

The Declining Price of Personal Computers: The Question of When to Invest

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When should a manager invest in new technology? This paper provides guidelines for deciding when to invest in microcomputers. The authors argue that the technology and marketplace of micros today fits the conditions of the declining cost paradox observed by Eden and Ronen (1988). Under these conditions, a decision to defer purchasing equipment until the future to take advantage of hardware price decreases may lead to higher overall costs. The paper concludes with recommendations for the manager confronted with the decision of when to purchase microcomputer technology.

Keywords: Personal Computers, Declining Cost Paradox, Investing in Technology, Management of Computing, Information Systems



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1. Introduction

Managers confront the decision of when to buy new technology when considering the purchase of personal computers. The user requesting personal computers wants to take advantage of improved computer performance. If the firm does not buy now it will lose the advantages it might gain from the new technology. The financial manager, however, may argue that the price of personal computers is dropping and that the organization should wait to purchase until some time in the future when the required investment will be less. The purpose of this paper is to offer an approach to the decision of when to buy personal computers in the face of declining hardware costs.

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2. The Declining Cost Paradox

In an earlier paper, Eden and Ronen (1988) developed a model of when to invest in technology in general under conditions of declining costs. In their research, the authors found a paradox: under certain conditions total costs might actually increase by waiting to purchase to take advantage of declining hardware costs! As stated by Eden and Ronen:

The greater the decline in the cost of a particular technology, the more urgent it may be to purchase the technology now.

The paradox only holds under certain conditions, and these conditions appear to characterize the current personal computer industry.

2.1. Conditions of the Paradox

1. The first condition required by the paradox is a decline in the expected cost to invest in the technology in the future. Certainly, for personal computers, there has been a steady reduction in the cost of individual components like the CPU, memory, diskette and disk drives, and so on. (There have been temporary increases in component prices due to government trade policies and shortages, for example, the recent shortage and increase in the cost of 32 bit DRAMS. However, over the long run, costs have been declining as power has increased.)

2. The second factor which contributes to the paradox is postponed or foregone benefits from the technology. The user must incur a cost by waiting for new technology. He or she has to postpone a planned application. The cost of being the fourth rather than the first airline reservations system to install personal computers in travel agents' offices is likely to be quite high. On the other hand, the cost of waiting for a 386 based machine to replace an 8088 PC for word processing is quite low.

3. Eden and Ronen observe that there is tendency to spend about the same amount on a system despite the fact that components are dropping in price. Part of this tendency is forced on the consumer by vendors; it is very hard today to find an 8088 PC that comes with 64K bytes of memory; vendors package machines with 256K or more memory, typically 512K or even 640K bytes. While two diskette machines are available, most corporate

buyers will opt for a hard disk unless the machine is to be a diskless workstation on a network.

The appeal of advanced features to users also encourages the tendency to buy more in the face of declining prices. In 1988 the Leonard N. Stern School of Business at NYU adopted a hard disk, color monitor system as its recommended computer for students in the Graduate Division. This configuration costs essentially the same as a two diskette model recommended the previous year. Both vendor offerings and the appeal of more powerful features to users encourage the purchase of systems whose total price does not decline as rapidly as the prices of their individual elements.

4. Software advances have accompanied advances in hardware. New versions of software and entirely new types of programs are available for the user. In addition to the purchase price, users have a significant learning cost for software. The longer one waits to adopt the technology, the greater the learning costs are likely to be. The user who bought an early PC and learned to use Lotus version 1A can make the transition to version 2 easily. The user who waited to buy a PC until version 2 of Lotus became available will have to learn a more complex piece of software.

5. The cost of PC software has not declined significantly. If anything, prices of software are rising as developers add more capabilities to their programs. The user who buys earlier can generally upgrade to subsequent versions of a package for a fee that is less than the purchase price of the new version.

2.2. The Tradeoffs

The Eden and Ronen model demonstrates under what conditions one should buy today rather than postpone a purchase. Intuitively, their model trades off the decline in the cost of technology against greater learning costs from postponing the purchase of a system. Foregone or postponed benefits are an important component of the model. The user who postpones purchase is likely to encounter steeper learning costs because advances in software will produce more complex and difficult to learn applications.

