

THE

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AUSTIN LETTER

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P.O. Box 1905 / Austin, Texas 78767-1905 / 512-498-9495 / Fax 512-327-1976 / e-mail News@AustinLetter.com

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Dear Client:

When Dell Computer began slashing prices late last year, its competitors (IBM in particular) called it “really dumb.” The price war is still raging, and every day, Dell looks smarter and smarter. In fact, the price war *timing* is particularly clever.

First, the tough economic environment leaves stocks depressed and **investors more forgiving of lower expectations**. Why try to hit home run numbers when you are not likely to get much credit for it? Second, with most customers eyeing their own bottom line, they are much more likely to be influenced by the low-price sales pitch. Lastly, the weak economic environment makes it even more **difficult for Dell’s competitors to fight back**.

Those are the views of **J. William Gurley**, a venture capitalist writing in the 7/9/01 issue of *Fortune* magazine. Gurley also points out that, by pushing for market share gains through a price war, Round Rock-based Dell has presented its competitors with a true lose-lose dilemma:

“On one hand, you can try to maintain market share by pricing against Dell. The problem is that because of its business model advantage, **Dell can stand in the deep end of the pool forever**. A competitor wading down there will likely run out of oxygen before too long.

“The other possible response is to declare the price war irrational. The problem here is that along the way you lose market share, and Dell continues the tear that led it to become the #1 maker of PCs in the world in the first quarter of 2001. **Sitting out the war is as dangerous as entering it**, which is precisely why Dell’s decision to push the pedal during these tough times is so remarkably shrewd.”

But, what about Dell’s bottom line? Gurley says “the unique aspect of Dell’s business advantage is its negative cash conversion cycle. Because it keeps only five days of inventories, manages receivables to 30 days and pushes payables out to 59 days, **the Dell model will generate cash – even if the company were to report no profit whatsoever**. Even in an environment where a price war eliminates all profitability – including that of Dell – the company will remain cash flow positive. **No wonder Dell would be willing to start a price war and IBM would find it ‘dumb.’** The screws are turning deeper, and Mr. Dell is asking everyone to put up or shut up – hoping they will choose the latter, and hoping that they eventually exit the business.”

What does the coming collapse of the United Airlines/USAirways merger and the full-throttle purchase of TWA by American Airlines mean for Austin air travelers, as well as Texas-based American's operations?

The “what-might-have been” with the United Airlines/USAirways merger, frankly, turns out **not to be much of a loss to the Austin air traveler**. United is not a big player in Austin, boasting only a 6.1% share of the passenger market here. And, US Airways doesn't even fly into Austin-Bergstrom International Airport (ABIA). Since United has so few flights at ABIA, the biggest hope – for which there were no guarantees – was United *might* add flights to take advantage of USAirways destinations. Of course, this hope is now moot.

But, for Austin, the American Airlines takeover of St. Louis-based TWA is another story altogether. **TWA was in bankruptcy court and ABIA was in danger of losing TWA's few Austin flights that offered good connections to the Midwest** through its St. Louis hub. TWA will ultimately disappear, but American – with its many flights out of Austin – will offer even better connections to the nation's heartland, as it assumes TWA's St. Louis hub operations.

What is the timing of the American/TWA deal? Well, you know AA closed the purchase of TWA in April. But it takes time for deals of this size and complexity. **So it will take several years for TWA to be fully absorbed**, but AA is making changes daily. The most visible – repainting TWA planes to use AA colors and logos along with TWA markings.

When it's complete, **Austin air travelers will have the biggest and most comprehensive long-haul airline in the nation as one of its two most dominant carriers**. In fact, AA is now the largest carrier in the nation, surpassing United. AA also will offer three excellent east-west hubs, once it gets St. Louis and Dallas-Ft. Worth adjusted and working well with its Chicago hub (United can count on only Chicago and Denver, and both have some problems).

On top of that, **Austin air passengers already enjoy the biggest and most comprehensive short-haul airline in the nation**. With Southwest Airlines running so many flights each day, it dominates – by far – the air traveler market in Austin. The latest figures show Southwest carries 37.8% of all the passengers and AA is #2 with 23.4% market share through May. It appears Austin (for its size) may have some of the best air travel options in the nation. And, as an added plus, both airlines are Texas-based.

