# Productivity Applications Mission, FY95-97
# DRAFT, 2/7/94

## Executive Summary

Microsoft has gained the lead in productivity applications with superior products, early exploitation of Windows and the Macintosh, leadership in the office suite category, and the missteps of DOS leaders Lotus and WordPerfect. Both companies have rebounded from these early errors and are now shipping competitive products. Lotus is particularly strong thanks to their creation of SmartSuite through acquisition and their competitive advantage in workgroup applications with Lotus Notes. Borland and WordPerfect are trying to catch up with Borland Office 2.0. Our applications compare favorably today and have considerable momentum and market share – 80+% of the suite category and ~50% share of Windows word processing, spreadsheet, presentation graphics, and project management – but the market increasingly views the alternatives as near-substitutes. This, plus increasing price competitition threatens to permanently damage the business.

Our mission is to develop the most successful desktop productivity tools in the world, marketed both as suites and standalone applications. Our market share goal is 80% for office suites and 60% for apps, including spreadsheet, word processing, presentation graphics, database, and project management. Achieving these goals hinges on our ability to sustain product development momentum, leverage other Microsoft assets (e.g. PSS), and create innovative marketing approaches to increase differentiation vis-à-vis Lotus and Borland/WordPerfect. At the same time, we have aggressive internal goals for reducing costs – particularly cost of goods sold and documentation and localization costs – and increasing development and marketing efficiency.

$2.8B is a reasonable revenue target for FY97. The market for productivity applications is maturing, but growth will not come to a screeching halt, and the annuity opportunity from our installed base will continue to increase. Even with moderate growth in major markets, narrowing of the uplift between European and North American prices, and price deterioration due to competition and mix changes, we can continue to expand this business.

Outlined below is a high-level view of the market today, the competition, and the product and marketing strategies needed to continue to grow the business profitably.

## Business Model

Steve's FY95 business planning memo projects Desktop Applications Division to be $1.8B in FY97 based on 2.3M competitive/version upgrades @ $100, 3M Office competitive/version upgrades @ $150, 2M standalone products at $200, and 2.4M new Office @ $300.

Forecasting three years out is an inexact science. There are enough variables in this analysis for pages of scenarios. Summarized below is an alternative $2.8B FY97 view of the Desktop Applications Division based on reasonable assumptions about market growth, pricing pressures, changes in the license mix, changes in market share, and our ability to upgrade our installed base. The following takes a trend-line approach based on the existing business, accelerating current changes in license mix and downward price movements. It is reasonable, if not a bit conservative. Relative to Steve's projection, it is more conservative on price (average revenue per license of Office $247 versus $300, single app version upgrade revenue of $73 versus $100). On the other hand, the combination of more aggressive category growth and higher upgrade rates contributes to the $1B difference.

### *Financial Summary*

We expect DAD revenues to increase $594M by FY97, primarily from an upgrade business which grows to 26% of revenues. Office sales also grow despite a conservative market share assumption of 70%. Revenue from new licenses of standalone applications decreases 14%. Revenue per unit is assumed to drop as much as 30% under this scenario.

**Desktop Applications FY97 Projection**

*Licenses in Thousands, Revenue in Millions*

| | FY94 Forecast | | | | FY97 Projected | | | | Growth | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Lic | $/unit | Rev | *Mix* | Lic | $/unit | Rev | *Mix* | Lic | $/unit | Rev |
| Office New Users | 2,580 | $ 355 | $ 916 | *40%* | 5,045 | $ 247 | $ 1,246 | *43%* | 96% | -30% | 36% |
| Other Apps* New Users | 6,264 | $ 158 | $ 989 | *44%* | 5,916 | $ 143 | $ 848 | *30%* | -6% | -9% | -14% |
| Office Existing Users | 543 | $ 139 | $ 75 | *3%* | 2,349 | $ 109 | $ 256 | *9%* | 333% | -22% | 239% |
| Other Apps* Existing Users | 2,372 | $ 89 | $ 210 | *9%* | 6,600 | $ 73 | $ 483 | *17%* | 178% | -17% | 130% |
| Other (DOS, other) | | | $ 83 | | | | $ 35 | | | | -58% |
| Total DAD revenue | | | $ 2,273 | *100%* | | | $ 2,867 | *100%* | | | 26% |

** Word, Excel, PowerPoint, Project*

Desktop Applications business performance during the next three years will be driven primarily by:

- The growth of the productivity applications market worldwide
- Microsoft's share of that market
- Prices, including the mix of lower priced license and academic versions
- Upgrading the growing installed base to new version of products
- Cost control: COGS, operating expenses, marketing, and PSS

Each of these factors is discussed below.