The model also suggests that the decline in the

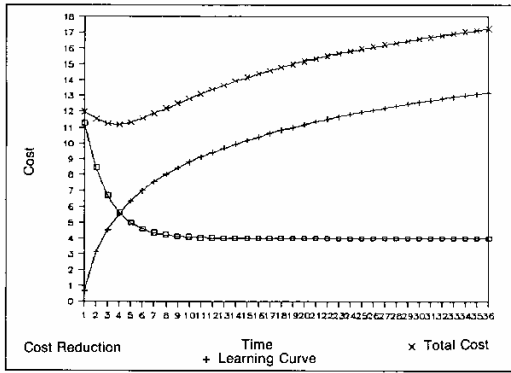


Fig. 1. Cost Reduction Vs the Learning Curve

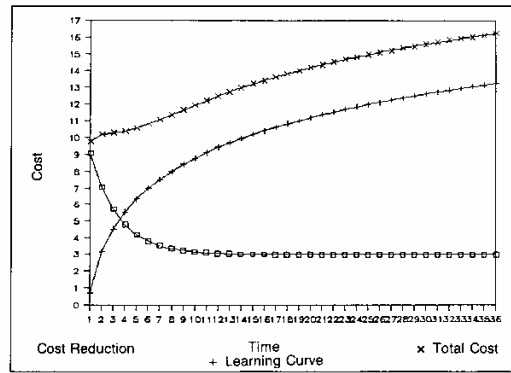


Fig. 2. Cost Reduction Vs the Learning Curve

costs of technology are partially offset by the tendency to purchase more powerful systems. As mentioned above, organizations today generally purchase a hard disk system as opposed to the original PC with diskette drives. (The hard disk system is also more complex to use than a two diskette PC.)

Figures 1 and 2 illustrate the tradeoff between the declining price of technology and the increasing costs of learning. In the figures the declining cost of hardware has been modeled by a curve of the form:

$$\text{beta1} + \text{beta2} * e^{-\text{alpha} * t} \quad (1)$$

where t is time and alpha , beta1 and beta2 are parameters. Prices are expected to drop quickly and reach an asymptote where further reductions are unlikely using current technology.

The learning cost curve is modeled by:

$$\text{theta} + \text{gamma} * \log(t) \quad (2)$$

where t is time and theta and gamma are parameters. The total cost curve is the sum of the technology cost and learning cost curves. This illustration does not include considerations of postponed benefits; it simply shows the tradeoff between decreasing hardware costs and increasing learning costs over time.

Ignoring postponed benefits, in Figure 1 the minimum purchase cost comes around time 4; here the decision maker would have to consider postponing a decision to purchase until that time depending on the advantage accruing from purchas-

ing earlier. In this example, costs for the technology drop more rapidly than the learning cost curve rises. In Figure 2, the shape of the curves suggests that based on technology cost declines and learning costs, one should purchase now.

2.3. Benefits

Based on costs alone, Figure 1 suggests that the decision maker may want to wait to invest in new technology. Whether or not one should wait to buy depends on the benefits expected from investing in the technology. What benefits would accrue to the organization from having the technology now rather than at time 4?

Figure 3 attempts to answer this question. Assume that two decisions are possible: purchase at time 1 or time 4. Figure 3 shows two identical benefits curves for purchasing at these two times; it

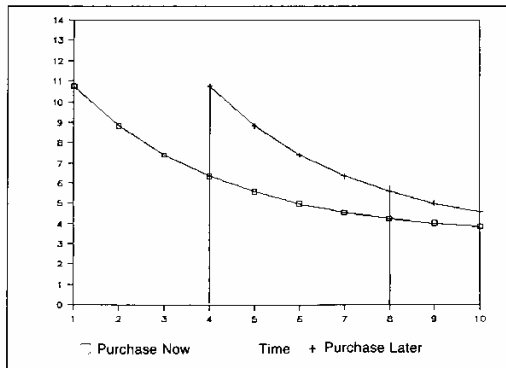


Fig. 3. Benefits

assumes that there are declining benefits from the investment and that if one waits until time 4, the benefits curve will start at the same level as purchasing at time 1. At time 8, the organization which purchased at time 1 will have obtained the benefits under the "purchase now" curve from times 1 to 8. The organization which waited will have obtained only the benefits from time 4 to 8 under the "Purchase Later" curve.

The decision maker will have to balance the additional benefits of purchasing now against the cost savings from waiting until later to invest in the technology.

3. Components of the Paradox

The paradox is based on five conditions described earlier. What is the evidence for the conditions leading to the Paradox for personal computers?

3.1. Declining Hardware Costs

The decline in PC hardware costs is well-known in the industry. The steady trend is to place more circuits on a chip which has helped to reduce the costs of computation. The decrease in cost per MIP is fairly steep and does not appear to approach an asymptote. While it is expected that silicon may reach a limit, faster chips are being fabricated out of gallium arsenide. Laboratory researchers are working on heterojunction transistors which have attained switching speeds of 2 picoseconds or two orders of magnitude faster than silicon chips. For the logic chips for PCs, costs have been decreasing as power has increased. In general the same trend has been observed for primary memory and disk storage.

