Microsoft Memo

TO: FY98 WWSMM Attendees
FROM: Jeff Raikes[1]
DATE: April 22, 1997
RE: FY98 Planning Memo

CC: Bill Gates, Steve Ballmer

Introduction

We are on track for a very successful year in FY97, driven by Win32 momentum, Windows NT Server and BackOffice revenue growth, and a successful Office 97 launch and desktop applications growth. We are achieving exceptional profitability, and excellent performance across the customer units and PSS.

But major competitive obstacles and challenges lie in front of us for FY 98. The Network Computer (NC) and the Java operating environment – led by Sun, Oracle, IBM, and Netscape – is making a big push to displace Windows. Corel is spending aggressively against Office and has met some success in small business and retail. Lotus Notes is outflanking Exchange in many customer segments and is benefiting from IBM's corporate might. Oracle has quickly focused on Windows and appears to be outselling SQL Server on the NT platform. While Novell is down, they are not out and have good directory services technology.

To win against this tough competition, we must drive healthy growth in our "traditional businesses" (Windows, Office, Windows NT) and crush the NC threat. At the same time, we must invest in and position ourselves to be the premier platform for business applications development, and drive the use of SQL and Exchange as the key building blocks. We must win the battle for Intranet and Internet applications.

To deliver on this strategy and position ourselves for future opportunities, we will be adding headcount for geographic growth and customer unit focus:

> We are creating a new Applications Developer Customer Unit to target Oracle, Notes, and Unix developers. ADCU will provide tremendous leverage by driving NT into corporate IT infrastructure, and as the platform for our customers' line of business applications (LOB).

> We have restructured Public Network Sales (PNS) and IDCU into an Internet Customer Unit to better serve our partners and customers in this space.

> We will extend our account coverage to companies with greater than 1,000 PC's. This investment in "breadth LORGs", supported by the development of solution provider partners and structured sales cycle, will eliminate a competitive disadvantage.

> We will increase our partner recruitment & development focus on competitive partners (SUN, Oracle & Lotus Notes) and build strength with custom application firms and ISPs. We will achieve strong reach and frequency to value-added partners (VAP's).

These enhancements to our organization should enable us to better meet the competitive challenges ahead of us. The last page of the memo is an appendix, sharing SteveB's WWRDM overview of our customer unit focus, activities, and measurements. They are further refined and described in the appropriate customer unit memos. In this memo, we'll look at the evolution of the key customer scenarios, the competitive challenges, and our goals for FY98.

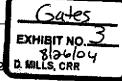[1] Rosa Garcia, Craig Bruya, and Lori Moore prepared extensive contributions to this memo.

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Selling the Platform

Windows is facing its biggest competitive threat since inception. If the NC is successful, it will mean a catastrophic downside in Windows revenue, our server business, our tools business, and our applications business – i.e. NC's threaten the heart and the body of our company. This is more than just an OS battle. This is about Windows clients, Windows servers, Windows tools, and Windows applications. If Microsoft technology is relegated into "yesterday's technology" in lieu of the Java operating environment and Java apps, Microsoft loses.

We must sell our platform. We must sell across customer segments, from small business to the largest enterprises. We must sell across partner segments, reaching from retailers to VAP's to solution providers to strategic integrators and other enterprise partners, with special focus on partners of our competitors. And we must sell to the influentials that drive bottoms-up demand: end-users (IEU's), developers, and IT professionals. We are making evangelism to the influentials a high priority in FY98 and we'll include specific metrics in the business reviews as a way to ensure marketing efforts are focused on them.

Paul Maritz's memo will overview the product group investment in our platform. In FY98, we will introduce versions of the Windows NT Server platform. These help us more effectively package our technologies for the needs of customers segments: small business, departmental usage, and the demands of the largest enterprises. *But the core products we must promote and sell remain the same: the Windows client, Office, Windows NT Server, SQL and Exchange.*

The Customer Scenarios and Our Competition

Customers and partners make it clear to us that we must do a better job tailoring our message for any given customer scenario. We must sell the entire Microsoft platform as a competitive advantage, incorporate Total Cost of Ownership (TCO) and Total Value of Ownership (TVO) messages in every sale, and promote partners that have developed services and solutions on, or with our platform that address our customers' needs.

