PLAINTIFF'S EXHIBIT 2655 Comes v. Microsoft

From: Brad Silverberg
Sent: Monday, February 17, 1997 12:28 PM
To: Bill Gates
Subject: FW: My Input on Office 9x

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-----Original Message-----
From: Robert (Robbie) Bach
Sent: Wednesday, February 05, 1997 3:07 AM
To: Richard Fade; Jon DeVaan; Chris Peters; Richard McAniff; Peter Pathe; Steven Sinofsky; Brian MacDonald (Exchange)
Cc: Paul Maritz; Brad Silverberg; Brad Chase; Dennis Tevlin; Michael Hebert; Kirstin Larson (Office)
Subject: My Input on Office 9x

I've attached below a Word doc that summarizes my views on where we need to go next with the Office products. Since I have not been super-involved in the most recent set of development meetings, the focus of this is to provide input from the marketing side for the decisions we are trying to make going forward. DennisT, MikeHeb, and KirstinL will provide on-going input during my absence this month (and hopefully beyond that!). Feedback welcomed.

Office 9x issues.doc

Thanks

Robbie

DEPOSITION EXHIBIT 32 Bach 6/27/01

Memo

To: RichardF, JonDe, ChrisP, RichardM, PPathe, SteveSi, BrianMac

From: RobbieB

CC: PaulMa, BradSi, BradC, DennisT, MikeHeb, KirstinL

Date: February 4, 1997

Re: Thoughts on Office 9x

Because we have been so focused on the Office 97 launch over the past few weeks, I have not been able to participate very much in the Office 9x discussions. But since I'm going on paternity leave shortly, I thought I would send some thoughts on the key issues I think we face with the Office going forward. Since I've only gotten a few of the memos/docs that the dev team has been working on, I'm not going to comment extensively on specific specs that are under discussion. Instead, I'm going to focus on the market, customer, and competitive situations and how we must address the issues that these trends raise.

Executive Summary

Here is a very high-level summary of my main points:

- Email and Collaboration are the next major share war. Office must win this war to continue generating strong growth.
- We must push hard to get new TCO, Outlook, web features, and performance improvements in Office by the end of 1997.
- We need a crisp components strategy ASAP. We can deliver code over time but we must have a point of view and be able to demonstrate some sample applications.
- We should be willing to gamble some with our Office 9x directions. Given what is going on in the market, incrementalism does not have much value. Office 97 (along with inertia) will be sufficient for us to beat an "incremental" competitive effort. The real threat is a fundamental rethinking of the applications paradigm that comes from a competitor.

The Window of Opportunity

The first thing to note is that Office 97, overall, is a great product. It is better than anything our competition can offer, has lots of new capabilities that are relevant and interesting to people, and it is a relatively easy product to market. I think we will see a nice surge in our retail business and a strong upgrade cycle. In corporate accounts the migration will be (too) painful, but I still think we will see solid momentum and good sales if we are smart about helping accounts make the move. If I were a Wall Street analyst, I'd be very bullish on the next 12 months of our business.

At the same time, I think Office 97's success will mask or hide a real threat in our business. Many analysts have commented that "Office 97 is the right product to upgrade to now, but it is not clear which product(s) will lead the market two years from now." Put another way, if our competitors are smart, they will not try to catch up to

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Office 97 (because they can't) – instead they will focus their energies on changing the user paradigm and invest in the next generation of tools. You see this with Corel and Java, Lotus and Notes components, and Netscape and Communicator. The big risk in our business is that our sales continue along nicely for 1-2 years based on built up momentum, and then begin to decline as customers adopt some of the "new technology" that has been maturing in the background. In this scenario, once you lose momentum, it is very difficult to get it back, even if you subsequently produce a credible product. In many ways, this is what happened to Lotus and WordPerfect: once they realized that Windows and Suites were the future, it was too late for them in the marketplace, even when they produced reasonably good products. As an aside, this is one shortcoming of our focus on "user driven development". I think sometimes it lulls us into an approach that is more incremental, and doesn't recognize that customers aren't very good at articulating major shifts in the market.

