Porter's five forces analysis of dell

Introduction

Dell is a computer hardware firm that offers “ a broad range of product categories, including mobility products, desktop PCs, software and peripherals, servers and networking, services, and storage” (Annual Report 2008). 61 percent of these products are PCs. Dell’s business strategy focuses on direct relationships with customers, improving competitiveness by reducing overall costs, and reaching more customers worldwide through new distribution partners (Annual Report 2009). According to Gartner, Dell holds 3rd largest global personal computers (PC) market share of 12. 8 percent in the 3rd Quarter of 2009.

The PC industry is one of the fastest growing industries in the world, with a 6. 6% growth in 2008, reaching a value of US$203. 7 billion (Data monitor 2009). The competition in the industry is moderate (see figure 3). Factors contributing this statement will be explained using Porter’s Five Forces.

Supplier Power

There is a strong supplier power. Component parts of a PC are relatively homogenous and standardized in nature, with fragmented suppliers (Sun Microsystems, NVIDIA, Hynix, etc), and they do not focus on product differentiation. PC manufacturers have many substitutes to choose from. However, there is a concentrated amount of supplier in terms of CPU and Operating Systems (OS) software. Intel dominates the manufacturing of processors (CPU), with 80. 6 percent market share in the processor market, while AMD only has 11. 5 percent (theinquirer. net September 2009). Intel has a strong brand which could be a significant bargaining chip with PC producers. Similarly, Microsoft dominates the operating system market (90%

market share). The industry's reliance on these two major suppliers inevitably triggers PC manufacturers to establish good relationships with these corporations, while some attempt to diversify its risks by increasing the number of AMD and other OS ran PCs. Dell's launch of the IdeaStorm website (see Financial Times) to find out customers preference for Linus operated PCs was a strategic attempt to begin diversifying its risks.

Buyer Power

There is a moderately-strong buyer power. Although buyers are fragmented (many, different), there is a significantly low expected switching cost given that the product specifications are relatively homogenous. With that, it leads to a low product satisfaction-loyalty relationship (Matos, Henrique, & Rosa, 2009), thus although customers' first satisfying experiences with the one PC does not assure the relevant PC manufacturer their repurchase intentions. There is certain degree of product differentiation nonetheless, in terms of style and design, and high brand awareness might create a certain level of brand loyalty, but most buyers are more interested in quality, product specifications and costs. There are some exceptions of course; Apple computers which use Macintosh operating system (OS) have high switching costs due to the vast differences between Microsoft and Macintosh OS. In this case, Dell should compete in terms of lowering production costs, and increase brand loyalty not through product specifications but servicing quality. E-commerce which eliminates retail costs (see Kumar & Craig, 2007), and on-site servicing are good strategic methods Dell has focused on and should continue.

Barriers to Entry

Barrier to entry is moderately-strong. Existing industrial players have strong brands and hold many patent rights. To enter the market, entrants are required to invest on R&D or the purchase of patent rights, which is often expensive. Existing industrial players are large and possess high internal economies of scale. Dell and HP have various departments specializing in different aspects; marketing, product innovation, servicing, etc. They are able to distribute their fixed costs, as well as managerial costs to a larger output, giving them significant cost advantages. Existing bulk purchase agreements have already been established with key suppliers, such as Microsoft's agreement with Dell to install its OS in production factories. Potential entrants will face challenges in gaining supplier confidence in both production as well as credit issues.

Threats of Substitutes

There is a moderately-weak threat of substitution given that the functionality of a PC is irreplaceable. Other electronic gadgets are often complementary to that of PC. For example, an mp3 player or a camera requires plug-ins with a computer to do file transfers. However, threats lies among the youth customers who are more attracted to the next generation game consoles such as Wii, PS3 or Xbox. Although the threats of substitutes are moderately-weak in general, targeting the youth market is crucial for long term profits as customer loyalty would be established at an early stage. Dell's acquisition of Alienware, a high-performance gaming PC manufacturer, in 2006 (NY times) was indeed a strategic move. More focus should be placed in expanding Alienware's brand value equivalent to that of Dell.

Degree of Rivalry

The degree of rivalry is moderate. In the past, “ Michael [Dell] has been absolutely brilliant at getting the industry to compete on his best basis for competition-price, delivery, and the ability to configure to order. But now the others can differentiate in ways that matter to the customers” (Kirkpatrick, 2000). Such differentiation includes establishing a brand identity among customers, personalizing customers’ respective PCs in terms of specifications, colors and designs, and the ability to innovate at a rapid pace to achieve short term competitive advantage (Lawless & Anderson, 1996) since an innovative new product tends to face low competition at the point of introduction before it is imitated (Roberts, 1999). Coupled with a high Concentration Ration of 57%, it decreases the level of rivalry. However, the homogeneity of the CPU from Intel and its monopolized Microsoft OS (except Macintosh) creates low switching costs for customers, which increases the cross price-elasticity of demand of the products, thus increasing rivalry. Still, the relatively strong growth, in addition to the successful introduction of the Netbook, means that firms could expand without the expense of its competitors. It is bad news to Dell as it specializes in production efficiency, not so much in product innovation. Its organizational culture might not be ready for a switch to innovative-led production. Outsourcing its R&D department might provide a new solution to the firm, while developing its own simultaneously.

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1. Financial Times 29 October 2009: Technology – How laptops took over the world.

2. Expected switching cost: The customer’s estimate of the personal loss or sacrifice in time, effort and money associated with the customer changing to another service provider. (Hellier, Geursen, Carr, & Rickard, 2003). It involves both financially and psychologically. (Dick & Basu, 1994)
3. High brand awareness: Interbrands 2009 Best Global Brands Ranking, IBM (2nd), HP (11th), Apple (20th), Dell (35th).
4. Interbrands 2009 Best Global Brands Ranking, IBM (2nd), HP (11th), Apple (20th), Dell (35th).
5. Dell has worldwide portfolio of 2, 253 patents, HP has 32, 000 patents, (Taken from Dell 2009 and HP 2008 Annual Reports) and Acer has a patent value of US $692, 000, Lenovo has US $5, 199, 000. (Acer 2008 and Lenovo 2009 Annual Report)
6. New York Times March 23, 2006: Dell to buy Alienware, a maker of high-end PC’s for Gamers.