Our thinking on customer scenarios has evolved. Let's look at the key scenarios and our competitive challenges.

Infrastructure. NTS and BackOffice depend upon the support of IT professionals and SP/VAPs for good architecture and deployment. They are under great pressure to deliver the lowest cost of ownership for IT (TCO), while making sure the IT investment will support all the business value (TVO) required to compete in today's economy. Their perspective includes the range of issues – the cost of hardware and software acquisition, replacements/upgrades, software distribution, interoperability, network and user management. We should not lose on total cost of ownership comparisons.

The NC threat, the desire of Sun and Oracle to promulgate Unix, the desire of Novell to transition to networking services (NDS) are all serious attacks on Microsoft as a technology provider for IT infrastructure. Customers will be reluctant to change. The integration of our platform – unified directory, security, application set-up and management – and the ability to interoperate with their existing investments are critical to success. We must clearly demonstrate our advantages, articulate the cost savings and increased value through the use of our products.

Personal Productivity. Our success with Office 97 requires that we move end users to a 32bit platform and demonstrate the value proposition that these new technologies offer to end users. We must convince customers that Office97 offers them important new improvements in features and functionality, and that these can be realized while addressing TCO issues. Customers cannot forget the total value offering our Office suite offers in a world where competition is trying to demonstrate that no one needs the features we are adding to Office. Our competitors will also leverage NC interest, and promote "thin client" productivity.

Corel and Just Systems continue to out market us in the retail space. In addition, piracy continues to threaten our revenue stream and short term growth. Customer inertia prevents our customers from realizing the productivity gains they could achieve by upgrading to a 32bit application. We must clearly demonstrate the excitement and benefits our technology can deliver to the broad range of Office productivity users, and help them pick the right solution for their needs (Office Pro, Office SBE, Home Essential, Works, etc.).

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Communications. E-mail is the fastest growing application category in both the business and consumer segments. Internet and intranet publishing is exploding. We face tough competition in this market. Lotus is offering strong products with Lotus Notes and Domino, creating a dangerous bridge between mail, workgroup and Internet publishing and using their well-known high-end groupware capabilities to cover a poor messaging system. They are also achieving great success with LORGs, MORGs, and developers. Netscape is using its browser leadership and server products to drive revenue from the enterprise. In addition, they will try to convert their consumer browser share into substantial revenue stream with Communicator.

Microsoft will address this market with IE 4.0 as the base free client. We will use Outlook Express (included in IE 4.0) to attack Netscape Communicator. Outlook will be the client with high value-add features such as offline support, better views, customization and richer authoring services. Exchange and IIS will be our recommended infrastructure. If the client needs to develop workflow applications or high-end groupware apps, you need to add SQL to the platform and recommend Visual Basic as the programming development tool. Remember that you must sell the full Microsoft platform as an advantage against our competitors and try to avoid direct Exchange vs. Notes confrontation for business applications.

Operations – Line of Business Applications. Our largest new revenue opportunity will come from selling the platform for line of business applications. The new ADCU group will assume a leadership role in evangelizing the benefits of using our tools, SQL and the NT platform to a broad set of developers including solution developers and customer application developers. SQL Server must become the preferred database server to be successful against Oracle.

Total Oracle database licenses revenue will grow about 30% in FY97 to $2B. Oracle has more than 50% NT database server share this year. Their strength with consulting, vertical applications, Unix support and scalability put them in an enviable position with the 7000 LORGs they manage. They have a huge field sales team with a strong focus on Solution Developers and vertical industries and they run more than 30% of units through developers. They are being very aggressive in ramping up a distribution channel to cover the SMORG market by trying to recruit and train our Solution Providers.