3.2. Benefits

As described above, the benefits from adopting the technology now rather than postponing the investment depend on the user and the organization; these benefits are unique to each purchase decision.

3.3. Declining Costs, Steady Prices

The third condition of the paradox is the tendency for system costs to decline much more slowly than component costs because 1) vendors include more standard features in their products and 2) users are attracted to more advanced features.

Table 1 illustrates the costs of a typical PC-based workstation from 1983 through 1988. During this period the capabilities of the workstation have expanded as the total system cost has stayed nearly constant. The typical system doubled in memory and added a hard disk. Companies have gone from a two diskette system to a 20 or 40 megabyte hard disk XT or AT with enhanced color graphics as their standard machine.

Table 2 adds software to the analysis; software costs have fluctuated, but in general have not declined dramatically. New operating systems like OS/2 are considerably more expensive than their predecessors, especially if the Presentation Manager is included.

Tables 2 and 3 illustrate that if one prices the systems that firms have typically adopted as their standard over time, system costs have not decreased as dramatically as the costs of individual components.

3.4. Greater Complexity

Greater complexity of systems and software lead to an increasingly steep learning cost curve. The demands on organizations for training and personal computer support are high. The greater the complexity of the software, the more difficult and costly it is likely to be to learn. The manager who postpones acquiring the technology until some time in the future will purchase hardware and software which will confront users with greater complexity.

The IBM PS/2 is a more complex machine than the original PC. The system features 3.5" instead of 5.25" diskettes and has a new bus called the microchannel. The system can be configured using software commands rather than hardware switches. When combined with new operating systems, the PS/2 should be capable of multiprocessing and multitasking. While the machine can be run as a first generation PC, its advanced features introduce new complexity for the user.

Table 1
Trends in PC costs*

| PRODUCT (HARDWARE) | 1983 | 1984 | 1985 | 1986 | 1987 | 1988 |
|---|------|------|------|------|------|------|
| IBM PC (256K 2 DR. MONO DISP) | 3430 | | | | | |
| SAME ABOVE + 128K | | 3000 | | | | |
| SAME ABOVE + 256 K 10Mb HARD | | | 2800 | 1826 | | |
| IBM XT 10Mb HARD + 256K | | | 3450 | 2713 | 1483 | |
| IBM AT 20Mb HARD + 512 + 1.2Mb FLOPPY MONO DISP | | | | 4522 | 3331 | |
| DELL 286/220, 4MEG HARD, VGA COLOR | | | | | | 3299 |
| EPSON FX80 | 579 | 579 | 389 | 375 | | |
| EPSON FX85 | | | | 353 | 336 | |
| EPSON FX86e | | | | | 384 | |
| EPSON LQ-2550 | | | | | | 939 |
| IBM MONO DISP | 335 | 335 | 248 | 234 | 223 | |
| IBM COLOR | | | 589 | 603 | 538 | |
| IBM ENHANCED COLOR | | | | | 665 | |
| IBM PRINT ADPT | 234 | 234 | 234 | 218 | | |
| IBM CGA | | | 219 | 226 | | |
| IBM EGA | | | | | 400 | |
| SMARTMODEM 300 | 234 | 211 | 197 | 137 | 129 | |
| 1200 | 533 | 506 | 457 | 381 | 385 | |
| 1200B | | 472 | 376 | 339 | 338 | |
| 2400 | | | | | | 449 |
| AST 6PAKPLUS 64K ABOVE BOARD 2 INTEL | | 277 | 262 | 228 | 169 | 479 |

* When a category has more than one model the latest model and price are used in calculation of total prices.

An analysis was performed of changes in several popular software packages as they have passed through different versions.¹ Between Lotus 1A and 2.01, Lotus added a number of features and commands. Among the more notable additions are matrix calculations and a regression procedure. Lotus 2 also provides string variables in addition to labels and values as data types.