So, I think there is a window of opportunity in the marketplace in calendar 1998 for someone (either us or a competitor) to harness new technologies and build a product or set of products that either marginalize or replace Office. To be successful, we must decide now that we can build the product that replaces (not just upgrades) Office in this next generation environment. We should be excited about this opportunity since paradigm shifts lead to big purchase cycles. To do this requires a willingness to be very bold in our approach since our competition certainly will and they don't have an installed base to worry about. In truth, I don't think we risk much by taking a more revolutionary path:

- If we take an incremental path, there is very little upside. It will continue to be difficult to convince people of the value of upgrading. Furthermore, the likelihood of a competitor following this same path and unseating Office 97 is very, very low.
- Someone is going to figure out how to exploit the paradigm shift(s) in the market. If we don't try to do this ourselves, we will certainly lose. If we try, we have the best chance of success since customers already use our products and thus we just have to "get close" to the optimal solution. If we try and some how miss the mark completely, we are not much worse off than in the incremental path option.

To be fair, I know it is difficult to define "incremental" and "bold approach" very precisely, but Office 9x feels like a "tweener" product. It is too late to help us with the immediate issues we have and too soon to address the more fundamental paradigm shift issues. Another way to think about this is that more of the "New Internet Applications" team's work needs to be part of Office 9x if we want to capitalize on this window of opportunity.

So What is New

I think much of this is common wisdom, but here's a quick list of changes in the market and what implications they bring. Note that many of these are very tightly inter-related.

1. Email Pre-Eminent: For awhile, people have talked about "what the killer app will be on the Internet." I think this app already exists and it is email. I don't have the specific data but email is one easy, compelling reason for people to get hooked up and on-line. And once you are hooked on email (as we all know) it becomes the place where you spend most of your time. I will argue that for the average knowledge worker (in a corporate environment, small business, or home office), the email inbox will be the hub of their work and the starting point for most activities. The browser will be important and Word will still be relevant, but if we want to hold the hearts and minds of knowledge workers, we must win resoundingly in email. In fact, not only do we have to win in email, but we must also make sure that Office is a key aspect of winning in this market. Otherwise, we run the risk of shifting Office sales to lower revenue email client sales.
2. Connected Environment: Office 97 is a great first step in taking advantage of the fact that LANs, Intranets and the Internet are becoming so "standard". The challenge for us in this area is that the tools and features people need are so "immature" that there is a tremendous opportunity for competitors to leap frog us. For example, while we can create HTML pages, we don't make it super easy or obvious how those pages get posted to a web-site or linked into existing webs. If I were a competitor, I'd pick up on 3 or 4 of these types of issues, quickly do the work to solve them, and then wack us in the marketplace. Put another way, Office

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97 will be "old" in terms of its web capabilities before the end of calendar 1997. We also need to think more broadly about collaboration and how Office can leverage technologies like NetMeeting, NetShow, etc. Collabra and Notes are now competitors and we have to address the scenarios on which they focus.

3. <u>Components:</u> There has been a lot of competitive activity in this area recently and much internal email exchanged on the topic. The difficulty is in understanding what is hype and what matters to customers. Here's what I think customers care about and don't care about:
   - They want much more flexibility in what is installed, and they want the ability to do incremental installs easily (i.e. user needs something they don't have).
   - They want more control over what is installed locally versus on the hard drive.
   - They want it to be easier to update different pieces of the software so that as patches, maintenance releases, new capabilities come out, they can take advantage of them.
   - They want the software to be faster – and they believe that small components must be faster.
   - Some of them want "light weight" components for use in custom solutions. I don't think this applies to everyone but it is something we see and it will be much more important going forward.

   I don't think they care that much about Java the language, but they hear that Java is what enables all of the things above. There is also some sentiment that Java provides cross-platform benefits, but I'm not a big believer that this will drive much demand in the marketplace beyond the email client world. Sometimes the components discussion gets combined with distribution issues (sell direct on the web, download add-on modules, etc.) so it's important for us to evaluate this as part of our components strategy. Overall, if components are seen as good "fairy dust" for making all of the items above happen, then customers and analysts will like components. The problem we face is we are the only vendor without a clear, articulate strategy for "components/Java".