It is imperative that we convince solution developers to port their applications to our platform and jointly market these solutions to our enterprise accounts. We must communicate crisply and consistently by industry, by target customer size and by business process, all the available solutions from our Solution Developer partners so that our customers have breadth and depth of application choices on our platform. OCU must build a channel to allow SDs to distribute their apps. Toward this end, recruiting Oracle's partners is a top priority.

Data Analysis. We can help our customers get the right data working together to make better-educated decisions. To make it happen, data analysis will require a comprehensive understanding of data management, system architecture and technology. It ranges from data transformation to statistical analysis to data mining and to visualization.

MS will address this market using SQL on the backend, IIS for publishing and Excel/Access for front-end analysis. MS Sales is a great example of how our tools come together for this scenario. Oracle is our main competitor but SQL Server is making some inroads and is now used for nearly 25% of all sites implementing data warehousing solutions. In late 1998, we will incorporate OLAP technology from Plato that should provide us with a more solid technical base. Before the implementation of this technology, we will face some technical difficulties in meeting all our enterprises' expectations. For this reason, we need to work with partners such as Digital to create comprehensive service packages for designing and deploying datamarts more quickly than competition.

Knowledge Databases. These are the systems that allow the company to make every piece of knowledge available in an easy way to every employee that needs it. They maximize the effectiveness of training, research and sales processes. Examples include Self-Service Online Learning, Technical Knowledge Bases (e.g., PSS KnowledgeBase), Online sales catalog (e.g., Infobase), Marketing Research Databases and Document Management systems. Our technology to more effectively support this scenario, will come together over the next couple years. In FY98, we will address the customer needs by working with the right partners, such as Saros with Mezzanine, Interleaf, FileNet, Eastman Software, and others.

Internet Electronic Commerce. By FY2000, business-to-business transactions should grow by a factor of 100 and online retail sales are expected to soar tenfold. This creates an immense opportunity to have our platform software support this e-commerce tidal wave. Our software will provide online vendors with fraud-resistant ways to handle everything from dispatching goods online to setting credit card transactions via BackOffice links to banks. Shoppers will be able to buy things by transmitting an encrypted digital ID.

We have made some progress, particularly with standards, by working with companies such as Verisign (services to prove merchant/shopper identities online), and MasterCard and Visa (SET standards). In FY 98, we will launch our Internet server that will include Merchant Server, but that is only the beginning. We will leverage ADCU to learn more about product needs, and to work with our customers and partners in developer e-commerce solutions.

Non-Work Usage. As more people around the world use a PC for non-work purposes, Microsoft has as a goal to provide the most satisfying computer experiences at home and at school. The consumer software market has evolved as a highly fragmented and financially challenging business for all vendors. Each consumer category has its own unique set of competitors: Intuit, IBM/ World Book, Disney, Logitech, Electronic Arts, CUC and others that vary by region. We need to beat them all with great products, focused and leveraged marketing, and great channel execution.

While specific tactics will vary from market to market, common tactics include:

- Aggressively push Windows/IE and DAD products, particularly to influential end-users (IEU), and in K-12 and universities.
- Out-execute competition in gaining retail presence, particularly during the holiday season where we have the heaviest consumer spending on the non-work categories.
- Create end-user and channel excitement around the launch of key new products (Memphis, Home Essentials, selected IMD and CID products)
- Make supply chain management a success – get in-stock on the key titles and ensure replenishment. Respond quickly to changes in demand.

Aside from the small teams with known responsibilities, subs should spend little or no time on our core online offerings (MSN, Sidewalk Local Information Guide, Expedia, MSNBC, MS Investor).