Word Perfect has progressed from versions 3

¹Tables describing this analysis are available from Professor Boaz Ronen at Tel Aviv University.

through 5 over a relatively short period of; this application has grown from a relatively simple word processor to a package approaching the capabilities of desk top publishing software.

dBASE, a popular database management system, has undergone many changes over time. See references 1, 3, 4, 5, 7, 9, 11, 14, 16, 18, 19, 20, 21, and 23. Note that the manual for this popular database package has increased in size from 375 pages to over 1000. dBASE III+ has a screen painter and custom forms capability. dBASE III has 52 more commands than its predecessor while dBASE III+

Table 2
Trends in Software Costs*

| PRODUCT (SOFTWARE) | 1983 | 1984 | 1985 | 1986 | 1987 | 1988 |
|-----------------------------------|---------|---------|---------|---------|---------|----------|
| dBASE II | 469 | 424 | 289 | 294 | 294 | - |
| dBASE III | | | 379 | 383 | - | - |
| dBASE III + | | | | | 390 | 365 |
| LOTUS 123 | 339 | 339 | 304 | 316 | 316 | 298 |
| WORDPERFECT | 350 | 350 | 290 | 224 | 196 | 242 |
| HARVARD PROJECT MGR | | | 258 | | | |
| HARVARD TOTAL P.M. | | | | 275 | 311 | 350 |
| HARVARD GRAPHICS | | | | | | 272 |
| MICROSOFT CHART | | | 173 | 182 | 178 | - |
| PEACHTREE ACCT SYS DACEASY (3) | 1200 | 1200 | 900 | 900 | 199 | - 163 |
| HAYES SMARTCOM II | | 84 | 96 | 95 | 85 | - |
| SIDEKICK | | | 41 | 38 | 47 | - |
| SIDEKICK PLUS | | | | | | 65 |
| SIDEWAYS | | 45 | 46 | 37 | 41 | 42 |
| NORTON UTILITIES | 65 | 60 | 58 | 58 | 50 | - |
| NORTON UTILITIES ADVANCED | | | | | | 79 |
| COPY II PC | 35 | 32 | 30 | 28 | 22 | 22 |
| PC TOOLS | | | | 22 | 21 | 36 |
| PROKEY | | 57 | 87 | 87 | 75 | - |
| THINKTANK | | | 136 | 105 | - | - |
| FLIGHT SIMULATOR | 35 | 34 | 36 | 31 | 29 | 29 |
| SUBTOTAL (SOFT) | \$2,493 | \$2,625 | \$2,834 | \$2,781 | \$1,960 | \$1,963 |
| SUBTOTAL (HARD) | \$5,111 | \$4,897 | \$5,285 | \$6,271 | \$5,089 | \$5,166 |
| TOTAL | \$7,604 | \$7,522 | \$8,119 | \$9,052 | \$7,049 | \$7,129 |

* When a category has more than one model the latest model and price are used in calculation of total prices.

has 104 more commands than version III. dBASE IV is in early release; advanced publicity indicates that it will be even more complex as it adds an SQL interface among other new features.

An analysis of these three products supports the contention that software is becoming more complex. These popular products do suggest a sharply increasing learning cost curve. The user who waits to invest in PC technology will be likely to encounter more complex software that is more difficult to learn than the early adopter of the technology. The

later one purchases a system in general, the more difficult and costly to learn how to use it.

Many times decision makers do not take learning factors into account in analyzing the purchase of technology. While an emphasis on "user friendly" interfaces does facilitate familiarization with a system, learning to use the interface is only one part of learning to use a system or application. While software is becoming more friendly, designers are adding more features and options which increase the learning task.

3.5. Software Prices

Table 2 shows a modest decline in the price of software packages, though the decline is not dramatic. For some packages prices have remained the same or risen slightly with new releases. The expectation of declining software prices is certainly not a good reason to postpone investing in new PC technology.

3.6. Summary

For personal computers, the evidence suggests that the price of a typical PC system has remained steady because the vendor tends to add more features and the user tends to purchase systems with greater capabilities. Thus, while component prices are declining, system costs decrease less rapidly.

Workstations with more features and new releases of software are more complex, giving support to a rising learning cost curve. Over time, one can expect to pay more for training and lost time. One would also expect that upgrading from one version of a piece of software to the next would be easier than learning the most advanced version from scratch.

Software costs have not decreased as rapidly as hardware; in addition some software packages have experienced price increases.

Based on all of the evidence, it appears that conditions in the personal computer field meet the requirements for the declining price paradox to apply.

4. Implications

This paper has argued that just because hardware prices are expected to decrease in the future, one should not necessarily wait for these lower prices to purchase a personal computer system. Declining hardware costs must be traded off against:

1. Postponed benefits from waiting to adopt the technology.
2. The tendency for system costs to stay about the same.
3. Increasing system complexity leading to higher learning costs.

4. Minor changes in software costs.

What should a manager do when confronted with the question of when to invest in new PC technology? The first step is to estimate the benefits from acquiring PCs. Benefits include:

1. Greater productivity
2. Better communications
3. Reorganization of work
4. Faster response
5. Competitive advantage
6. Cost savings.