4. <u>TCO:</u> It is difficult to have any discussion about software these days without discussing TCO (which is closely related to the components issues above). Despite the fact that we have done more in this area than ever before, this is the one area that could single handedly prevent Office 97 from being a success. It is my #1 worry about the product as we roll it out to customers. I am a firm believer that anything we can do SOON on reducing migration costs is worth any delay it causes in Office 9x.

5. <u>Less is More:</u> For the first time since I've been on Office, I feel exposed at the lower end of the feature spectrum. Influentials now talk about bloatware, feature creep, etc. as common wisdom, and Office 97 is going to be the poster-child for this commentary (even if we are smaller than our competitors). We can no longer assume that customers will default to "wanting more". I think there really are two things going on here. First, there are some aspects of the product that are very specialized or "over featured" and people react negatively to that. More importantly, the products just feel too complex. The UI makes it difficult to find things, menus cascade, people have a hard time finding out what's "new" in the product, etc. In both cases, we need a heavy dose of simplification.

6. <u>Form factor:</u> The advent of the NC and the WinCE/Pilot hardware does raise some new issues for us in terms of scalability. In the case of the NC, if it catches on, we do not have any story for our applications running on those machines. Corel and Oracle look to be the only people today who would have credible applications. Personally, I think this is a risk worth taking. If we make ZAW and our TCO work successful, we will win over the NC in the long-term. But it is a risk we should take as a conscious decision. The handheld market is also interesting; in particular for Outlook and how it integrates with products like WinCE and Pilot. I think we want to have some subset of Outlook available for this platform (and I don't really know what that means), and we certainly want good "synching" between these machines and Outlook/IE on the desktop.

Competitors

Overall, I think our "competitive set" is changing quite quickly, and we need to reflect that in our plans. While we still have the traditional set of competitors (basically WordPerfect and 123), I'm more concerned about winning

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the battle in the email/collaboration category where we face tough battles against Lotus and Netscape. It's also worth noting that we now face much more "integrated" competition. Both Netscape and Lotus try to sell a complete, end to end system that combines client and server elements. And for a variety of reasons, they are just better at doing that today than we are – even though our product solution is arguably superior in key areas. Here's a quick recap of the competitive situation:

1. Microsoft Office 4.x/95: I still view our existing products and installed base inertia as our toughest competitor in the short to medium term. The Office 97 life cycle is mostly based on upgrading these users to our latest technology and the more we can do to raise the benefits or lower the costs of that migration, the better. While inertia in our installed base will always be a challenge, it stack ranks lower on the list of issues in the 2-4 year timeframe. In that period, the real concern is being replaced by some combination of email and component apps from our competition.

2. Netscape: It's easy (and in vogue) to get caught up in the "fight Netscape" battle, but even if I discount the threat somewhat, I still think they are our biggest threat over the next 2-4 years. Winning the "collaboration client" is key to their strategy, and they can leverage their current browser installed base by moving quickly with products like Communicator and Constellation. They are also sticking their toes in the water with Corel which could lead to broader cooperation. The interesting thing is that Netscape doesn't really have to attack Office itself. Basically, their strategy can focus on email and collaboration as the "center of your work" and then claim that "they work very well with Office." Over time, they beat Office by adding capabilities to the Communicator product that just makes Office less and less relevant. No frontal assault necessary; just a steady war of attrition.

3. IBM/Lotus: In general, I think SmartSuite is not a central part of their strategy and therefore is not a dangerous competitor for us. Notes, on the other hand, scares me quite a bit. This product has solid momentum behind it and is receiving significant marketing and sales support from IBM corporate. If they can turn out a credible client that approaches what we are doing with Outlook/IE, they will have a very solid solution. Unfortunately, Exchange probably hurts the Office story as much as it helps us since it is seen as big, cumbersome, and proprietary. I also think Lotus' components strategy fits quite well – basically they are taking the most meaningful parts of SmartSuite and using them as value added pieces to supplement Notes solutions. If this cannibalizes SmartSuite, they don't really care since they are making almost nothing there anyway. More likely, it will cannibalize Office sales or, as in the Netscape example, reduce our relevance.

