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DRAFT

To: List

From: Steve Ballmer

Date: March 20, 1992

Subject: FY94 Sales and Support Strategic Objectives

This memo outlines our major strategic objectives for FY94 and sets the course for the coming three years. We have had a great deal of success in the past due to your hard work and creative thinking, and there are tremendous opportunities still ahead. There are also significant challenges that must be met.

Overview

[handwritten: very MS term / channel not customer]

Our business mission is to serve customers, gain market leadership, and grow revenue in three distinct, but related, businesses — desktop productivity, solutions platform and consumer. Today our OEM and retail channels are key corporate assets. We must develop new channels into similarly valuable assets to win in the solutions platform and consumer businesses. We must leverage our existing partnerships, and develop new partnerships, to drive the business through to our different customers. We must, through our direct efforts and the efforts of our partners, ensure that we continue to improve customer satisfaction with Microsoft— our products, our support, and our company. We should use revenue, profit, customer satisfaction and Microsoft image as the ultimate measures of our success. *[handwritten: — growth, influence]*

The desktop productivity business. MS-DOS/Windows and desktop productivity applications make up the core of our revenue. Desktop productivity applications target every category of Microsoft customer, and the strength of our retail, OEM, and ISV partnerships is a key contributor to our success.

Our primary business objective in this market is to *grow, protect, and leverage Office and Windows market share. In some parts of the world Windows penetration is high and in others it is low. In virtually all parts of the world our apps share on Windows is high.* Our business will grow as customers continue to convert from DOS to Windows and in some areas as we grow share of apps on Windows. However, as our desktop share reaches higher levels, the revenue upside from share gains is diminished. We must gain new customers and secure existing customers. The incremental revenue opportunity will shift to the installed base, and we must capitalize on this with more effective marketing of upgrades to existing customers. We need to have an on-going relationship that is valued by a broad set of our customers, at lower net cost than today's PSS relationship. *[handwritten: — Should not be measured against PSS]*

[handwritten: cross selling; small add ons]*

[handwritten: More than upgrades]

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We must also expand the profitability of our operating systems business by striving to put
DOS and Windows on every PC that ships, and by generating more revenue from each
sale of Windows.

The solutions platform business. Our solutions platform strategy is to provide the
solutions platform and the *stimulus* necessary for value-added partners and large accounts
to build, implement, and support business solutions using our desktop and server operating systems
products. Business solutions are typically thought to be implemented primarily by large Tools
accounts, but they are also used by thousands of mid-size and small businesses. Both
segments are full of opportunity - to lead in this market we must win business in both. We
must expand our existing solution provider channel to create a partnership asset that is as
valuable and strong as our OEM or retail channel assets.

Our primary objective in this market is to *drive sales of server and desktop products* by
driving the development of business solutions that include them. Our objective is not in
general to develop the solutions and provide services ourselves. Microsoft provides the
solutions platform -- products, tools and methodologies, information, and support -- and
the *stimulus* - education, certification, and marketing - to encourage the building of
business solutions.

Our business model is not one in which education, consulting, and support are key profit
businesses by themselves. Although some profit will come from services, we are not
primarily a services company. Similarly, while sales of our tools and promotion of
architectures and methodologies may bring in some revenue, we are in this business to *sell*
Windows for Workgroups, Win NT, Win NT Advanced Server, SQL Server, Mail Server, DB
Hermes, etc. *and* the Office. The solutions platform market is where we can realize
incremental gains in Office sales, but only if we ensure that business solutions are built
using Office. Therefore, success in this business is measured by our ability to drive
solutions that utilize Microsoft server *and* desktop products.

To accomplish this, we will implement programs to bootstrap a solutions business around
Microsoft products, and recruit and mobilize a strong community of "value-added"
solution providers.

The consumer business. We are now fully developing our thinking for this market. Our
broad strategy is to popularize Windows and sell key applications in the home market. In
FY94 we will conduct some experimentation with new distribution, selling, and
partnership models and attempt new approaches to market the product lines. This
experimentation will be limited to a few large markets in FY94, and will not take any
focus from the primary FY94 goals. By FY95 we should have a broader product line that
has been more localized as well as some experience marketing these products. Involved
subsidiaries will work with their directors for FY94 planning.