Resources

As we evolve our strategic direction and tactics to better respond to the marketplace, we must remember we do not have unlimited resources – we need to focus them on strategic functions in every subsidiary. You should redeploy 1%+ of your resources (some subsidiaries will be able to redeploy as much as 5%) and discuss your redeployment efforts during the FY98 scrub presentation. As mentioned earlier, we will invest in sales and marketing headcount so that we can get ready to address new businesses, new technology, and cover new customers/channels. I have categorized resource additions into 6 buckets:

- **Geographic Expansion** – new headcount in countries with more than 40% growth.
- **Geographic Growth** – more cities in established geographics.
- **Breadth LORG focus** – discussed in ECU memo.
- **Application Developer Customer Unit** – discussed in ADCU memo.
- **New Technology Areas** – the headcount here will be to cover major technology areas such as e-commerce.
- **Partner Coverage** – for the few subsidiaries that believe that they do not have enough headcount to cover the value-added partner channel (VAP's or what SteveB sometimes call FOO-VARs), or reaching out to custom application developers and ISP's, or competitive partner recruitment. Our OCU channel development is a great asset and to grow it, the business reviews will include reach and frequency metrics for VAP's and targets for depth partner additions.

Goals

1. **Achieve revenue goals**

   - Overall FG revenue should grow at least 15%. BSD growth will lead at 45%+. DAD should grow 10%+ in most countries. PSD revenue will drop off in many countries, but the decline should be no more than 12%.
   - We expect PC growth of about 17%, and we would expect OEM revenue to grow at that rate or a little better. We will be more aggressive in the Windows NTW bundling, and some of our apps bundling.
   - Continue strong anti-piracy campaigns and Select audits.

2. **Achieve profit goals**

   - Every subsidiary will get a P&L target from their regional management. As SteveB shared with us at the Worldwide Regional Directors Meeting, we will make invests in headcount in FY98, but we will not allow WW responsibility margin to decline by more than one point. You must invest in key areas strategic for the future of our company and at the same time identify in your business plan areas of efficiency gain or cost saving that help further our new investments.
   - Improve marketing efficiency. Marketing as a % of net revenues will remain about the same in most countries, but develop marketing tactics that achieve more for your money.
   - Target MCS to breakeven with 10% investment hours.
   - PSS. Maintain flat support cost %. Improve the quality of service for key segments, and but we expect this investment to be offset with cost reductions due to increased acceptance of self-help, product improvements, and higher cost-recovery.
   - Target efficiency gains in operating expenses. Some regions such as Europe have done a good job while other regions must start joining in.

3. **Win against the Network Computer – Sell the Windows platform**

   - Leverage our evangelism efforts to reach a significant percentage of, and win the hearts and minds of influential end users (IEU's), developers, and IT professionals. Drive their enthusiasm for Windows, Office, NT, and our development platform. Build your database and set metrics for contact through a combination of broad-reach events and seminars.
   - Drive Win32 penetration of installed base to 65%+.
   - Drive Windows NT server share to 50%+.
   - Successfully launch IE 4.0 and Memphis and create end-user and channel excitement. Increase Windows sales through retail to at least 35% of Windows FG.
   - Achieve 51% total IE share across platforms (Windows, Mac, Unix)! Get 60% IE deployment share and 50% IIS deployment share in the ECU accounts. Publish many significant design wins and references.
   - Launch BackOffice Small Business Edition ("SAM"), quickly develop broad distribution among VAPs, and develop a worldwide business exceeding $50M.
   - In those countries with a focus on the Education market, continue aggressive sales and marketing of the Windows platform and our applications as a way to secure customer loyalty from a new generation of users, encourage migration from Macs, Novell, and Unix, and discourage adoption of NC's.

4. **Grow Office business and market share**

   - Maintain or grow share in all markets.
   - Leverage the TVO/TCO and migration tools, and drive deployment in the ECU space. Achieve 70%+ license share (i.e. 70% of ECU Office desktops should be licensed for 32bit) and 50%+ deployment share (of which half or more should be Office97).
   - Drive up Office revenue per PC for MORGs and SORGs. Leverage the VAP efforts to drive up the number of active resellers and increase DSP application bundles.
   - Defend our Office business from Corel at retail. Reverse any share losses. Increase productivity revenue per home PC. Make Home Essentials a major success in every geography where available.