### *Market*

This forecast assumes a relatively quick flattening of the growth curve for the new-user market. The Windows suite category will fuel the growth in the years ahead, although suite growth will slow from its current pace to 30% by FY97 and will be at the expense of standalone applications. Much of the growth will come from international markets. We expect that emerging international markets will leapfrog the standalone apps phenomena and move directly to the current suite model. The Macintosh / PowerPC categories are expected to plateau.

**Desktop Applications Categories: Growth Projections**

*New Users, Licenses in Thousands*

| | FY92 | FY93 | | FY94 | | FY95 | | FY96 | | FY97 | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Windows** | Licenses | Licenses | *Growth* | Licenses | *Growth* | Licenses | *Growth* | Licenses | *Growth* | Licenses | *Growth* |
| Suites | 325 | 1,581 | 387% | 2,797 | 77% | 3,916 | 40% | 5,287 | 35% | 6,873 | 30% |
| Other Apps* | 5,615 | 8,534 | 52% | 13,992 | 64% | 15,112 | 8% | 14,395 | -5% | 12,990 | -10% |
| **Macintosh** | | | | | | | | | | | |
| Suites | 108 | 187 | 74% | 202 | 8% | 212 | 5% | 223 | 5% | 234 | 5% |
| Other Apps* | 1,379 | 1,448 | 5% | 989 | -32% | 1,039 | 5% | 1,091 | 5% | 1,145 | 5% |
| **Total** | 7,426 | 11,750 | 58% | 17,980 | 53% | 20,279 | 13% | 20,995 | 4% | 21,241 | 1% |

** Word Processing, Spreadsheets, Presentation Graphics and Project Management.*
*"Other Apps" does NOT include suite licenses*

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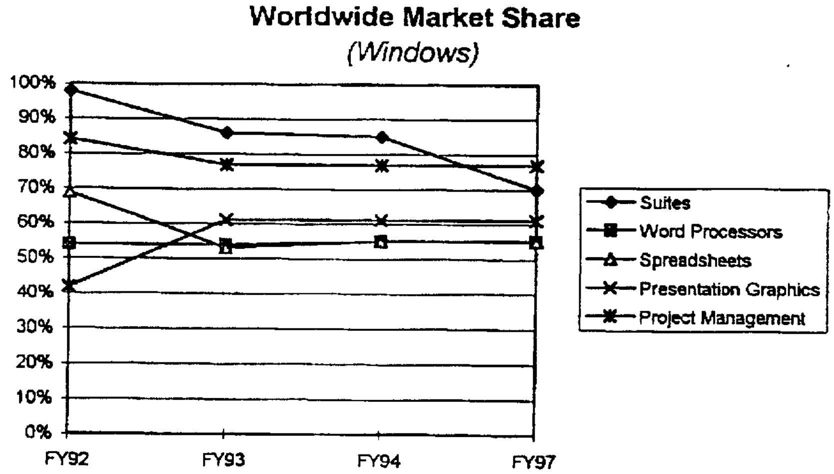
### *Market Share*

Win Office market share is assumed to drop to 70% by FY97. Other individual apps will maintain current share levels in their respective categories. Success in emerging markets will be important, but the top five markets now account for 75% of DAD revenues and will continue to be critical during the next three years. Each marginal share point in the Windows category overall will be worth $33M in FY97.




### *Price/Mix*

- We project prices to drop significantly during the next three years as international prices settle to a 1.1 uplift, we respond to competitive price pressure, and lower-priced SKUs (OEM, academic, and Select) figure larger in the mix.

- We forecast a 30% price drop for Office licenses to $247 by FY97. This is slightly faster than the 10% drop ($393 to $340) from FY92-94. By FY97, we expect 70% of Word and Excel sales to move through Office, lowering revenue per license. Tempering these downward pressures is the potential for a mix increasing towards Office Professional.

- Office academic and Select mix will rise dramatically due to new Office academic SKUs and continued emphasis on Select in corporate accounts. The new academic Office will replace a significant business (25% of licenses) for individual apps. OEM sales will rise to a slightly larger share of the mix as competitive pressures in this channel continue, especially outside the US.

