrill Lynch's Milunovich.
Indeed, Dell has had no trouble gobbling up sales as markets mature. In storage, its sales now account for 10% of EMC's revenue, some $600 million annually. In the low-margin home-PC market, which Dell long avoided, unit sales have grown an average of 46% in the past four quarters.

Michael Dell certainly would take exception to HP's jabs about his company being the Kmart of tech. But there are some striking similarities between Dell and another giant retailer: Wal-Mart. Like the behemoth from Bentonville, Ark., Dell has built a business as a superefficient distributor, with the tightly run operations and thrifty management to enter any number of new markets quickly and easily. "We've always toyed with the idea that we could distribute anything," says Morton L. Topfer, a former Dell vice-chairman who now sits on the company's board. Maybe not anything. But Dell is striving to greatly expand his reach in the tech world. With his management philosophy of constant improvement, he seems well on his way.

Available online

MANAGING THE DELL WAY

Michael Dell revolutionized the PC biz with a direct-sales model that keeps costs low and customer satisfaction high. That was 19 years ago, yet Dell is still outdistancing rivals. Credit his management principles:

BE DIRECT

It's an attitude, not just a business model. When the CEO talks, he doesn't mince words, and workers shouldn't either. They're supposed to question everything and challenge their bosses. And no one is exempt. In Dell's own annual 360-degree review, workers complained of his detached style, so he has pledged to be more emotionally engaged.

NO EXCUSES

Dell believes in accountability above all else: "There's no 'The dog ate my homework' at Dell," he warns. A manager must quickly admit a problem, confront it, and never be defensive. Dell ruthlessly exposes weak spots during grueling quarterly reviews. And execs know they had better fix the problem before the next meeting.

NO VICTORY LAPS

To Dell, celebration breeds complacency. He once rejected an idea to display Dell artifacts in the company's lobby because "museums are looking at the past." When they succeed, managers must make due with a short e-mail or a quick pat on the back. The founder's mantra: "Celebrate for a nanosecond, then move on."

LEAVE THE EGO AT THE DOOR

The company favors "two-in-a-box" management, in which two executives share responsibility for a product, a region, or a company function. That forces them to work as a team, playing off each other's strengths and watching out for each other's weaknesses.

NO EASY TARGETS

It's not enough to rack up profits or turbocharge growth -- execs must do both. Miss a profit goal, and you're not cutting costs fast enough. Overshoot it, and you're leaving sales on the table. In the past year, the server, storage, and networking chiefs were reassigned, despite solid results. "Pity the folks who didn't use all the bullets in their gun," says a former exec.

WORRY ABOUT SAVING MONEY, NOT SAVING FACE

Unlike its rivals, Dell is quick to pull the plug on disappointing new ventures. The latest: Despite a year of work and extensive news coverage, Michael Dell spiked a plan to put e-commerce kiosks in Sears stores after just four were installed. Instead, kiosks are going into public areas in malls.
BEYOND THE PC

With 80% of its sales coming from the maturing PC market, Dell wants to apply its low-cost ways to new markets. If successful, it could maintain a brisk 15% annual growth rate.

Consumer Electronics

TOTAL 2003 MARKET: $95 Billion

ESTIMATED DELL SALES FOR 2003: NEGLIGIBLE

Dell is dipping its toe into the cutthroat industry with flat-panel TVs, digital music players, and an online music service to appeal to its home PC customers. Dell spent $361 million on advertising last year, much of it to build its consumer brand.

PC Peripherals

TOTAL 2003 MARKET: $65 Billion

ESTIMATED DELL SALES FOR 2003: $3.8 BILLION

Dell has sold its own monitors and digital projectors for years, and introduced its Axim personal digital assistant in late 2002. While it now sells wireless e-mail devices made by other companies, Dell is looking at going solo.

Printers

TOTAL 2003 MARKET: $50 Billion

ESTIMATED DELL SALES FOR 2003: $500 MILLION

Rather than only resell other company's printers, this year Dell debuted six of its own models. Merrill Lynch thinks Dell's printer sales could rise to $1.4 billion in 2006 — good, but not enough to undercut printer king Hewlett-Packard.

Storage

TOTAL 2003 MARKET: $19.2 Billion

ESTIMATED DELL SALES FOR 2003: $1.5 BILLION

For the past two years, Dell has teamed with EMC to develop versions of the storage giant's low-cost models. That has helped Dell nab 5,400 new customers. Look for Dell to build the pricier models in the future.

Networking

TOTAL 2003 MARKET: $11 Billion

ESTIMATED DELL SALES FOR 2003: $127 MILLION

Attracted by networking giant Cisco Systems' 70% gross margins, Dell sees a chance to take significant share with low-end switches that cost 50% less. The major challenge: Developing more sophisticated products.
Services

TOTAL 2003 MARKET: $368 Billion

ESTIMATED DELL SALES FOR 2003: $4.1 BILLION

Besides offering basic repair services, Dell now helps customers make better use of Dell gear -- for instance, when a company needs guidance on setting up a corporate network. Dell hopes this will boost hardware sales -- and margins.

(available online)

BUILDING A BEHEMOTH

Dell is gunning for $60 billion in revenue by 2006, an ambitious goal that requires it to grow 15% a year for the next four years. Here’s how it plans to get there:

<table>
<thead>
<tr>
<th></th>
<th>2001</th>
<th>2002</th>
<th>2003*</th>
<th>2004*</th>
<th>2005*</th>
<th>2006*</th>
</tr>
</thead>
<tbody>
<tr>
<td>PCs</td>
<td>$20</td>
<td>$23</td>
<td>$26</td>
<td>$27</td>
<td>$29</td>
<td>$30</td>
</tr>
<tr>
<td>SERVERS/</td>
<td>5</td>
<td>5</td>
<td>7</td>
<td>8</td>
<td>9</td>
<td>10</td>
</tr>
<tr>
<td>STORAGE</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SERVICES</td>
<td>3</td>
<td>4</td>
<td>4</td>
<td>5</td>
<td>7</td>
<td>9</td>
</tr>
<tr>
<td>SOFTWARE/</td>
<td>3</td>
<td>4</td>
<td>4</td>
<td>7</td>
<td>10</td>
<td>13</td>
</tr>
<tr>
<td>PERIPHERALS**</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>TOTAL***</td>
<td>$31</td>
<td>$36</td>
<td>$41</td>
<td>$47</td>
<td>$54</td>
<td>$62</td>
</tr>
</tbody>
</table>

All figures are revenues in billions

* Estimated

** Including printers

*** May not add up because of rounding

Data: Merrill Lynch & Co., Dell Inc.

[Illustration]

Credit: Andrew Park in Round Rock, Tex., with Peter Burrows in San Mateo, Calif., and bureau reports