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You have the first Draft

Microsoft Memo

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Dt:	April 30, 1990	
Re:	FY91 USSMD Strategic Planning	Final

FY88 was the year to implement and refine, at a tactical and operational level, the enormous strategic changes that were effected in FY87. Many new ideas were introduced and the beginning of a programmatic marketing framework was developed.

FY89 was the year of balanced, focussed execution of stable programs. Relationships with key customers (reseller and corporate accounts) matured. People effectiveness improved with the application of training in critical skills areas. Marketing programs benefitted from repetitive execution. Our PR efforts gained wide visibility. Trade shows were managed professionally. Advertising creative was excellent. But, USSMD fell short of attaining our revenue and profit goals.

FY90 was the year of profitable attainment of revenue. Virtually every business decision we made in USSMD had to pass the test of that decision's impact on USSMD's profitability. The results were admirable. We exceeded the profit goals for the fiscal year by a wide margin. Being over plan on revenues certainly helps. However, we were also assiduous in our focus on the expense side of the equation. Cost of Goods Sold is at an all-time low. There is now constant awareness of the need to maintain gross margins of no less than 74% of net revenues. We have developed sub-channel profitability models that are used to price proposals for special opportunities, as well as to help make investment decisions for the respective channels.

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FY91 is the year of GUI. Not just any GUI. The real strategic opportunity is market preemption of the Windows platform, in terms of both creating sockets as well as taking possession of those sockets with our Windows applications. This is the single largest opportunity for the company to exploit in FY91. Timing is critical. Currently, the category is absent our traditional competitors in the key product market segments. This will not be the situation for long. Lotus, WordPerfect, Aldus, Ashton Tate, et al will all have Windows based applications available within the next year. It is a key strategic imperative to coalesce around and marshall our sales and marketing resources to fully exploit this once in a lifetime opportunity.

FY91 Strategic Objectives

The following strategic objectives and guidelines establish the umbrella under which your individual business plans will be developed.

<u>Profitability:</u> It is a key goal for USSMD to operate at a 15% pre-tax, pre-Lan Man, burdened operating income for FY91. Even though we will be making major investments in establishing the Windows platform, we will still maintain a respectable level of profitability for the division. Naturally, this will require the combined support of the entire company. Key areas that must be addressed include:

First and foremost, we will meet or beat the revenue plan. This is still the most leveraged way to impact USSMD's profitability.

Gross margins need to be improved further by continuing to focus on improvement in Cost of Goods Sold. Cost of Goods Sold as a percentage of net revenues must be brought down to 25% of net revenues from its current 27%. Part of this improvement will occur as our product mix shifts to higher srp products. However, we must squeeze out further improvements to product cost as well as decrease the manufacturing and distribution allocation (manufacturing variances, scrap, obsolescence, etc).

Operating expenses as a percentage of net revenues will be held to 33% (exclusive of Lan Man; inclusive of Windows Push). We will look for every opportunity to eliminate waste and improve on operating efficiencies. We will use and leverage technology which will allow USSMD to continue to grow at 30+% per year without requiring similar growth in headcount. This technology investment should offer cost effective alternatives to existing business practices.

With all of the field headcount additions that have already been approved as a part of the Lan Man and Windows Push programs, we will limit field headcount growth to virtually nil. No reseller headcount will be added outside of what has already been approved as part of Lan Man and Windows Push. Field increases in the non-reseller areas will be limited to

no more that a 2% increase over FY90 levels. Headquarter based personnel increases will be limited to no more than a 10% increase over FY90 levels.

Allocated expenses will hopefully decrease as a percentage of net revenues from FY90 levels. This will certainly be the case for Corporate Communications and PR/Events where operating expenses will be held to minimal increases over FY90. I would hope to see efficiencies from the other support organizations. Development expenses as a percent of net revenues should not increase over FY90 levels.

We will further refine and use the sub-channel profitability models to add to the quality of business decisions made. Virtually every decision made will first pass muster of how that decision affects the appropriate channel profitability model.

Products: Own the Windows platform. Microsoft has an enormous, one-time opportunity to pre-empt our traditional applications competitors (Lotus, WordPerfect, Aldus) in this market. We can spend relatively little now to capture long term market share that becomes increasingly expensive to take away once competition becomes entrenched. That means making a significant up front investment, focussing the majority of our resources on the Windows opportunity, and moving with speed to create as many new Windows sockets as possible and then have our applications plug and play. If we can win with Windows, the long term systems strategy (OS\2) is reinforced.

The most direct relationship we have is with the apps division. The single largest opportunity we have is the Windows platform. However, there is another very strategic opportunity that we will invest significant resources to exploit. In fact, our effectiveness at selling applications long term is symbiotically linked to what we are doing in the systems area...most especially the network operating system area. Therefore, we will invest heavily in the network operating systems business.

Sell the products we have. We will continue to take a disciplined approach to focus on marketing and selling the products that are shipping. USSMD will not invest any resources until a new product or version reaches its code completion stage in development. Only then, will we initiate plans to launch that product (advertising, pr, packaging, collateral, to include it in trimester programs, to train the sales force, to gain breadth of distribution, etc). We will not announce new versions of existing products or new products before they have been released to manufacturing.

Regardless of the specific product market segment, it is a key goal to maintain or improve Microsoft's relative market share position. This obviously needs to be balanced by where the product sits in the product maturation cycle. Products with high market share and slow growth (DOS, Mac apps) generally generate cash in excess of the reinvestment required to maintain share. Products with low market share and low growth should be avoided (PC Chart). Low market share, high growth products (Win apps, Lan Man) require large investment spending for purchase of market share. The high share, high growth product (Windows) will become large cash generators if it stays a leader and reinvestment requirements diminish.