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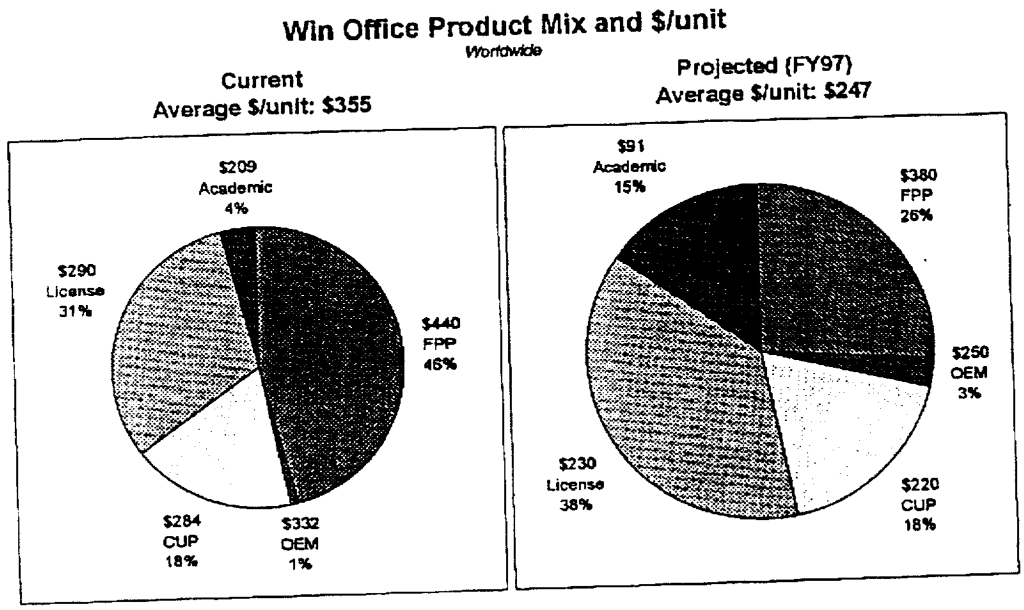
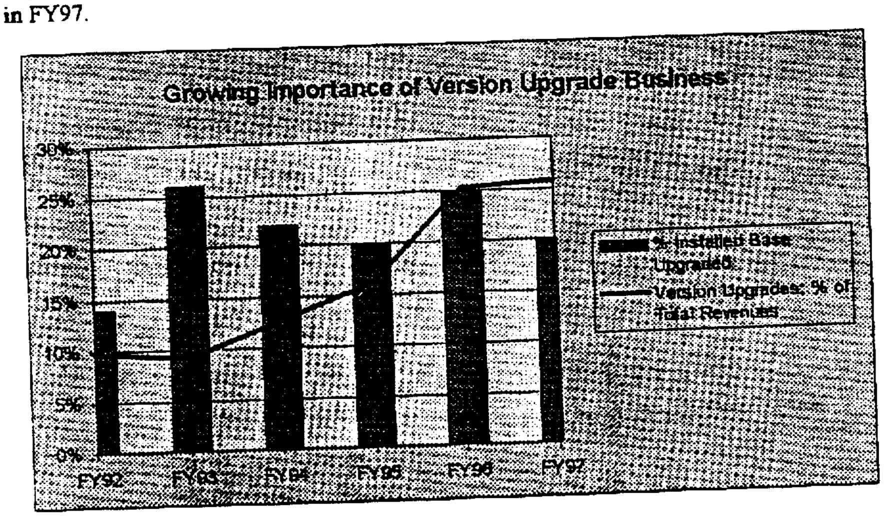



## *Existing Users*

The projected sales of new Microsoft licenses will result in the installed base of Word and Excel users increasing from 10 million today to 30 million worldwide by FY97. This is an incredible opportunity for an annuity business, but a serious challenge as well. Motivating users to upgrade every year will require compelling product advances and increased focus on installed-base marketing.

Meeting these challenges is key to our forecast. If 20% to 25% of the installed base upgrades every year, the existing-user business will grow from 10% of revenues to 26% in FY97. This is in line with historical percentages, but a shortened release cycle and the aging of the installed hardware base could challenge historical performance, particularly in minor release years. Each percentage point will be worth $31 million in FY97.

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### COGS

Although the average price per license has fallen about 25% over the last 2 years ($191 to $142 for all Desktop Applications Division licenses, worldwide), COGS as a percentage of revenue has trended slightly downward. Some headway has been made in reducing packaged product COGS, but the primary driver has been a mix favoring licensed product, including OEM.