4. Corel: Corel is really the only "pure competitor" to Office since they don't really have a server story and are almost exclusively focused on selling application software. Because they have limited financial resources, are mostly focused on the smaller retail market, and have to compete directly against Office, I'm slightly less worried about Corel Office itself. We have lots of work to do at retail and will have to stay aggressive against them, but I just can't see them having the ability to invest enough to do us damage. One scenario that would be worrisome is if the Corel Office technology ended up with someone like Netscape. While I'm not sure Netscape needs or wants this burden, it would make them a more complete and challenging competitor for us. The other scenario that could prove problematic is if NCs catch on and Corel is able to use Java Office on those machines, but I think that is a lower priority issue.

5. Others (Oracle, Sun): I don't see these guys as direct competitors per se, but they certainly use Office as a whipping boy for pursuing their server side goals. As such, they create some problems for us in PR (see components and bloatware) and we need to factor that into our plans.

Key Product Imperatives

Based on what I've outlined above, here are the important areas I think we need to address in the next generations of Office:

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1. The Outlook Hub: We must assume that overtime Outlook will displace Word as the primary app in Office. That is not to say Word won't still be important – for some time to come, people will want to use Word either for specific document types or because old habits die hard. But in the past, we always viewed Word as the foundation application, and I don't think that will be the case 18-36 months from now. From a practical perspective this has two important implications:
   - First, we need to figure out how to make Outlook email a very rich environment that has the key tools that Word includes. We can do this by adding a new HTML editing and output (print and viewing) environment or by fixing WordMail – or some combination of both. We want to make sure we are the leaders in communications tools – not the "former leader" in producing great word processing tools.
   - Second, we need to make sure that Office and Outlook are tightly integrated so that people who want Outlook are willing to pay for Office to get it. Today, our average $/unit in Office is something like $175. If you assume Outlook is the hub that does much of the base communications work, we run the risk of people just upgrading Outlook and spending only $75/unit with us. We have to ensure that people want all of Office, both because the other apps are compelling in their areas and because using Outlook with the rest of Office is a great combination.

2. Components Strategy: we must develop a clear strategy for components, and we need to begin discussing this with customers immediately. My team has been making this up as "market-tecture" with some input from the development team, but we need some specifics with sample applications. I am NOT advocating that we lay out a plan to ship a "Components Office" or a "Java Office". However, I do think we need a strategy and product plan that has at least the following attributes:
   - Demonstrates how we will give customers control over where, how, and when component pieces of Office will be installed and executed. This is ZAW made concrete and explicit.
   - Incorporates Java in some way. This could be as simple as having Ross Hunter's group produce a set of Java add-ons that run in/with Office. We want the magic of Java without the overhead of doing something big. Corel's approach of rewriting their apps in Java is only valuable if the NC catches on, and I'm willing to bet it won't.
   - Provides programmable components for developers to use in custom solutions, and includes the ability to move this data to the "real apps" for full-featured activities. On the surface, Lotus has a good approach here. We could do something similar and differentiate ourselves by providing unique integration with the "fully functional" apps that have over 80% market share.

3. Reduce TCO ASAP: There have been many debates about this and about whether we can deliver something compelling this Fall. I think the risk of this slowing Office 97 adoption is great enough that we should take some hit on Office 9x timing or feature set to produce a better TCO product sooner. Without reviewing specific plans, it is difficult for me to make specific tradeoffs. But I know that this topic comes up in every single conversation I have with analysts, the press, and customers. That is a very bad sign.

