

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

Executive Summary

Our mission is to develop the most successful desktop productivity tools in the world, marketed both as integrated suites and standalone applications. Our share goal is 80% for office suites and 60% for apps, including spreadsheet, word processing, presentation graphics, database, and project management. For FY97, our revenue target is \$\$\$ and our profit target \$\$\$\$. We have aggressive internal goals for reducing costs and increasing efficiencies. Externally, we will maximize the potential of our installed base while exploiting new markets in smaller organizations and overseas. In some of these markets, our competitors have stronger awareness and distribution than we do, and we will continue to adapt and innovate with our programs and products to crush them.

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, however, 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 and cc:Mail. Borland/WordPerfect are trying to catch-up with Borland Office 2.0. Our applications compare favorably today and have considerable momentum and market share — Office has 70+% of the suite category — but the market increasingly views the alternatives as near-substitutes. This plus increasing price competition threatens to permanently damage the business.

Market Situation

The productivity applications segment is the largest one in the industry and at Microsoft, but is also the most mature. It will be about \$2B for Microsoft in FY94 and \$XX for the industry. [Rest of section is a series of charts with short discussion the concisely explain key trends.]

Business Model

Revenue objectives moving forward
COGS
Factors that will impact COGS
Support costs?
Estimates, scenarios
Key factors
Upside and downside risks

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Competitive Situation

Lotus. Though still primarily a spreadsheet company, Lotus is a formidable competitor. Accelerating momentum behind Notes, including a growing list of third parties adding value to it, SmartSuite, improving financials and company image, 20 million customers, high product awareness, broad distribution, and an alliance with IBM — these assets are a challenge to neutralize. We expect Lotus to continue to push Notes as a computing platform and to 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. We must provide better workgroup features in our applications, including support for Notes as a back-end, to break this perceived advantage.

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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 (17% layoff in January, 1994) the company to achieve greater (some?) profitability. The company has launched the final release of its flagship DOS product and backed-off its free support policy, historically its most valuable asset. Their challenge is to quickly become competitive in the suite market through their alliance with Borland while trying to grow their 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. 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 at parity with Office, has not garnered serious interest in the market. They do offer the only suite that is not licensed as a single product, but have not advertised that even their license is poorly integrated.

Claris. Works OEM success, pressure on the definition of the integrated category, and a poor man's alternative even to our individual apps. Need some facts on Mac phenomenon.

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. As a result, although these goals are closely intertwined, on the margin we will subordinate individual category goals to Office/product line goals. 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. Release synchronization will make it much easier to share code and designs.

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. MOM was a good example of leveraged value-added in Office 4.0. REN will be our primary focus in Office '95. In addition, an image editor, possibly RPM, and other additions/servers are candidates for Office '95 and beyond
- **Organization usability**
- **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. To the extent possible, we will time apps releases with systems releases and ensure Microsoft applications uniquely exploit these releases for customer advantage. We 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

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Macintosh, no new platforms are contemplated. OS/2 success, even to the point where it becomes the relevant second platform in cross-platform, is a risk in this plan.

- **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. Features such as Visual Basic for Applications, PivotTables, Word's AutoFormatter, OLE 2.0 support, and the applications infrastructure effort can provide differentiation for years. We will need to reduce the number of "small" features to achieve this goal.
- **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 de facto choice for general productivity use and makes them very difficult to dislodge. 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.
- **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.
- **12/24 is an approach to scheduling releases that allows for both major architectural releases every 24 months while ensuring competitive releases every 12.** Since architectural changes takes 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, not by changing the core .exe.
- **Office Friendly.** We will license pieces of the Office UI (and, in the future, Office code) to complementary ISVs and eventually SPs to build an extended family of applications with a common look, feel, and behavior.
- **Expand into new geographies.** Productivity application market growth 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 our use of shared code to 40% by 1996. This plus investments in new tools and processes are needed to address the difficulty and time required to debug and ship these large applications. Finally, we will reduce the number of print-based and on-line words by at least 50% by 1995. This plus increased use of outsourcing and process improvements will address the user-assistance and localization goals.

Release Plan

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

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"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
- 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 Analysis of Release

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

Marketing Strategy

Over the next three years, there are several key themes for the productivity applications marketing strategy:

- Lead with Office, especially Office Pro, but not to the exclusion of standalone applications business. Suites are the fastest growing segment of productivity applications and we are especially strong, so this is an obvious direction. However, the standalone products will remain important factors in the suite decision, and large categories by themselves. Moreover, selling an app standalone puts it in a great position for future upgrade to Office. We are outsold on a standalone basis today. Some of this is the result of our Office success, but some is undoubtedly attributable to competitive issues that must be addressed.