**COGS as a % of Gross Revenue**
*Desktop Applications*

| | FY92 | FY93 | FY94 (YTD) |
|---|---|---|---|
| North America | 11.2% | 10.4% | 9.6% |
| Europe | 8.6% | 8.3% | 8.1% |
| ICON (ROW) | 11.5% | 13.0% | 12.6% |
| Far East | | | 17.1% |
| OEM | 5.3% | 1.2% | 0.8% |
| Total | 9.9% | 9.6% | 9.5% |

As the business moves towards lower-priced products, including version upgrades, we will focus increasingly on COGS containment, particularly in smaller markets where lower product volumes mean higher unit costs. Other opportunities include new methods of distribution, and a move towards CD based product. The positive effects of CD media can be seen below:

**Win Office Domestic COGS**

| | *Media* | *Documentation* | *Other* | *Total* |
|---|---|---|---|---|
| Version 3.0 | $15.88 | $28.74 | $4.33 | $48.96 |
| Version 4.0 | $14.12 | $23.81 | $4.92 | $42.85 |
| Version 4.2 | $22.95 | $16.84 | $4.92 | $44.71 |
| CD | $3.57 | $0.00 | $2.45 | $6.02 |

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# Headcount

## Desktop Applications Division

*Headcount by Function*

| | Actual | | | | | | Budget | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Jun-92 | | Jun-93 | | Dec-93 | | Dec-93 | | Jun-94 | | Jun-95 | | Jun-96 | | Jun-97 | |
| **Function** | | | | | | | | | | | | | | | | |
| Management | 18 | 3% | 21 | 3% | 20 | 3% | 35 | 5% | 35 | 5% | 37 | 5% | 39 | 6% | 39 | 6% |
| Program Mgmt | 69 | 11% | 95 | 13% | 107 | 16% | 107 | 15% | 104 | 15% | 120 | 18% | 120 | 17% | 120 | 17% |
| Development * | 164 | 26% | 209 | 29% | 181 | 27% | 198 | 28% | 200 | 29% | 200 | 29% | 210 | 30% | 220 | 31% |
| Test | 137 | 22% | 140 | 19% | 143 | 21% | 148 | 21% | 148 | 21% | 148 | 22% | 150 | 22% | 150 | 21% |
| User Ed | 176 | 28% | 184 | 26% | 137 | 20% | 157 | 22% | 135 | 19% | 110 | 16% | 110 | 16% | 110 | 16% |
| Marketing | 65 | 10% | 71 | 10% | 83 | 12% | 74 | 10% | 72 | 10% | 65 | 10% | 65 | 9% | 65 | 9% |
| **Subtotal** | 629 | 100% | 720 | 100% | 671 | 100% | 719 | 100% | 694 | 100% | 680 | 100% | 694 | 100% | 704 | 100% |
| *Growth* | | | 14% | | -7% | | | | | | -2% | | 2% | | 1% | |
| Ireland | | | 106 | | 92 | | 100 | | 91 | | 85 | | 80 | | 80 | |
| Japan | | | | | 109 | | 109 | | 109 | | 100 | | 90 | | 90 | |
| Buffer | | | | | | | 27 | | 47 | | 0 | | 0 | | 0 | |
| **Grand Total** | 629 | | 826 | | 872 | | 955 | | 941 | | 865 | | 864 | | 874 | |

- Headcount for the Desktop Applications Division is projected to be nearly flat over the next 3 years. Actual headcount will decrease nearly 10% in FY94 (excluding Ireland and Japan) due to reductions in user education and localization, and we will close the fiscal year at about 660 heads. Ireland and MSKK will be a total of about 30 heads below plan for a grand total of about 100 heads below plan.
- Future declines in other functions will be matched by modest increases in development capacity and program management (esp. FY95). Testing is assumed to flatten due to improved efficiency.
- UE will decline as a percent of headcount due to shrinking documentation, increased outsourcing, and improved process. This analysis assumes flat UE headcount from FY94 forward (actuals).
- Marketing is assumed to decline by about 10% from FY93-FY95 and then flatten.

## Competitive Situation

*Lotus.* Lotus is formidable. Thanks to accelerating momentum behind Notes (including a growing list of third parties adding value to it), Windows SmartSuite, OS/2 SmartSuite, improving financials and company image, 20 million customers, high product awareness, broad distribution, and an alliance with IBM that is increasingly affecting corporate purchase decisions, Lotus is on the upswing. Lotus will continue to push Notes as a computing platform and will integrate their apps more tightly using Lotus Basic, Application Field Exchange, and OLE. Notes, plus the little work they've done with AFE and Version Manager, has positioned them as the leader in workgroup computing and SmartSuite as the leading workgroup application. Microsoft must effectively challenge Notes with EMS and later with Cairo. We must provide better workgroup features in our productivity applications, including support for Notes as a back-end, to eliminate this perceived advantage.