<u>Customer Service and Satisfaction</u>: "The average American company will lose 10% to 30% of its customers this year. Most of them will leave because they are dissatisfied with the quality of the company's service, and their departures will have a severe impact on corporate competitiveness and profitability."[1]

We will search for better ways to deliver value to customers. While the burden of delivering value might well rest on the shoulders of the product divisions, there is nevertheless a wealth of techniques we can employ to reaffirm for our customers, their value to Microsoft. Over time, as product differentiation dissipates, we must recognize that superior customer service is a key competitive weapon.

We need to start thinking about our customers from the standpoint of their lifetime value to Microsoft. We need to determine better ways to establish an on-going dialogue with customers once they have decided to purchase a Microsoft product. How do we get them to register? What do we do once they have registered? How often should we be communicating with them? What are the most effective vehicles to reach them on a constant basis? How do we leverage other product sales to existing customers? How can we increase the percentage upgrading to newer versions? We should determine the appropriate level of investment in direct marketing, RegBase enhancements, and lead generation follow-up.

<u>Sales Force</u>: USSMD is in the business of selling packaged products through the reseller channel. It is a key strategic goal to increase breadth of coverage of reseller outlets. We will continue to rely on flex-time ASR's, and RTR's in the largest SMSA's to provide breadth of reseller outlet coverage, not so much to sell-in our trimester programs, but to provide reseller sales person training and to support outbound selling practices at outlet level.

Care must be taken to not over extend ourselves in the Lan Man business. We must have extremely happy customers during these very early stages. Similarly, we will focus resources on named corporate accounts in order to gain depth of penetration into these accounts.

We must continue to invest in the constant training of the entire sales and support organization. We must possess the technical acumen to be able to position Microsoft as the provider of the key components in the GUI, client/server work station solution. Given the rapid growth in field people resources in FY91, we must also enhance middle management effectiveness.

<u>Integrated Marketing</u>: We must leverage our marketing dollars by tightening the integration of the various vehicles used (advertising, pr, trade shows, user groups, trimester and other channel oriented programs, and collateral materials) to discover, create, arouse, and satisfy customer needs. Communications between the U.S. Marketing disciplines will be heightened. 'A close working relationship with our clients is important and necessary.

We will continue to develop the brand Microsoft asset. In an industry where product life cycles are short and technological advantages brief, brand Microsoft will provide one of the few sustainable marketing advantages. We will continue to operate on the paradigm of

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[1] Wall Street Journal, <u>Making Sure Customers Come Back for More</u>, March 12, 1990.

brand, line, and product specific communications. We need to expand the reach of our message to include a far broader audience than that reached via industry publications.

We will continue to invest in a comprehensive marketing database. Measuring sales effectiveness, marketing program effectiveness, communications effectiveness, and market demographics is critical to providing insight and direction for how marketing dollars get invested. In all areas of marketing, we must be more responsive and timely in measuring the results of our spending on marketing programs and sharing the results will all stakeholders in the company.

Marketing Segmentation: The following matrix should be used to help us identify and reach the key target audiences and market segments. For each cell, we should think of the following: What is the business opportunity? What is the short and long term growth, market penetration, processor use, and profitability model? What is the Microsoft product opportunity? What is the purchase process? What is the delivery mechanism? What is the demand mechanism? What is the competitive framework?

	Corporate Accounts			Small and Medium Businesses			Government	Education
	Target 300	Very Large	Large	Medium	Small	Very Small		
Influential End User								
Corporate Decision Maker								
General Business User								
MIS/DP/Prof Programmers								
Non-PC User								

We will marry the concepts of integration and segmentation. Targeting is the result. For all areas of USSMD we will be assiduous in our application of relevant programs for specific market segments. As an example, we will not attempt to run MRSS's with resellers who have never used seminars as a sales practice. We will not attempt to get a reseller to display in-store collateral if they are primarily outbound driven.

Reseller Marketing: No major structural changes are anticipated. We will refine the reseller strategy that we have had in place for the past year. We will take a neutral position regarding how much product our resellers take. Stuffing is not something we want to encourage in any way. We will take a very active role to devise policies and programs that incent resellers to focus on the sell through of Microsoft products. Increasing breadth of coverage and an end-user focus are major themes.

The benefits of broad distribution are readily apparent. Products that have broad distribution, like Lotus 1-2-3, WordPerfect, Netware, Microsoft Mouse, enjoy high sales. We will focus on increasing the breadth of distribution for Windows and Windows applications. We will strive to continue to ramp up breadth of distribution for all Microsoft products. We will develop marketing programs that will reach 3,000 outlets on a regular, recurring basis by the end of FY91.

We will maintain the key components of the trimester marketing programs (retail merchandising, demo stations, direct mail, and seminars). Where in the past we focussed on the in-store opportunities, in FY91 we will strengthen programs that reach out and complement the outbound activities of resellers selling to small, medium, and large businesses. We will rely on our own sales resources to focus on the very large and huge businesses.

We will continue to "own" more and more of the reseller real estate and will give meaning to "Microsoft Reseller" (an advanced product dealer and/or an authorized dealer). This includes shelf space, demo machines, reseller sales person mind space. We should look to establish ownership of these key variables on a permanent basis rather than renting on a temporary basis. Permanent fixtures should be evaluated for ensuring prominent display in a retail environment. We should create a means to ensure that our product demos and attract loops are a permanently installed on the resellers demo machines. We should capture the loyalty of the reseller sales rep via training programs and a reward system for selling Microsoft products. We will launch the Microsoft Programs Reseller in order to do the aforementioned on an on-going basis.