4. Slimfast Office: Performance is a problem in Office 97. I don't want to have a benchmarks debate, but the product will require a hardware upgrade of some kind for many users. No disrespect intended to the teams, but I think Outlook and Word are the primary issues here. Access and PPT performance really improved in Office 97 and XL is probably as good as Office 95 (which was a big improvement). But people spend most of their time in Word and Outlook and at times they are painfully slow – particularly if you use them in combination. This is bad enough in my mind for us to address in a maintenance release, particularly some of the more egregious issues in Outlook. I also think Office is too fat. To some degree, I know this doesn't matter since we don't load all of the code, hard disks are getting bigger, and running from a server may be more common in the future. But the perceptual issue of requiring 120+ MB and having a total install of 191MB is very painful. Let's be hardcore:
   - The value pack should no longer ship on the CD. We should make it part of the annuity program and provide it for download from the web.
   - We should also take out a meaningful number of components from the product and make them only available on the web, as part of our annuity program, or by fulfillment. I don't have all of the data on component usage, but the Binder, Solver, Analysis Toolpak, Genigraphics stuff, Outlook Notes, etc. should be put back on the table as things that get moved to the add-on category. I know there are

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compatibility issues but it's worth figuring those out to get the savings. Marketing will have to sacrifice some things here as well, and we will gladly do that.

- The next time we release Office, typical install should be under 100MB and full install should be under 150MB. I know that is "impossible" to do. We should figure out the trade-offs and determine how to do it.

5. Web Office: In general, Office 97 does a good job today of "integrating with the web". Unfortunately, this will be a relatively short-term advantage. The fruit for doing better integration is hanging relatively low and I think our competitors will pick it quickly. Some of this may be difficult to do, but we must get better, native HTML into all of the applications as the default way to create and view content. We need to rationalize our content creation strategy (so is it FrontPage, FrontPad, Publisher, Word, or PPT to create web page content???). This is a question we get increasingly frequently, and it is very difficult to explain when a user should use which tool. We must do a better job of browser integration for smooth content viewing – today's doc objects make for a fine demo, but they are not very useful for users because they are slow and cumbersome. Finally, we need to look at our UI and incorporate as much as we can from the "web world".

6. New Web Applications: In a way, I'm kind of embarrassed to put this on the list because I'm not sure I could define a new "web app" in a crisp way. Having said that, the "connected world" creates all kinds of new assumptions and usage scenarios that should imply some new tasks or entirely new types of applications. We've talked mostly about what these applications are NOT (NOT a Java port, NOT big, NOT replacements for Office), but I haven't seen anything focused on what they could be. What I do know is that someone is going to figure out that there are activities and tasks that you want to do electronically once you realize everyone is connected. And the company that figures this out first will have a huge advantage. Note that in this area, we could be very aggressive about "pre-marketing" including concept previews, early beta postings, etc. In fact, we will have to do this to keep pace with the conceptware from our competitors.

7. Intelligent Office: In all the hoopla about the web, I don't want us to lose some of the important aspects of our on-going work to make our software easier to use (basically IntelliSense capabilities). Office 9x definitely needs to push the ball forward on making the applications smarter about what the user is trying to accomplish, and we need to make the Office Assistant much smarter about providing tips and help.

8. Reallocate Resources: As long as I'm wading into the deep-end where I don't belong, I'll claim that we need to reallocate our resources more radically. I know developers are not "interchangeable" and that more resources doesn't always accelerate the pace of work. But I think we should stop some projects and move those people to areas of greater benefit. Another way to put this is that I believe our $5 billion dollar Office franchise is threatened and it's not worth risking this franchise by investing in some peripheral areas. No disrespect to the teams or the people, but to me, investing in Team Manager is not a good use of our resources. It will not be a big business anytime soon and the Outlook team is not going to have the time to do the support/infrastructure work Team Manager really needs anyway. Stop this project and move the folks elsewhere. Likewise (and now I'm in very deep water), we should finish up the next version of Project quickly and move most of those folks on to Office 9x work ASAP. I know Project is a good business and it has competitors, but once we ship this version of Project, we can afford to under-invest in that business. Understand that part of my point is about development resources, but these projects all have infrastructure that could be used elsewhere. In my case, there are marketing heads associated with Team Manager in a world in which I don't have enough heads for Outlook and can't get more. For me, this is an easy tradeoff.

The Product Line-up

Of course, all of this comes back to a schedule question: when can/should we ship the next version of Office. I've been a big fan in the past of spreading out our releases because corporate customers can't absorb them fast enough. But given the current market environment and our risk profile, I think we need to move quickly in the areas of communication/collaboration, web integration, and TCO. This will create some angst for some customers but the alternative is to allow our competitors too much of a headstart.