*WordPerfect.* The time has never been better to seize WordPerfect's traditional franchise. New CEO Ad Reitveld has announced plans to diversify the business, with word processing expected to contribute only a third of revenues by FY97, while he is aggressively shrinking the company to achieve greater profitability. They launched the final release of their flagship DOS product and have backed off from unlimited free support, historically their most valuable asset. Their challenge is to become competitive quickly in the suite market with Borland Office while growing the workgroup and consumer businesses.

*Borland.* The price renegade in the industry, Borland recently announced the success of its Quattro Pro promotion – one million new users – and quarterly earnings of $.02 per share. To the extent our research confirms the truth of their claim, we run the risk that Borland will succeed in developing a new low-end market that their cost structure lets them control. The company, leaner through layoffs, has been nimble in introducing features that keep a semblance of parity with ours. The Borland bundle, which is priced the same as Office, has not garnered serious interest in the market.

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*Claris.* Works is pressuring our premium standalone apps business and challenging the value proposition of our suites. Claris is strong and well positioned. Its revenues grew 48% to $154M in FY93, and its awareness more than doubled to 17%. On the Mac, where Works is frequently bundled, the integrated category is growing faster than the total Mac software market. There is the risk that the same growth phenomenon could impact Windows productivity apps segments.

## Product Strategy

The 3-year strategy for productivity applications is based on the following principles:

- **Focus on Office first, but continue category innovation.** The suite category is the fastest growing in the business and is an area of competitive advantage for Microsoft, especially versus historically single-product competitors like Borland and WordPerfect. Increasingly, many of the traits that define a great application are becoming common to all of the productivity applications. As with Office 4.0, future areas of focus will include ease of use (IntelliSense features, improved discoverability), user interface consistency, interoperability between the applications, and programmability. We recently created the Office Business Unit to drive this effort. Individual product releases will be synchronized beginning with Office '95, making it easier to share code and designs and to market and sell.

  At the same time, we cannot afford to lose the best-of-breed battle. It is crucial to the perception of Office, and even the most aggressive scenario for Office cannibalization implies that the standalone application businesses are among the largest in the company.

- **Add value to Office.** We will continue to add value in the form of additional product breadth and value-added data and services. MOM was a good example of leveraged value-added in Office 4.0. Our primary focus in Office '95 will be Ren, an integrated PIM and mail client, and possibly Resource Planning Manager (RPM), a non-CPM based planning tool. Other candidates for Office '95 include the image editor and other add-ons/servers. Ren and RPM will also be sold standalone. Both have potential to add upside revenue to the plan and significant value to the product line.

- **Build long-term product differentiation.** Although we have benefited from the last releases of the applications, competitors have proven they can neutralize many feature advantages, particularly the user-oriented "auto" type features. We must continue to innovate and invest in sustainable technology advantages. Visual Basic for Applications, PivotTables, Word's AutoFormatter, OLE 2.0 support, and the applications infrastructure effort are examples of features that can differentiate for longer periods of time. We will need to reduce the number of "small" features to achieve this goal.

- **Exploit systems releases** (and rest of Microsoft). Microsoft's ability to set industry direction is a key asset for the company and the productivity applications mission. We will time apps releases with systems releases and ensure Microsoft applications uniquely exploit these releases for customer advantage. We will take a similar approach to leveraging other parts of Microsoft, including workgroup applications, Advanced Development and Research, the Consumer Division, and others. An added benefit of release synchronization across divisions is that it facilitates technical cooperation and synergy.

  This plan assumes that Windows (moving to Win-32) and Macintosh remain the dominant platforms in the next 3 years. Other than moving our products to RISC platforms running NT and to the PowerPC Macintosh, no new platforms or operating systems are planned. OS/2 success, even to the point where it becomes the relevant second platform in cross-platform, is a risk in this plan.

- 12/24 is an approach to scheduling releases that allows for major architectural releases every 24 months and competitive releases every 12. Since architectural changes take longer and frequent releases are inefficient and hard on the team, the majority of the development resource will work on the 24 month release. In between, however, up to 25% of the team will develop low-cost, high-visibility releases designed to win reviews, respond to competition, and create upgrade revenue. The goal will be to create much of the value of these releases through add-ons, OLE Servers, and through VBA code rather than changing the core .exe.

