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Dell Pins Hopes On Services To Boost Profit

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Abstract (Article Summary)

Mr. [Kevin B. Rollins] focused on maintenance and repair after a review of rivals' service businesses found that 75% of their operating income came from basic install-and-repair procedures, not the higher-profile computer outsourcing and consulting businesses. He believes services can boost Dell's overall profit margin, which has slid to 6.4% from 8.3% during the price war that has gripped the PC industry since 2000. Analysts say Dell reaps margins of about 30% on services, higher even than those on its best-selling computer servers. Dell won't be specific, but Mr. Rollins says the business delivers "better margins" than computers.

A year ago, the Katy (Texas) Independent School District signed a contract with H-P for PCs and services, knocking Dell out as the district's supplier. But under a new contract this year, the district returned to Dell for PCs and installation services. Compared with H-P, Dell's service fees "were less than half the price for installation and de-installation," says Scott Wright, the district's executive director of technology operations. Cheaper services made Dell's total bid 5% below H-P's for the same package, he says.

Many of the service calls from Dell customers are answered in low-wage areas such as Idaho and India. When a problem requires a visit to a customer, Dell searches for the nearest and lowest-cost service provider. Dell uses its clout to negotiate favorable terms from the providers, which include BlueCurrent LLC, Getronics NV, Unisys Corp., and QualxServ LLC. These companies are willing to trade low prices for predictable volumes. Garis Smith, the Getronics liaison to Dell, says the price review is so detailed it requires separate fees for, say, clearing data off 5-gigabyte disk drive vs. a 20-gigabyte drive, Mr. Smith says.

Full Text (1017 words)

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CHRIS PORTER, a 26-year-old computer technician with a master's degree, works for a temp agency. Every day, the agency sends him out to customize Dell computers. That puts Mr. Porter on the front lines of Dell Inc.'s next major business push.

Dell is applying the low-cost techniques that put it atop the PC industry to the computer-services business. It is tapping a glut of trained technicians and hungry-for-work service companies, aiming to make the unsexy business of maintaining and servicing computers for corporations its next big moneymaker.

The low-cost structure mirrors the way Dell revolutionized the PC business a decade ago. While competitors designed their PCs with special bells and whistles and filled warehouses with them, Dell bought components off the shelf and built the computers to customers' orders, reducing overhead and keeping prices low.

With services, "we can do it differently," insists Dell President Kevin B. Rollins. He says Dell's approach results in service costs that are 20% lower than rivals', and predicts the fast-growing business will contribute \$10 billion in annual

revenue within a few years, up from about \$1.5 billion today. By contrast, such services contributed \$9.5 billion to Hewlett-Packard Co.'s revenue and \$25.1 billion to International Business Machines Corp.'s last year.

Yet unlike IBM and H-P, Dell won't repair other manufacturers' equipment, focusing instead on the nearly 90 million computers it has sold in the past five years. That could lessen the appeal of its services operation to customers that own many brands of gear. Dell, though, expects to take customers away from H-P and IBM as these clients buy Dell equipment.

The effort also is giving Mr. Rollins, the company's No. 2 executive and chief strategist, a chance to put his personal imprint on a company closely identified with its founder, Michael S. Dell. A former Bain & Co. consultant, the 50-year-old Mr. Rollins has a chance to create a new business and demonstrate that Dell's cost-and-volume formula applies beyond computer hardware.

Mr. Rollins focused on maintenance and repair after a review of rivals' service businesses found that 75% of their operating income came from basic install-and-repair procedures, not the higher-profile computer outsourcing and consulting businesses. He believes services can boost Dell's overall profit margin, which has slid to 6.4% from 8.3% during the price war that has gripped the PC industry since 2000. Analysts say Dell reaps margins of about 30% on services, higher even than those on its best-selling computer servers. Dell won't be specific, but Mr. Rollins says the business delivers "better margins" than computers.

Beefing up services is crucial for Dell to continue to boost computer sales. H-P and IBM use their services expertise to bolster sales of their servers and PCs, since companies tend to buy hardware and services together. And with H-P slashing computer prices and gaining market share, Dell needs to offer a package of equipment and services.

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Once before, during the height of the dot-com boom, Dell tried to fashion a similar business and failed. That business, Internet consulting, relied on partners such as Arthur Andersen, Xuma, MarchFirst and Lante Corp., but its plan, and many of its early partners, fizzled amid the dot-com bust.

Competitors predict Dell's new, basic-services thrust also will fall flat. Customers want one company to take care of their services needs, not a ragtag army of outside contractors, insists Neil Knox, executive vice president at Sun Microsystems Inc. "What Dell is trying to do in a loosey-goosey manner will prove very, very challenging," he says.

Some of the methods Dell uses to keep costs down do, in fact, irritate some customers. James McKinnie, computer administrator at Intelligent Business Solutions, a Winston-Salem, N.C., developer of medical-records software, says it irks him that Dell sent refurbished parts when his servers needed repairs.

"You're paying that new sticker price. When there is a problem, why are you getting refurbished parts?" he wonders. Mr. McKinnie says his next purchase will likely be elsewhere. A Dell spokesman says its practice of providing new and refurbished parts is the same as rivals'.

Despite such criticism, Mr. Rollins believes Dell can reshape the economics of the services business. By teaming with specialized companies and assembling a database of past problems and fixes, Dell can resolve 93% to 98% of its customers' computer-server problems over the phone in about 15 minutes, says Gary Cotshott, Dell's vice president of services.

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Dell pays these subcontractors a flat fee for each visit based on the particular task performed. On bigger jobs, Dell may ask its contractors to compete, auctioning the work to the lowest bidder.

Does it bother customers if the technician who shows up isn't a Dell employee? Not among companies that have embraced computer outsourcing and so are used to having other companies run their equipment. "If you find a subcontractor that's able to support your customer base, that's smart business," says Ed Wojciechowski, chief

information officer at Menasha Corp., a Neenah, Wis., packaging and printing company that's a Dell services customer.

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