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- Differentiation is obviously part of any marketing plan. The noteworthy point here is that differentiation via traditional product-oriented "best of breed" means is getting more difficult. Efforts at branding, both at the feature level ("IntelliSense"), Office level, and more broadly through programs like Office Friendly are approaches to this. We also need to leverage other Microsoft assets from our PSS advantage to our relationship with Microsoft Systems to position versus competition.
- Evolve messages and strategies for different markets. Although we expect the basic productivity businesses growth to slow, ongoing evolution and segmentation of the market must be addressed. We have recently identified an acute weakness with small organizations, a market that Lotus and WordPerfect are apparently targeting. The SP market addresses SMORGs in part, but is also a marketing effort on its own. The increasing importance of upgrade business to our revenue stream requires increased sophistication in our approach to the installed base. In general, as the market matures it will segment and more specialized approaches toward underpenetrated segments may be an effective way to differentiate our products and gain share.
- Address broader market. Increasingly, growth is coming from customers who are more difficult to reach through traditional techniques. Our traditional IEU-driven influence model still applies, but we will need to identify new approaches to reach these less involved users. The awareness of Microsoft applications is alarmingly low today.
- Adapt to changes in technology. Numerous changes in technology, from the systems platform to CD distribution to widespread usage of on-line services enabled by cheap bandwidth, represent new opportunities to position, market, and distribute productivity applications. We need to be the leader in exploiting these changes.

Target Customers

We have been successful in the past promoting product trial among influential end-users and computer professionals, whose recommendations drive purchase by others. Penetrating these early adopters of Windows, primarily in large organizations, fueled our early growth and enabled us to ride the rapid acceptance of Windows. Our Macintosh strength has contributed to strength in corporate accounts requiring strong cross-platform support. We have also developed expertise in upgrading users of competitive products to Microsoft applications.

We will continue our efforts to market to influential end-users and need to build on our strength in corporate accounts. There are several additional markets to target:

- **Current Users:** The installed base is a critical asset to defend and exploit. We must learn how to upgrade a higher portion on a regular basis, cross-sell them new apps/content/tools/service, and, most importantly, move a greater number to Office Professional. Historically, relatively little attention has gone into understanding the needs of this segment nor in marketing to them. It may, for example, make sense to build more specialized upgrade SKU's including different components to better appeal to these people. In 1997, each 1% increase in response rate above our current 25% would year an additional \$XXXMM per annum.

Competitive users will remain an important part of this effort, particularly in upgrading them from a competitive applications to Office Professional.

- The installed base of over 3 million OEM Works users must be leveraged. Recent tests indicate WHAT??
- Individual Users within Small Organizations (smorgs): WordPerfect and Lotus outperform us among organizations with fewer than 100 employees, but the market represents a huge revenue and

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share upside for Microsoft. We believe that the "influence model" is still crucial for reaching these customers, but we know that the traditional model doesn't quite apply because smorgs do not employ dedicated computer professionals.

- Other segments/verticals. Point here is that we need to get more sophisticated. We have targetted legal and accounting, but need new approaches.

Positioning and Communication

Past positioning strategies have been heavily-oriented around the specific best-of-breed features of individual products, and more recently features of Microsoft Office. This basic activity will remain a fundamental part of future positioning activity (as will assets such as cross-platform and others), yet our communication needs to be modified in a number of ways:

- We need to more aggressively redefine product categories. A static positioning framework is easier to copy or neutralize, leading to commoditization and price pressure. In the past we were able to define graphical applications and usability with positive results. We have a unique opportunity with Office 4 because the suite category is still largely undefined in the minds of most consumers. In the same way that Lotus defined spreadsheets and WordPerfect defined word processing, Microsoft can now define and own office suites. We must continue to communicate our unique product and company attributes (IntelliSense, OfficeLinks, Microsoft product innovation, no-charge support, etc.) and make them highly relevant with end-users. Finally, we have a very significant sales advantage over Lotus which we need to exploit as proof of our superiority.

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, and others.

- We must expand our positioning to include non-product or non-version-specific attributes. Building on our product support advantage will create an asset that is less fleeting than short-lived feature advantages. Although some aspects of branding of controversial, establishing a higher-level meaning for Microsoft Office (or better attaching "Microsoft" and its meaning to Office) would be an important, long-term asset. Less controversial but also important is the need to brand and invest in a small number of features/technologies such as IntelliSense, OfficeLinks, Visual Basic, and perhaps personalities.
- We need to clearly establish our leadership position. Although we have won the majority of product reviews in recent years and have dominant market share, we have not effectively declared victory. Higher awareness of our long-term success would contribute to the perception that Microsoft is the preferred brand and safe purchase for the future.
- Position Microsoft Office as the client apps for workgroup solutions. Lotus has a significant advantage. It will take several years to neutralize the momentum of Notes and the perception that SmartSuite is uniquely suited for workgroup computing.
- Awareness and satisfaction (say what?)