- **Best desktop applications for use in a workgroup.** We must build support for workgroup scenarios into all of the applications. They will be designed to support multiple back-ends, including Lotus Notes and others. It is our goal to have better workgroup application support than Lotus.

- **Be the best platform for business solutions.** Productivity applications are increasingly being used as part of company-wide solutions, including solutions that automate important business processes. Getting design wins for these solutions is an important source of business, but more importantly makes the tools the preferred, entrenched choice for general productivity use. We will invest more in the use of technologies (e.g. VBA, OLE 2.0, OLE controls and forms, MAPI, etc.) that make our applications great components of customer solutions. The 12/24 development approach recognizes that supporting these technologies often takes longer.

- **Organization usability.** Software administration – installation, tracking, updating, supporting – is far too costly for our customers. We took some steps with the integrated Setup and un-install features of Office 4.0, but we have a long way to go to dramatically reduce customer administration costs.

- **Expand into new geographies.** Market growth for productivity applications will be highest in new geographies, including the Far East, Eastern Europe, and ROW. Development groups will take greater responsibility for Far East development to bring the delta down to 60 days and increase the Far East product content. Deltas for all languages will be reduced to less than 90 days, while improvements in localizability, development of third-party localization partners, and reduction in word count will reduce localization time and cost.

- **Increase development efficiency**, including efficiency of code development, user assistance development, and localization. There are redundant development efforts within the mission and across the company. Our goal is to double the use of shared code to 40% by 1996 and to invest in tools and processes that simplify and shorten the development cycle. We will also reduce the number of print-based and on-line words by at least 50% by 1995, outsource more localization, and improve internal processes wherever possible.

## Release Plan

We've scheduled two significant releases of Office and its components over the next 3 years, as outlined below.

### *"Office 94 1/2"*

We are considering some tactical activity in 1994 to combat Lotus' growing ability to leverage their Notes success into SmartSuite business. Key features would be support for Application Field Exchange and the ability to save documents into a Notes database. At press time we have not determined whether this is a ".01" release of Office timed for Spring Comdex or an add-in.

### *Office '95 (March 1995)*

**Themes**

- Exploit Chicago, EMS, Notes, Ren
- Meet competitive workgroup challenge
- Leveraged category features — every feature demoable

**Design Goals**

- 32 bit version for Chicago and NT

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- Potentially 16 bit version for Chicago, Win 3.1, OS/2
- NT, RISC, MAC OS, and PowerPC; "top 10" (possibly other) Int'l versions
- 25% of development effort (done in parallel with Office '96)

**Competitive Advantages**
- Leadership application of the Chicago generation
- Best support for workgroup scenarios
- Best integration, consistency, programmability

### *Office '96 (March 1996)*

**Themes**
- Discoverability and ease of use
- Memphis synergy
- Significant category innovation
- Improved performance (operation, file I/O, memory footprint)
- Programmability and customization

**Design Goals**
- 32 bit only, targeted for Memphis
- All NT platforms
- Mac (68020 + PPC, Sys 7+ only)
- Office infrastructure 1.0 (shared across applications)
- 75% of development effort

**Competitive Advantages**
- Sustained leadership in programmability, ease-of-use
- Best support for systems services and other technologies
- Other innovative responses to customer requirements

## Marketing Strategy

Differentiation is our core marketing challenge over the next three years as product feature advantages become increasingly short-lived. To continue to grow the business, we must build new marketing assets that are less tied to individual products or versions, reach new customer segments, and exploit new technologies to fight commoditization, gain market share, and fight price erosion. This is not to say we plan to abandon our traditional marketing approach, but rather will add complementary new strategies, programs, and initiatives.

Customer Initiatives

- **Large accounts** will remain an important segment, although our message will evolve to be more solutions-oriented. Productivity applications will increasingly be used as components in business solutions. Consistent with our product strategy, we need to develop the infrastructure (SPs), tools, and programs to promote our products as a development platform and get these design wins. They are an important source of revenue, are difficult to reverse once obtained, and will drive definition of company-wide productivity standards.

- **Gain share in small organizations (smorgs).** WordPerfect and Lotus outperform us among organizations with fewer than 100 employees. This segment represents about 25% of the desktops in North America and is growing faster than the market overall. The initial focus will be to raise awareness among smorg influencers with business press advertising; increase visibility and availability of the product in retail environments; and leverage SPs who develop solutions within targeted segments. Longer term, we must learn to reach the business and industry peers (the most important smorg influentials) in a number of targeted industries, including accounting, legal, real estate, and insurance.