FY94 will bring much higher penetrations of CD drives as OEM's replace their 5 1/4 inch disk drives with CD drives in new machines...This will certainly help the consumer momentum. It will also give us an opportunity to introduce two other new kinds of CD product that will help with the key objectives out lined in this memo. Both of these types of products will need to be thought through from a distribution standpoint. The first is a CD-based product with "lock and key" technology. This will be a CD-ROM that includes a number of products that are "locked" - that is, the .exe is not accessible by the customer. When a customer buys the CD and pays for only Windows, for example, he/she can call a number, pay for an additional product, and get the code that "unlocks" the product on the CD. (The first product of this form is likely to include Chicago unlocked with other system products under lock.) We will also introduce a subscription or "end-user annuity" product, in which a subscriber (customer) pays a fee and receives CD's from us that include all updates and other information about the products that they have subscribed to for a year. This can, but does not have to, include support services. (The first annuity product will most likely be Office and will be joined by Windows.) There is not a near term action for you on these products but they both open up interesting distribution challenges and changes which we all will need to deal with this year.

Competitors

There are many competitors that will try to take business from us in these three areas. I think the most significant customers we face this next year are Lotus and Novell. Certainly, IBM OS/2, Wordperfect, and Borland will remain forces but I think they will be less significant next year as customers increasingly look for suites of desktop applications or a rich foundation for building business solutions or both. Lotus has a good suite of Windows applications, an intriguing platform strategy in Notes (almost an OS in a sense), and an apparent aggressiveness and fast moving approach that is impressive. Novell has a dominant position in plumbing/network systems and with their recent acquisition of USL a more complete platform for business solutions. They also have a network of 20,000 CNE's who have a very loyal attachment to Novell and specifically netware networks. Novell also has a lot of cash and market value to use to do acquisitions and the like. We will need to really understand Novell and Lotus strategies in every area where we do business— product, pricing, marketing, sales and support. We will also need to recognize their market positions (Novell's especially) and make sure that our products and our strategies give us a way of selling into their installed bases as well as give us opportunties to convert their installed bases. We will certainly make sure that our solutions platform works very well on Novell networks.

FY94 Strategic Objectives

FY94 is a year to begin long-term initiatives while we protect and grow core businesses. The strategic objectives we must achieve are:

1. Achieve sufficient revenue and profitability.

2. Expand operating system profitability
3. Gain Office share
4. Build higher profit on-going end user relationships
5. Develop a solutions-platform business
6. Enhance the Microsoft image
7. Empower our people

Revenue and profitability - Revenue growth will slow in FY94. In markets where Windows penetration and Office share are high it will be tough to grow revenue dramatically. We see pricing pressure through the world. There is upside in upgrades and the solutions business but dramatic growth could come slowly. I expect each GM to do their own revenue forecast though.

Profitability targets will be set for each area with each of my direct reports, and specific goals will be communicated to you by them. Many of you in low revenue growth markets may need to recommend flat headcount or very low growth in order to meet your goal in FY94. The emphasis should be on leveraging the people you have and redeploying them as needed to meet your FY94 objectives. Take the approach that headcount should not grow to a point that it could not be supported by flat revenue growth from FY94 to FY 95. We will need to work hard on the solutions business even in markets that cannot afford much headcount growth so we must focus on increasing productivity through more aggressive use of third parties. Extending the Microsoft's reach through third parties is key to maintaining a profitable business.

This year we move to a Contribution P&L to measure our business. This will give us a more accurate measurement tool than today's Operating Statements. You will all see the profitability of your businesses in a way that you can directly compare to corporate averages. The budgeting process will follow the format of the new Contribution P&L.

Expand operating system profitability. Increasing Windows penetration and reducing the number of naked machines shipped (no MS-DOS and/or Windows license from us) are essential business goals that must be accomplished. In FY94, we must also *increase the revenue to Microsoft from each sale of Windows.*

We must focus on driving sales of higher average selling price Windows versions such as Windows for Workgroups and Windows NT. These products lock in Microsoft customers. They also tend to have longer, more technical sales cycles. You will need to recruit, educate and support partners to drive this business. Be prepared to invest to develop the channel to drive these sales. Chicago due later in the fiscal year will be a major opportunity to accomplish this goal.

Each sale of Windows is an opportunity to sell Windows add-ons such as Font Pak, Mice, etc. Find creative ways (for example the Upgrade Your World promotion in the U.S.) to drive add-on sales and to leverage the retail channel.

Gain Office share. In FY94 we must aggressively pursue market share gains and carefully defend against potential market share losses. We can set ourselves up in a great long term position by holding or gaining share this year.

Selling the Office SKU should be the primary focus this year. This is true on both Windows and the Macintosh. Office sales raise the number of Microsoft applications being used per desktop, and therefore raise Microsoft's revenue per desktop. We must focus on shifting the customer purchasing criteria to the benefits of the Office suite - it is here that we have and will continue to develop a more compelling story than our competition.