- ~~[Untouched remnant of Sage writing] Marketing spending—Given the relatively low awareness of the office suite category and the players in it, as well as the increasingly competitive environment, we are planning a sustained level of communications. This will enable us to sustain broad exposure in the PC press as well as the general business press. We are considering additional communications investments and will also evaluate the merits of spending more to improve our long term in store presence (merchandising, stocking) and targeted small business messaging.~~

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Pricing Strategy

We should seek to maintain our current strategy of pricing leadership, commanding a small price premium over the #2 player, Lotus. As the market leader, inability to maintain this premium should be seen as a failing report card on our product development, efforts to add value to Office and create perceived value for individual components, and marketing investments. As discussed above, avoiding commoditization and maintaining both share and reasonable price levels is the overriding objective of this plan.

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) and should respond accordingly.

Hankv—what else? Price discrimination? Rationalize pricing structure

Marketing Initiatives

Over the next 3 years many of the current marketing activities will remain in place although evolving as indicated above. Additional emphasis areas or new ways to build the business include:

- **Annuity Business.** As discussed above, increased focus on the installed base will generate increased need to invest in end-user affinity (e.g. Microsoft Plus) and to develop greater understanding of current users and what it will take to increase their propensity to upgrade or buy complementary products and services on a regular basis. The concept of personal maintenance may be an asset in building this business.
- **Distribution.** We need to grow distribution of Office and Office Professional (in N. America anyway) while not losing sight of the ongoing importance of the standalone applications. In the US we are losing in the retail channel (superstore and mail-order reseller may be better) to Lotus and WordPerfect.
- **OEM.** Although we'd like to be able to leverage our OEM relationships to sell applications, this will generally remain a short-term tactic because the OEM channel is such a price-oriented channel and occasionally conflicts with other channels. OEMs will be used to respond to competitive initiatives (currently underway in Europe and elsewhere) and leverage product advantages. Our primary thrust in this channel should be entry products such as Works.
- **CD Unlock.** The expected rapid growth 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 for \$1.50

CD Unlock may also change the model for purchasing software. Rather than buying Excel all at once, for example, they could pay a lesser price and purchase core functionality only, choosing to never purchase functionality like Solver or simply deferring the decision. A better alternative is the user could choose to purchase add-ons or third-party products from the CD on an a la carte basis, generating additional revenue.

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We should aggressively promote rapid adoption of CD technology.

- **Other Packaging.** We will need to constantly evaluate the current Office/Office Pro configuration as well as others that could help differentiate the Office. 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.
- **Small Organizations.** We have an excellent opportunity to increase share and revenue for Office applications in this growing segment. The focus of our short-term activities is on raising Office awareness among smorg influencers with business press advertising, increasing visibility and availability of the product in retail environments, and identifying SPs who develop solutions within targeted segments. Longer term, we will increase our focus on reaching business and industry peers (the most important smorg influencers in a number of targeted industries (accounting, legal, real estate, and insurance), and recruiting and training a broader base of SPs to develop and sell Office-based solutions.
- **Specialized Solutions.** We need to evaluate creating alternative forms of Office to meet the needs of specialized markets. The SMORG marketplace, for example, sees little need for PowerPoint and Mail, gravitating instead toward products like Publisher and Access. Even better, they would prefer a "build your own" Office wherein they get a choice of applications beyond Word and Excel. A related idea is to offer a family of vertical add-on packs to Office. Although it may be possible to make this an interesting proposition by itself, the primary thrust would be differentiation of the key product.
- **Office as a Development Platform.** Beginning with Office 4 we are positioning Office as a development platform. Further evolution of the products will make this a stronger message and generate additional demand for special pricing and packaging for Sps. Embedded license (runtime) pricing is in demand today and will need to be resolved. We also need to develop a model for resell of individual application components. Over time, we need 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 (=non-competitive), and one that is proprietary to our applications.
- **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 (e.g. UI, look and feel, etc.) 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.
- **Support.** We need to increasingly view support as a marketing opportunity. Not only does this mean leveraging our current support advantage, but taking the leadership role in defining productivity application support. The advent of CD distribution creates opportunities to build more support information into the core product. Integration of the application with Microsoft On-Line is another opportunity for providing fast, easy, high-quality support cost-effectively. Programs such as the Microsoft Support Network will need to evolve as applications become a more significant development platform.

Key Success Factors (call this summary?)

- Leverage Microsoft assets - leadership, systems and research, partners, installed base
- Listen to our customers. Innovate in product development and marketing.
- Execute efficiently and effectively
- Leverage change, new platforms
- Protect our franchise in large organizations

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- Adapt to new markets (segments and geographies)
- Provide relevant differentiation in mature categories
- Continuously add value to Office

Issues/Risks/Threats

- Price erosion (including volume discounts, concurrent use, category dilution)
- Lotus creates a sustainable technology and marketing advantage by linking Notes and SmartSuite
- WordPerfect converts its huge and loyal installed base before we win them over
- We underinvest in category innovation while focusing on consistency, porting, competitive response
- We fail to communicate a leadership message
- Lotus succeeds in its partnerships with IBM and others

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