- **Build an annuity business from our installed base.** We must learn how to generate more revenue from our installed base on a regular basis by upgrading a higher percentage of them, moving more to Office or selling additional apps, or selling them add-ons, data, or service. Building this business profitably, including tools and techniques to reduce the cost of upgrades, will be a challenge. Historically, relatively little attention has gone into understanding the needs of this segment, developing unique product for them, and marketing to them. Yet, in FY97 each 1% increase in upgrade rate above our current 25% would yield an additional $31M per annum. Additionally, there are over 3 million OEM Works users that we can potentially upsell to Office applications or all of Office. Competitive users will remain an important part of this effort, particularly in upgrading them to Office Professional.

  Building this business will require better marketing and additional investments in end-user affinity programs such as Microsoft Plus. Various ideas for personal maintenance, subscription, etc. also warrant exploration. We also will need to investigate product strategies (12/24 is a start) that capture the imagination of the installed base and encourage them to upgrade regularly.

- **Solution Providers.** Beginning with Office 4 we are positioning Office as a development platform. Further evolution of the products will make this a stronger message, generating increased opportunity to develop and leverage the SP channel to sell productivity applications to all customer types. Solution providers with content expertise or expertise in key vertical areas can make our products indispensable components of solutions that may be far more compelling than new features. We have the dual challenge of meeting their needs for development platforms and supporting their requirements as remarketers. The solution provider channel will also generate additional demand for special pricing and packaging. Embedded license (runtime) pricing is in demand today and will need to be resolved. We also need to develop a model for reselling individual application components. Over time, we need to define a layer of application functionality that is available to all developers in say the Windows SDK or C Compiler, one that is available to Office Friendly developers (see below) and proprietary to our applications.

### *Positioning and Communication*

Past positioning strategies have emphasized the best-of-breed features of individual products, and, more recently, of Microsoft Office. This should continue, but our focus should change:

- **Define and own the suite category.** In the same way that Lotus defined spreadsheets and WordPerfect defined word processing, Microsoft is the only credible company that can now define and own the suite category. We have a unique opportunity with Office because the suite category is still largely undefined in the minds of most consumers. There must be a high synergy and convergence between key messages for the standalone products and Office to maximize the effectiveness of marketing spending.

- **Lead with Office, especially Office Pro; balance with standalone applications.** We have established Office as the required applications platform for many users and will continue to emphasize it. We have to understand how to balance this with standalone applications that may help us in specific user segments and channels, create opportunities for Office upgrades, and redress share loss against competitors' standalone products.

- **Exploit long-term leadership.** Although we have won the majority of product reviews in recent years and have dominant market share, we have not declared victory effectively. Higher awareness of our long-term success would contribute to the perception that Microsoft is the preferred brand and safe purchase.

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- **Effectively address the broader market.** Increasingly, growth is coming from customers who are more difficult to reach through traditional techniques. Our IEU-driven influence model still applies,



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but we will need to identify new approaches to reach less-involved users. The awareness of Microsoft applications is alarmingly low today.

- **Use new approaches to positioning** that go beyond product features. IntelliSense and OfficeLinks are attempts to brand features in a non-version-specific way. Branding Office establishes a higher-level meaning and a long-term asset. We also need to build a marketing asset from our product support advantage. This means communicating our cost and quality advantage, but also developing new programs based on CD distribution, Microsoft On-Line, and special programs such as the Microsoft Support Network. Finally, we have the opportunity to communicate our hardcore commitment to rapidly exploit Microsoft systems products as well as other initiatives throughout the company.

- **Define the new generation of applications.** Coming advances in systems technology must be related to advantages for business usage and tasks and made our unique advantage. Just as we led the definition of GUI applications and to a lesser extent usability, critical future opportunities exist to lead the definition of Chicago applications, Memphis applications, productivity applications as a development platform, as tools for business process automation, applications for small organizations, for vertical markets, etc. Inherent in our strategy is bigger investments in major technological advances. We need to do a better job of selling these advances, not just as technologies for technically-proficient users, but as solutions to real business problems. Lotus has done a brilliant job positioning Notes as the solution for business process re-engineering.