In FY94 we will deliver a value-added version of Office that includes Access plus other add-ins. Be prepared for this. Focus on selling the new Office upgrade SKU. This can be offered and promoted aggressively. Leverage the upgrades of Excel and Word to drive customers to upgrade to Office. These are key opportunities that must not be missed.

Aggressive pricing strategies from our competitors will no doubt continue, and we must be aggressive in return *when market share is threatened.* Low price OEM bundles are financially unattractive but necessary when threatened by competition. Be competitive when share is threatened. If profitability has to be sacrificed in critical situations, work with your directors for guidance on how to win the business.

Build higher profit on-going end user relationships. Three primary factors motivate the need for higher profit end user relationships. First, PSS cost as a percent of revenues is rising steadily. The growing complexity of our product line will increase our customer's support requirements, and our support burden, in the future. Second, we have no efficient mechanism to communicate with our broad set of customers. The majority of our customers have no contact with Microsoft yet upgrade revenue will grow in importance. Third, upgrade revenue from many products (but particularly Office with T3 and Excel 5 and Windows with Chicago) will be a primary opportunity for revenue growth this fiscal year.

In FY94 we will roll out programs designed to alleviate the rising costs of support, and to communicate with the broad set of our customers. There are two program concepts that will drive our end-user marketing strategy: pay-for support and customer loyalty.

The PSS Support Framework, or Delta, sets out pay-for support programs. Delta redefines support as a "product" to be purchased after a warranty period of free support. Delta shifts the customer attitude from one in which support is a "free entitlement" to one in which support has monetary value. In addition to cost-recovery for support of all products, prices for advanced support services are set high to create a market for third parties to provide support and leverage sales of our products through their value-added work.

Customer loyalty programs are designed to demonstrate the value of a relationship with Microsoft to the broad base of customers. Customers receive on-going contact with Microsoft via newsletters and other (1) many communication vehicles, special access to product promotions, invitations to events, etc. This on-going, positive contact makes the customer feel "special" and enthusiastic about the Microsoft relationship, and allows us to more effectively sell to them. This type of program can include support services, but does not have to.

In FY94 we will roll out Delta. We will also design and roll out a branded customer loyalty program. Both of these will be worldwide initiatives.

A key goal in this context is to increase our registration base. We must know our customers to sell to them. Registration is also an effective mechanism to battle piracy. Implement strategies to expand, segment, and more effectively leverage the registration base.

Develop a solutions platform business. The success of Windows NT, and our long-term success in the solutions platform business, depends on our ability to sell client/server solutions to all sizes of customer - large accounts and thousands of medium and small businesses. This business involves a selling framework that is different from the product-driven desktop productivity framework. To succeed in this business, we must provide the platform for the development of business solutions, mobilize solution providers to develop them, and drive demand for them. We must recruit and mobilize a strong community of "value-added" solution providers to build, implement, and support business solutions on our platform. We must have great products but we will not succeed just by showing how they win reviews. Solution providers will include large and small network integrators, consultants and other custom developers and vertical application developers. Our strategy is to:

Provide the solutions platform of 1) products - off-the-shelf desktop and server applications, 2) tools and methodologies - development tools such as C++ and VB, methodologies such as WOSA, OLE, and the solutions development methodology, 3) information - Microsoft Information Network, and 4) support - problem resolution.

Mobilize solution providers and large accounts through education, certification, and marketing.

In FY94 we will re-orient MCS and MSU to complement the mission of educating and partnering with solution providers. We will execute a massive individual certification and company authorization effort. The new PSS Support Framework (Delta) will be implemented to encourage third parties to support this strategy. We will build an information distribution machine, the Microsoft Information Network (MSIN). We will recruit valuable partners who will be Microsoft zealots, and we will create a comprehensive marketing umbrella to drive demand for solutions built on our platform.

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Implications

Marketing
The development of business solutions is driven primarily by success stories that demonstrate their value, and by the availability of certified third parties capable of developing and supporting them. In FY94 we will build tools to drive demand and help solution providers sell. We will demonstrate the value of, and generate demand for, Microsoft-based business solutions through the build up and promotion of case studies and success stories. The existing case study database will be improved and implemented worldwide.

Certification
We will implement an education, information, and certification program that is designed to train and certify thousands of individuals and hundreds of companies. We must create a world where Microsoft-authorized individuals are not only ubiquitous, but viewed by our customers as extensions of Microsoft. This of course lowers Microsoft's support burden as well.