Estimate the benefits from adopting the technology now and the benefits of waiting, following the curves in Figure 3. Select an arbitrary point and assume that all of the benefits from both options are received at this point; in Figure 3 one might choose time 8 or 10.

Next, estimate from forecasts the extent to which system costs are likely to decline. Also predict the learning effort and costs for the intended users of the technology. Try to construct curves like Figures 1 and 2.

At the completion of the estimating process, the decision maker should have the following information:

An estimate through some future point in time of the benefits from purchasing now

An estimate of the benefits through some future point in time of waiting for a specified time period before purchasing, say time t

The current purchase price

The estimated purchase price at time t

The estimated learning costs now

The estimated learning costs at time t

Next subtract the costs associated with purchasing now from the benefits and do the same for purchasing later. If the later purchase is a year or more in the future, it may be necessary to apply a discounting factor to the future costs and to the benefits numbers. A comparison of the results should help the manager decide when to invest in new technology.

Consider the following numerical example:

Estimated benefits from purchasing now realized through month 12 = 200

Estimated benefits through month 12 of waiting

to purchase in month 6 (time t) = 175
 The current purchase price = 75
 The estimated purchase price in 6 months = 50
 The estimated learning costs now = 50
 The estimated learning costs in 6 months = 70
 Total current costs = 75 + 50 = 125
 Purchase now benefits - costs = 200 - 125 = 75
 Total future costs = 50 + 70 = 120
 Benefits of waiting 6 months = 175 - 120 = 55
 (ignoring discounting)

In this example, the estimates suggest that the expected decrease in investment cost in six months does not offset higher learning costs and postponed benefits. In theory, one should apply a traditional discounted cash flow analysis to the numbers. However, given the tentative nature of the estimates and the short time times that will generally be involved in contemplating PC purchases, such added sophistication is probably not warranted.

The manager can conduct an analysis of the type suggested above to gain insight on the purchase decision. Intangible factors need to be combined with any numerical calculations. The purpose of such an analysis is to demonstrate that the idea of waiting for declining prices will not necessarily result in lower total system costs due to the declining cost paradox.

5. Conclusions

The purpose of this paper was to offer guidelines on the timing of an investment in PC technology when hardware component costs are declining. Because of the declining cost paradox, it does not follow from decreases in hardware component costs that one should necessarily wait to invest.

The paper identifies a number of factors to be considered by the decision maker in choosing when to invest in the technology. One must balance the declining costs of hardware components against greater learning costs from waiting to invest and against lost opportunity costs. Also, the decision maker should be aware that the cost of a total system tends not to decrease as rapidly as component costs and that software costs may not decline at all.

Based on the evidence presented in this paper, for personal computers it appears that often the decision will be to invest in new technology sooner rather than later.

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The Declining Price of Personal Computers: The Question of When to Invest. Authors: Ronen, Boaz | Lucas Jr., Henry C. | Eden, Yoram. Article Type: Research Article. Abstract: When should a manager invest in new technology? This paper provides guidelines for deciding when to invest in microcomputers. The authors argue that the technology and marketplace of micros today fits the conditions of the declining cost paradox observed by Eden and Ronen (1988). Under these conditions, a decision to defer purchasing equipment until the future to take advantage of hardware price decreases may lead to high D. The general price level increased by 4 percent last year. C. The price of personal computers declined last year. Which of the following statements is true? A. Microeconomics focuses on specific decision-making units of the economy; macroeconomics examines the economy as a whole. B. Macroeconomics focuses on specific decision-making units of the economy; microeconomics examines the economy as a whole. C. Every topic in economics is either a microeconomic or a macroeconomic issue; a topic cannot be both. B. It is too hot to jog today. C. The temperature is 92 degrees today. D. Summer evenings are nice when it cools off. C. The temperature is 92 degrees today. TERM Spring '10. A) The price of personal computers declined last year. B) Unemployment was 6.8 percent of the labor force last year. C) The real domestic output increased by 2.5 percent last year. D) The general price level increased by 4 percent last year. Ask for details. Follow. Report. by Ggghh3645 12.12.2018. Log in to add a comment. Answers. just4ask. 80% of questions are answered in under 10 minutes. Answers come with explanations, so that you can learn. Answer quality is ensured by our experts. I want a free account! What do you need to know? Ask your question. Ask your question. Newest Questions. Economy. 13 points. 6 minutes ago. Compare maharashtra and bihar on the basis of per capita income. Answer. Economy. 13 points. 36 minutes ago.