- **Position Microsoft Office as the "front office" for "back office" workgroup solutions.** Despite Lotus's significant lead with Notes and SmartSuite, opportunity exists to define real advantages for productivity applications in workgroup scenarios. Using a better back office (EMS), better programmability, and richer support for key workgroup scenarios while also embracing Notes in our applications, we must make Office the client side of workgroup solutions.

### *Pricing Strategy*

We should seek to maintain our current strategy of pricing leadership, commanding a small price premium over Lotus. As the market leader, inability to maintain this premium should be taken as our failure across a broad front: product development, marketing, and our value-add strategy. It is essential that we avoid commoditization and maintain market share and reasonable price levels.

We will add more functionality and bundle more bits to slow price erosion and strain competitors' development capability. Ren in Office '95 is a good example. It is critical to this strategy that we create a strong sense of value for these additional components.

At the same time, although we should seek to avoid escalating a price war that would have long-term, negative effects for all players, we cannot allow competitive initiatives to gain share through specific channels such as large accounts or OEM (the threat today). We should use our financial strength to respond aggressively to these situations.

## Other Marketing Strategies

There are a number of other marketing strategies underway or worthy of consideration that cut across customer types:

- **Retail Distribution.** We need to grow distribution of Office, Office Professional (in N. America anyway), and the individual applications. We are losing in the retail channel (superstore and mail-order resellers) to Lotus and WordPerfect.

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- **OEM.** Our OEM focus should be on tactical response to competitors, as is underway in Europe today, or to take advantage of unique channels (e.g. Gateway). Our primary thrust in this channel should be consumer products or collaboration to advance new technologies.

- **CD Unlock.** The expected proliferation of CD-ROM drives creates new distribution and packaging opportunities. We will be able to offer CDs with encrypted versions of our products that allow customers to try before buying. Purchase will be the acting of calling an 800 number to unlock and then install desired products off the CD. AliBaba is the codename for internally-developed software to enable this approach. CD Unlock will be a useful tool to promote trial, as a CD with Microsoft applications could today be given away by a reseller or included in an OEM machine.

  CD Unlock may also change the model for purchasing software. Rather than buying Excel all at once, the customer could pay less to purchase core functionality and never buy Solver or buy it later. Another alternative is to let users purchase add-ons or third-party products from the CD a la carte.

- **Leveraging Microsoft On-line** represents an opportunity to deliver cool add-ons, vertical solutions, data, special support, documentation, easy upgrades, and on-line registration, as well as design special features in the products to utilize other services. We can dramatically expand the use of on-line services by a less-technical audience by making sign-up, connection, browsing, and downloading virtually automatic from within our applications.

- **Packaging/specialized solutions.** We need to constantly evaluate the current Office/Office Pro configuration as well as others that could help differentiate Office in different segments. Versions with different workgroup components and value-added, for example, may be necessary to combat the forthcoming version of SmartSuite that includes a Notes client. The smorg marketplace sees little need for PowerPoint and Mail, gravitating instead toward products like Publisher and Access. They would prefer a "build your own" Office wherein they choose an applications to go along with Word and Excel. A related idea is to offer a family of vertical add-on packs for Office. Independent of whether there's a large standalone add-on business, they would add to the perceived value of Office and help us target Office at specialized segments.

- **Office Friendly (final name tbd).** This is a key initiative designed to broaden the scope and visibility of Microsoft Office and to create an industry-wide Office standard for companion products. We are encouraging ISVs to adopt certain Office UI conventions and, over time, components and technologies (e.g. Setup, VBA, Text Control, OLE servers). They will also be given the opportunity to co-market with us and place an "Office Friendly" mark on their boxes.

## Key Success Factors

- Innovate in product development and marketing
- Leverage Microsoft assets – leadership, systems and research, partners, installed base
- Leverage market discontinuities – Chicago, CD, on-line, at-work, 32-bit apps
- Define new categories and new pricing, marketing, and business models
- Provide relevant long-term differentiation
- Learn to upgrade our installed base
- Execute efficiently and effectively, while managing costs

## Issues/Risks/Threats

- Price erosion (including volume discounts, concurrent use, category dilution)
- Lotus creates a long-term technology and marketing advantage by linking Notes and SmartSuite
- Lotus /IBM relationship
- WordPerfect converts its huge and loyal installed base

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- Borland/WordPerfect build momentum for a suite
- Continued decline in productivity application penetration on the Macintosh. ClarisWorks success.
- Failure to communicate a leadership message or leverage our leadership position
- Failure to identify and gain leadership share in emerging growth markets and segments
- Failure to define and dominate key categories