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Therefore, I think our release schedule should look something like the lists below. Obviously, I'm not the resource planner, so I'm sure there are several reasons why some of this is "not possible". But the real point I'm trying to make is that we need to feel the urgency of the situation and move quickly. Not blindly, but quickly. If resources are an issue, we should be even harder core than I was above and move people from other products. Office is the crown jewels, and we must optimize for its success.

Office 98 – Released November 1997

- Outlook web release (see BrianMac spec)
- IE4 integration (partially Outlook work but some Office work)
- Low hanging TCO features
- Low hanging web features (easy posting, better HTML)
- Launch of annuity and content programs
  - End User and Corporate annuity (includes some of the TCO work)
  - Programmable components – XL grid control, etc.
  - Stripped out value pack and other features – <100MB typical install
  - End user add-ons, including Java add-ons
- Maintenance work — this is the "a" release
  - Performance (especially Word/Outlook)
  - Bugs

Office 99 – Released November 1998

- UI simplification and enhanced intelligence
  - More webish UI
  - Feature accessibility
  - Intelligent Assistant – user tracking
- Major web capabilities
  - HTML as default file format
  - Web server-based features
  - Content integration
- Next level of ZAW and all other TCO improvements
- Enhanced Outlook integration
- Programmability
  - Apps as ActiveX controls
  - Scripting
  - Java support
- End user productivity enhancements

Issues I Won't Debate

There are several issues I've chosen not to debate or opine on in any detail – mostly because I haven't been in enough meetings to have an informed opinion. Here's a short list:

1) Trident: I don't know enough about this to know how this fits in to Office beyond Outlook. My only perspective is that whatever we do for HTML editing and viewing should at some point become a "shared code" component in all of the products. And we must be very clear when people should use our various tools for HTML work.

2) IE Dependency: This is a difficult issue because despite the trends, Navigator is still the world's most popular browser and will be a presence in the market for a long time. I think we must be the first to take advantage of IE innovations, while at the same time making sure that we work effectively with Navigator. Outlook and IE will certainly be tightly linked, and it's good if specific Office capabilities only work with IE. But the broad benefit areas that we emphasize cannot be wholly dependent on IE.

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3) **NT Dependency**: Here, I think you need to separate out the client and the server. I think NT Server has enough momentum for us to develop some capabilities that require it. For example, we could build some scripting scenarios on top of NT services. On the client side, it is more difficult. Windows 95 is still the predominant desktop OS and will be for some time in the future. If something relies on having NT on the client, I think we will have some major problems.

4) **Exchange Dependency**: I'm not up to date on the plans for Exchange server so I don't want to sound overly negative. But my impression today is that Outlook's dependency on Exchange is a measurable negative because it makes us look very proprietary and requires accounts to make major infrastructure decisions in order to install Outlook. A specific example is our current dependence on Exchange for our collaboration messages. Clearly, this will change for the better as Exchange's strategy evolves, but it also points out the need for Outlook to become more back-end independent. We have many requests to run Outlook against a Notes server...

5) **Office SBE and Home activities**: I could write a separate memo on things we need to do to optimize Office for small businesses, and I believe we need a group of people focused on this. I choose not to discuss it in this memo in order to concentrate on the central issues of email, TCO, components, etc. Likewise, there is a whole team working on the next generation of Home Essentials and that is better handled as a separate discussion.

New Metrics

As a final set of thoughts, I've included a list below of some new "vital statistics" that we should consider tracking to assess where we stand in the market. I'm sure there are others so this is just a start.

- Email client market share. Obvious measure for how we are doing in the "next share war".
- Outlook installation and usage rates (% of Office buyers who install and use Outlook). Ancillary measure of our success in the email market and a key measure of how much Office is helping us gain email share.
- HTML document share (% of HTML docs created by Office or FrontPage). A surrogate measure for how "relevant" Office is in the web world.
- Word, XL, Access, and PPT utilization rates (includes frequency and depth of usage). Designed to track how "relevant" Office is for the average knowledge worker.
- Average time to deployment for Office (from time of first test to final roll-out). Key measure of the effectiveness of our TCO work.

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