Education:
MSU will be refocused from a training delivery business to a product development business. The key goal of MSU moving forward is to develop *courseware* needed for certification of integrators and developers. Certification courses should be delivered by third party training organizations, and therefore highly skilled training organizations must be identified, recruited, trained, and certified. The training of end-users will be de-emphasized, with the exception of limited train-the-trainer courses necessary to certify the training organizations.

MCS will be a key driver of or success in the solutions platform business. MCS will focus primarily on knowledge transfer to solution providers and large accounts. MCS will build solutions, but they will do less implementation and on-going support and more architecture and design. For solution providers, MCS will be a "cooperative" group dedicated to helping solution providers gain expertise. A new MCS Partner agreement will guarantee a mutually profitable relationship for MCS and solution providers, and MCS will position solution providers as the mechanism to get on-going implementation and support of the Microsoft-based solutions they build. You should discuss with your directors and Bobmc as appropriate plans to expand MCS in your countries/regions. We will look for MCS to break even in this role.

PSS
For the solutions platform business there are two key concepts for PSS. First, the primary purpose for support in this business is for problem resolution. We will implement a new Product Service Policy that gives SP's visibility on bugs and internal information on our products and guarantees quick fix capabilities on key server offerings. Second, the PSS Support Framework (Delta) will introduce a new pay-for support model. High-end

support will be priced at a premium to encourage a market for third-party support providers. The objective is to push as much support as possible to solution providers. _ _ _ _ _ _ _ _ _ _ _ _

Microsoft Information Network (MSIN)
MSIN will be our information distribution machine. It will deliver technical and strategic information via subscription service to executives, support professionals, and developers via CD-ROM, hard copy, and other media. This is a highly leveraged tool that will be developed aggressively in FY94.

Recruiting Strategy
We must develop a solutions platform channel asset in FY94. Cultivate relationships with *valuable integrators* — those that want to work with Microsoft, and that are investing in new markets, pursuing the client/server opportunity, willing to position Microsoft solutions to clients considering competitive solutions, etc. Smaller, hungrier organizations may more likely fit this description. Focus on preparing and incenting *Novell Platinum Resellers* to deploy and administer Windows solutions on Novell networks (we will create specialized material to provide an "Express Certification" to Novell CNEs working for Platinum resellers). Build a team of zealous Microsoft *"methodology developers"* - developers of key vertical market applications and custom developers. Finally, implement leveraged marketing programs to mobilize *vertical and small ISVs, top consultants, and other solution providers*. The mix is your decision, the imperative is that you are successful in FY94.

Enhance the Microsoft image - Moving forward we will make a concerted effort to enhance the Microsoft image. We will work to improve our image as a partner by developing and publicizing case studies and success stories with referenceable partners. This should be a focus in all countries this year. Billg is making this a priority for his PR work and it will be vital to our continued success with partners and the growth of a set of SP partners. IBM should not be positioned as our enemy - they are company that we work with on many fronts, and that we compete with on others. Microsoft will take the high road - avoid gratuitous competitor bashing *IBM should be viewed as a partner when possible*
We will help you more effectively communicate to customers the benefits of working with Microsoft and our products. We have an incredible opportunity to make Microsoft the dominant brand name in PC software. We will start a clear articulation of how a software leader like Microsoft can really open up new vistas for customers far and wide in a very unique way.

Empower our people - One of our key assets is the quality and dedication of our people. Harness their energy and creativity by directing them towards common organizational goals. Communicate clear business strategies and goals for your organization, and map specific, realistic goals to these strategies. Encourage longer term strategic thinking by developing annual plans and measuring on their *results* against plan. Create an

atmosphere in which broad business thinking is encouraged, and where creativity is fostered *and acted upon.*

This is a year to focus on developing our existing resources, and training and IT tools are the keys to empowerment. Work with your people to write professional development plans. All training should be connected to skill improvements. Use existing, internal training resources as the first course of action to ensure cost efficiency and quality control. Work with HR and the internal training groups to determine the most appropriate courses and consultants.

Some Specifics:

This memo lays out a broad framework. Some things will vary by geography especially from very large subs to emerging subs. Work with your directors on localization strategies. Some concrete things that we all must do:

1. Achieve profitability goals. (These will be delivered to you shortly by your directors).

2. Ensure that 85% of new MS-DOS licensed machines are sold with Windows installed. Reduce the number of machines sold without MS-DOS by 50%.

3. Increase and maintain market share of the Office and its constituent apps. I hope we can achieve 60-80%+ shares on Word and Excel counting Office this year. (That is share of the Windows and Macintosh markets and excludes DOS apps)

4. Implement strong training and certification programs based on updated MCP and MSU (TAP) programs.

5. Shift toward new Delta PSS framework.

6. Improve registration rates by 25%+.

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