

Case 6-4 Intel Pays High Price for Losing Focus

Getting customers to try a product is important. But maintaining their loyalty is just as vital—if not more so—to a business' bottom line. It's a relatively well-known fact in the management world that it takes five times as much to attract a new customer as it does to keep an existing one.

Intel Corporation spent years—and millions of dollars—convincing consumers that its microprocessor chips are the brains of personal computers. With its campaign, “Intel Inside,” the company managed to make its brand a household name in regard to computers. By 1994, 80 percent of personal computers contained Intel chips.

Dell computers, especially, benefited from the “Intel Inside” campaign, rising to the top of the PC industry as an “Intel-only” competitor. By the end of 2005, Dell was the global leader in PC manufacturing, with revenues in excess of \$55 billion.

Intel, too, was doing well. At the close of 2005, Intel revenues had grown from \$20 billion in 1996 to more than \$38 billion, with sales to Dell and HP comprising about 35 percent of its business. Another 60 percent went to Asia, where most electronic manufacturing takes place.

But after spending so much time and money winning over customers, the company, made up mainly of engineers and mathematicians, failed to take the next step—keeping customers happy.

Release of the Flawed Pentium Chip

In the spring of 1993, Intel released its Pentium series of chips—the company's most advanced microprocessor. About a year later, the company began receiving complaints from

some high-tech users concerned with erroneous calculations. About the same time, the company discovered that the chip contained a flaw—a bug that affected complicated computations. Believing that the flaw affected mainly high-end theoretical math problems and that there was no impact on the average personal computer user, Intel decided not to alert customers about the problem. Until October 1994 (18 months later) when a new chip was designed and distributed, Intel continued to sell the flawed chip.

On October 30, 1994, a mathematics professor at Lynchburg College in Virginia reported the problem in an Internet message. The story spread quickly, at first through the computer industry, then among the general public. Intel's initial reaction was mainly defensive. Company spokespeople claimed the problem was so minor that it would affect a computer's calculations only once every 27,000 days (or more than seven years). They also pointed out that most computer chips by their very nature have some type of flaw or bug when they are released. Experts acknowledged the truth in that, but admonished Intel for failing to let the public know about the flaw and letting customers make their own decisions as to whether it was a big deal.

Intel Takes a Defensive Stance

For weeks, Intel maintained its defensive position. The company had the facts on its side and thought the facts mattered. Intel engineers didn't know that it's how the facts are presented and perceived that matters. In that light, it offered a replacement chip *only* if consumers could prove that the flaw affected them.

For several weeks, Intel managers held 8 A.M. daily meetings to work on the crisis. Each member of the group reviewed news stories that covered the Intel issue and discussed reports that contained information from sales representatives in the field and from the customer hotline set up to handle customer questions. The group met again at 5 P.M. each day, sometimes staying until late in the night. After two weeks, calls to the hotline slowed down. Intel executives began to think the worst was over.

IBM Deals a Deadly Blow

In reality, the worst was yet to come. On December 12, IBM announced that its scientists determined that the flaw could affect users much more often than Intel claimed. As a result, IBM suspended shipments of computers containing Intel chips.

The news stunned Intel. In a *New York Times* article, Intel's then-CEO Andrew Grove said that was when he started to realize "an engineer's approach is inappropriate for a consumer problem."

In addition to the IBM announcement, consumer advocacy groups were concerned:

- Attorneys general in two states asked Intel to level with customers.
- The Gartner Group, a well-known and respected consulting group, said companies would be wise to put off purchasing computers containing Pentium chips.
- On the Internet, where news of the flaw was initially released, more than 10,000 messages were posted.
- Engineers and computer writers wrote harshly about Intel's reluctance to replace the flawed chip.

An About-Face for Intel

On the Tuesday after the IBM announcement, Intel ran ads in major newspapers containing an apology for the way it had

handled the flaw. It offered to send a new chip within 60 days to those who requested one and to help install the chip or pay to have someone do it.

Intel continued to dispute IBM's findings that the flaw would affect users once every 24 days instead of once every 27,000 days as Intel had claimed. Grove told *USA Today*, "We hope to convince them, engineer to engineer, that they're wrong." But some analysts thought politics were behind IBM's decision to stop shipments. At that time, top PC makers were concerned with Intel's dominance in the market. Some were busy developing their own chips.

Regardless, Intel was faced with a serious public relations crisis. From the beginning, CEO Andrew Grove spoke for the company. An engineer by nature, he told *USA Today* he was shaken by the episode. "I feel personally responsible for the decisions," he said. "These are harsh lessons to learn. We made a lot of mistakes. But we can't replay history."

Wall Street was immediately pleased by Intel's change in its replacement policy for the flawed chip and its public apology. Intel's stock was the second most actively traded stock that day, rising \$3 to just over \$61 a share. Explained Drew Peck of Cowen & Co in *USA Today*: "Rightly, analysts and investors see this as stopping the crisis."

A High Price to Pay

If only the crisis could have been avoided. When the final figures came out in January, Intel realized how expensive its mistakes had been: It took a \$475 million charge against its fourth quarter earnings to cover expenses incurred from replacing the flawed chip. Analysts had anticipated the charge would be between \$50 million and \$300 million. Fortunately for the company, net income fell just slightly for the year.

■ 156 CHAPTER 6 Consumer Relations

Not Intel's Last Recall

In his book *Only the Paranoid Survive*, Andrew Grove wrote that this incident, Intel's first recall, was a defining event for the company. Since then, Intel has been forced to recall other products. It has also felt the pressure of consumers regarding product design.

The Pentium 4 was introduced in November 2000 *without* the controversial PSN (Processor Serial Number) that was in the Pentium 3. Its presence in Pentium 3 processors caused consumers to boycott Intel, because they feared an invasion of consumer privacy, according to the organization Big Brother Inside. Intel's push to be first in this market—to beat out its competition—is continually being tempered by consumers' needs and expectations.

In 2006, Intel and Apple announced new software (Boot Camp) that will permit

Mac users to install Windows XP and thereby use Apple Computers as if they were Microsoft-based PCs. The technology that permits this revolution in computer usage is contained in Intel's microprocessors, which Apple began using in 2005 after a long relationship with Motorola. Thus, Apple, with Intel's help, is positioned to recapture some of the momentum currently held by Microsoft and PCs.

But, not long after the Boot Camp announcement, Dell announced it would begin using high-end microprocessor chips from AMD. Although this decision likely had little or nothing to do with the flawed chips, it is the first major departure by a major chip customer. Time will tell if this is a blip on the screen or the first step in a trend away from Intel's chips for high-end usage. ■

QUESTIONS FOR DISCUSSION

1. How might formal research by Intel have helped the company's strategy?
2. What can go wrong with an "engineer's approach" to a "consumer problem"?
3. What value is there to the "engineer-to-engineer" approach?
4. When facts and perceptions clash, which usually prevails? Why?
5. Should Grove have acted as Intel's spokesman during this crisis? Why? Why not?
6. Do you think the \$475 million cost of the recall influenced Intel's strategy? How?
7. Why did IBM "turn on" Intel (a valued supplier) during the crisis? What impact did that have on the outcome?