5. Win with SQL Server and Exchange, and development partners

- Reverse our SQL share losses, and achieve 60% unit share. Strive to achieve 60%+ revenue growth and 20% attach rate, but for revenue planning purposes will be more conservative (40% revenue growth and 10-15% attach rate to NTS).
- Target Exchange revenue growth of 40%+.
- Win 75%+ of Exchange messaging infrastructure battles in ECU accounts. Drive deployments and achieve 35% of ECU desktops licensed, and 20%+ deployment.
- Plan tools revenue growth of 10%+, but stretch to achieve 20% increase. Secure 50% primary usage share of VJ++ in Java market, secure 35% primary usage share for VB in professional tools market, and increase Visual Studio to at least 15% of total tools revenues, and expand the MSDN subscription base.
- Grow your SQL development partners. Recruit top Oracle partners. Build these relationships such that 80% of Solution Developers view Microsoft as a better partner than Oracle or IBM.
- Grow your Exchange partners for messaging deployments and application development. Recruit top Lotus Notes partners. Evangelize Exchange as an applications platform such that 30% of Notes SDs/Business Partners ship native Exchange applications by FY 2000.
- Evangelize the Windows & Back Office architecture such that 75% of Depth SDs and 50% of Breadth SDs adopt all of its components for their key applications by FY2000.

6. Interactive media titles, and gaming and input devices

- Tier 1 countries should show IMD revenue growth of at least 20%, and higher in those countries with greater than 20% market growth.
- Grow revenue and share in our mouse and keyboard businesses, particularly with the Intellimouse as our FPP prices decline – and grow revenue on games input devices. Hardware division revenue should grow 20%+ (excluding Actimates, a real wild card that is hard to forecast).
- Grow our Encarta business to leading share where we have localized the product
- Promote high-potential games and establish Microsoft as the leading games vendor, as this is the largest product category in the consumer market and the one with the most repeat purchase
- Other priorities will vary by region based on localization decisions communicated to you market-by-market.

7. Extend customer satisfaction

- Reverse any slippage in PSS customer satisfaction – recover the FY96 customer satisfaction levels for free support and continue growing satisfaction in the rest of the paid offerings.
- Achieve premier customer satisfaction of 80% very satisfied.
- Increase overall ECU worldwide customer satisfaction from 15% to 20% extremely satisfied and 90% somewhat satisfied. Increase MCS Customer satisfaction by 10% over FY97.

Success Factors

Competitive focus. We have excellent competitors and we need to understand them completely. Among the things we must know are their overall strategies and product positioning, their revenues in every country, the channels they are tapping to deliver products and services, and the amount of marketing dollars they are investing. We should adopt their best practices, learn from their mistakes, attack their weaknesses and force them to react.

Sales readiness. All subsidiaries mentioned that they had a sales and support readiness problem. There are many new technologies, and the subsidiaries just don't have enough time to prepare their people so that they can intelligently discuss issues with customers before products hit the market. Setting up the processes and approach to improve this situation is a top priority for SteveB. If successful, it will help drive early adoption, share, sales, internal morale and customer satisfaction.

Clear messages, well published. Information publication and training are large problems for the company overall. We need to determine the appropriate content, form, authorship and audience for information and training materials. We've taken steps in the right direction with Infobase '97 and Microsoft.com, but much more must be done if we are to successfully communicate our messages both internally to our people and externally to our customers and partners.

Efficiency. We need to minimize bureaucracy and ensure that all actions are designed to have a direct impact on the customers, partners or competitors at whom they are directed. We need to continue sharing information, resources, and procedures so we gain efficiencies. Before you start budgeting for the next FY, please check all your procedures and actions, address the root causes of inefficiency, and advise us of changes at Corporate in order to help you gain efficiency. The less time we spend on bureaucracy, the more time we can spend in contact with customers.

Partners. Another great way to increase our efficiency is to enable our partners to work with us in addressing the broad range of customers and their needs. We need to make sure that we have done a great job in knowledge transfer, that partners can articulate our strategy, that the quality of their customer care meets our standard, and that their services exceed (or at least meet) customers' expectations.