While AA's potential as the biggest airline in the nation appears to be quite good, the **airline industry as a whole is in the midst of serious financial problems right now**. All airlines, except Southwest, are losing money. And, Southwest is feeling the pinch so much, it initiated a major fare war that most airlines are matching on routes where they compete with Southwest. Which brings us to our final point: if you're looking for cheaper airfares for your business, or for leisure, you have until mid-July to book low-fare trips that will be good until December.

Since recent research has shown Austin is attractive to tech workers because of numerous lifestyle elements that appeal to knowledge workers, and because there is a pervasive notion Austin is a place where careers can be kicked off, jumpstarted or even rejuvenated, what recommendations do researchers have for Austin businesses?

In the last few editions (6/29/01, 6/22/01 and 6/15/01), you have noticed a **careful examination of some of the key findings** in the Benchmark Company's comprehensive study titled *Austin at The Crossroads: How the Downturn Impacts a Tech City*. The timely study of workers in Austin yielded some interesting findings. So now the obvious question arises: what should be done as a result of this research into the impact of the tech downturn in Austin?

Benchmark's CEO **Rob Balon** suggests **"from a recruiting standpoint, don't knee-jerk."** He says his research found "many qualified applicants are in the Austin area and they're not about to leave." But, he did urge some specific actions based on what the workers told him:

"Austin firms must make a concerted effort to address the issues of gridlock and the 'Expectation Deficit,' Balon counsels. You can go back to our 6/15/01 issue for the details where Balon pointed out the number of workers who say the Austin area has not been what they expected it to be (the 'Expectation Deficit') is growing. Two suggestions: **flex time and staggered hours** to reduce the traffic crunch.

"Also, the avenues for providing more **affordable housing** must be explored," advises Balon. "Most in previous Benchmark surveys think Austin housing is unaffordable. This drives workers further and further out and creates a sense of disassociation with the city."

Balon notes the Austin area workforce is highly educated, with 85% claiming at least some college education. As a result, he recommends **companies should take advantage of retraining**. "Austin area employees are used to it," he observes. "Forty percent of the workforce has gone through some retraining for their most current job. So, don't stereotype jobs or job categories. **The local workforce is surprisingly adaptable.**"

The other major recommendations that came out of the Benchmark study revolve around usage of the Internet in your business. **"The Internet is not about to fade away because tech firms are laying off,"** concludes Balon. "It may not portend the advent of an entirely New Economy, but it certainly has created new philosophies and new ways of doing business."

In fact, Balon points out consumer spending on Internet purchases rose 35% in 2000 and high speed Internet connections are up more than 150% in the past year. **"While Wall Street may have cooled on the Net, the average consumer or business user has not,"** claims Balon. "And our Benchmark data reveals that more than 80% of Austinites are Net users. The Austin area will still have pure play Internet firms, but the key is building value and a sense of stability for the customer, as well as the employees."

It's not talked about, but it's in the back of everyone's mind. And, you can bet there is a contingency plan in place at the very highest level. What happens if Vice President Dick Cheney is not able to finish his four-year term?

Cheney, the survivor of his first heart attack at age 37, is walking around with a highly sophisticated, computerized defibrillator implanted in his chest – a machine that can **immediately shock his heart back into operation in case of another heart attack.** As a result, the odds of his heart disease turning fatal are in Cheney's favor.

But, what if the heavy burden of being the most powerful and hardest-working VP in US history becomes too much for someone with heart disease? **What if his doctors, or Cheney himself, decide the situation is too untenable to continue?**

The law provides for the President to choose a successor. And who might that be? Put your money on Secretary of State **Colin Powell.**

It's believed Powell was **George W. Bush's** first choice for VP, but Powell's wife strongly objected to Powell's involvement in a bitter campaign. That objection reportedly has been tempered, and all Powell would have to do to become VP would be to raise his right hand and swear to uphold the constitution.

Looking even further into the future – at a possible bid for a **second-term** for a Bush presidency – a **Bush/Powell ticket** (assuming there are no political disasters during Bush's first term) would be the odds-on favorite to win a 2004 national election. It probably wouldn't matter who the Democrats put on their ticket, the Bush/Powell slate would still be favored. Obviously this is speculation. But, knowing those closest to Bush, **it's hard to believe they don't have a plan such as this quietly in place** – ready to implement, if circumstances dictate.

Dr. Louis Overholster likes to point out we're living in times of great convenience: "Thanks to air conditioning and the stock market, you can have cold chills all year long!"

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