Customer care. We are committed to continuing improvements in customer service in every department. ECU has developed a plan to increase customer loyalty by measuring and increasing satisfaction. PSS noted problems in FY97, and is working to find the right balance between reducing cost, using outsourcing, and increasing customer satisfaction. MCS is targeting an increase in client satisfaction. Partner satisfaction requires similar attention.

People. We must be able to attract, develop, and keep great people. Have hiring plans to bring in great recruits, particularly technical talent; this is critical for MCS, SE, ADCU and Cluster 4 PSS groups. Have sound development plans for our people that balance business needs with employee development goals. And to keep our great people, make Microsoft an outstanding and fun place to work.

Success in FY98

We really do have exceptional people around the globe. Their talent and relationships with our customers and partners are the foundation of our success. Thank you for your hard work and leadership. Inspiring our people to build on this foundation will lead to further success in FY98.

I look forward to seeing you at the WWSMM and hosting you for our Global Summit in Orlando, Florida USA.

Customer Entity or Partner	US Quota	CU/Org	License Type	Drive Activities	Participate in Activities	Measurements
Lorg-depth	1500	ECU	Custom	1:1 mgt, Eval's, Exec, EPM, Enterprise SP recruit	SSC, ISB,SP,IT sems, Devt Sems	Design Wins; Contact reach
Lorg-breadth	5000	ECU	Custom	Partner follow up, Oppt. Calls, Multi-acct, Build DB	SSC, ISD,SP,IT sems, Devt Sems	Design Wins, Contact reach
Morg	400,000	OCU	MOLP	SSC, SP Recruit, Build DB, Reseller co-mktg/mgt	ISB, Devt Sems, IT sems	%SSC, #Pilots, # Partners, Contact reach
Sorg	400,000	OCU	MOLP	Breadth reach/freq(schn, mail, phone),Build DB, SORG association speeches, Anti-piracy, Distl mgt	DSP mgt, Devt Sems, IT sems	Sem Reach/freq, Non sem # customers, freq of purchase
Sd-depth	300	BADCU	PIP	1:1 mgt, Benchmarks, Joint mktg plan/Sales calls	Devt sems	Design Win status, Share, Contact reach
Sd-breadth	3,000	BADCU	PIP	Joint mktg, Light mgt, Multi-acct, Oppt joint calls	Devt sems	Design Win status, Share, Contact reach
LOB mgr/IT	450,000	BADCU	NA	ISB's	LORG calls	ISB's attenders, SIA's, SD cover
Home/SOHO/EU	250	CRCU	FPP	Retail mgt, EU events (store,user group,PC)		Share, In-stock, Stores/SKU
ISP's depth	250	ICU	License	1:1 acct mgt ,Referral server, Exec events	IT Sems	Design win Status
ISP's breadth	5,000	ICU	MOLP	DM/EM, IE license, Build DB	Breadth reach/freq, IT sems	% signed up, Contacts reached
ICP's depth	250	ICU	License	1:1 acct mgt, Active Desktop	Devt sems	Design Win status
OEM depth	50	OEM	License	1:1 acct mgt, Exec		MDA Status, apps status
OEM breadth	100,000	OEM	DSP	Build DB, Phone/E:mail, DSP mgt, Monitor selling,AP	Breadth reach/freq	Freq of purchase, # customers
IEU's	15,000,000	Desktop PM	FPP	Advertising, DM/EM, Build DB, IEU Events		Contacts seeded or sem attendee
Developers-Pro	1,500,000	BADCU	FPP	Advertising, DM/EM, Build DB, Devt sems,PR		Sem attendees, Visual Studio sales, MCSD's
Developers-Ad hoc	3,000,000	BADCU	FPP	Advertising, DM/EM, Build DB, Devt sems, PR		Sem attendees, VB/OH Dev Sales
IT People	7,500,000	SES/DSD PM	NA	Advertising, DM/EM, Build DB, IT sems, PR		Sem attendees, MCP's (NTS/SE)

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