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From: Scott Old
Date: April 2, 1991
Subject: FY92 Strategic Objectives DRAFT

Please review this document and provide feedback to me no later than April 9th. The following draft document is offered as the synthesis of discussion that occurred in the work group sessions at the SMSD FY92 Planning Off-site in Phoenix. In contrast to previous years, this year's memo employs a bottoms up approach to setting this divisions' strategic direction and priorities. The Planning Off-site had the benefit of attendance from the Product Divisions, as presenters and participants, in the work group sessions. Pursuant to the incorporation of your input, this document will be distributed to key managers in SMSD and will provide a foundation for the FY92 business planning.

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, focused 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 benefited from repetitive execution. Our PR efforts gained wide visibility. Trade shows were managed professionally. Advertising creative was excellent. But, the division 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 the division had to pass the test of that decision's impact on the division'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 was reduced dramatically. There is now

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constant awareness of the need to maintain healthy gross margins. Sub-channel profitability models were developed that are used to price proposals for special opportunities, as well as to help make investment decisions for the respective channels.

FY91 was the year of GUL. Not just any GUL. The real strategic opportunity is market penetration of the Windows platform, in terms of both creating sockets as well as taking possession of those sockets with our Windows applications. Create sockets we did...over two million in the U.S. alone. Yet, the real opportunity of filling those sockets with applications is still unfulfilled. And, the window of opportunity is closing.

**SMSD FY92 Theme:
Reach Out and Earn Share**

FY92 is the year to "reach out and earn share". The urgency of gaining significant market share in the Windows applications category cannot be underscored heavily enough. The window of opportunity to gain share relatively inexpensively is closing quickly. Once the competitive landscape is cluttered with competitors (especially Lotus and WordPerfect) it will become very expensive indeed to wrest away even small amounts of market share.

Shifting market share does not come cheap...even with our competitors helping us. We will have to earn each and every share point...through the investment in R&D to create first and foremost a great product; then, by applying integrated programs in the marketing, sales, service, and support areas.

In order to achieve a modicum of success in shifting share, we will have to invest in key areas of marketing, sales, service, and support. We will have to reach out, share ideas with the Microsoft subsidiaries, and learn from the many successes we have. We will have to reach out and improve the way we communicate with and touch customers (channel and end users). We will have to reach out and increase the visibility for Microsoft and our products through a comprehensive and integrated communication strategy. If potential customers aren't aware of what we have to offer, it is hard to convince of them spending money on it.

SMSD Mission Statement

To profitably and passionately secure lifetime customer partnerships, based on the employment of superior Microsoft products and services, that enable our customers to leverage the power of personal computing to their greatest advantage.

SMSD FY92 Strategic Objectives

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SMSD Values

Accomplishment: The strong commitment to continue to be the industry leader and create lasting contributions in superior fashion in everything we do. We are making a difference.

Integrity: The desire to be honest, sincere, and truthful with ourselves, each other, and our customers. We walk our talk.

Ambitious: The aspiring, purposeful, driven, and intense work ethic. We take pride in working very hard.

Imaginative: The creative, daring, and individualized expressions of intelligence. We associate and seek out great thinkers.

Helpful: The continual effort expended to make both customers and co-workers successful in working with us and our products. We care about people and respect their needs.

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Increase applications market share. From a product market segment basis, increasing Windows applications (Excel and Word) market share will be the #1 focus for the division. This does not mean other product market segments, like EBU or SPAG or Mac Line or Systems, will be left to their own devices. However, it does mean that the long term rewards associated with gaining significant share in the spreadsheet and word processing categories is sufficient to justify the immediate focus we will place on these categories in FY92.

With respect to product market segments where we enjoy high share but the category growth is low (Mac apps, Works), we will take a defensive posture. These segments generally generate cash in excess of the reinvestment required to maintain share.

With respect to product market segments that are new, like EBU (early Windows apps), we will invest the necessary resources to pre-empt competition and establish high share early in the life of the category.

With respect to product market segments where we enjoy both high share and high growth (Mouse, Windows, DOS), we will continue to invest in order to preserve or heighten its net cash generator status. With few viable competitors to Windows or DOS, and the symbiotic relationship with the Mouse, we can "control" the growth of the category by the level of spending.

With respect to product market segments where we have low share but high potential growth for the category (Win apps), we will invest significant resources for purchase of market share...share that hopefully will be transformed into large cash generation if reinvestment requirements diminish.

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Increase awareness and trial of Microsoft and its products. With absolutely no increase in Windows applications market share, we can still exceed the FY92 unit and revenue forecasts for Windows applications by simply doubling the number of Windows sockets being used by customers. We will create a broadscale effort to increase the quality of the experience a customer has with the installation of Windows 3.0.

We cannot ignore the importance of continuing to broaden awareness for Windows specifically, and all Microsoft products generally. We have to prime the pump. We have to look to new mediums to convey the Microsoft message. We have to place more emphasis on marketing vehicles that have proven successful and contribute to the strategic objectives for FY92. We have to coalesce around marketing vehicles that provide a comparative difference to our competitors and provide Microsoft with a rallying point to integrate the marketing message and programs both internally and externally.

A key vehicle that we should expand greatly in FY92 is seminar selling. We have been very successful in facilitating trial of our products through seminar selling. In addition, we have proven that seminar selling is very leveraged in selling full retail product. We simply need to increase the number of seminars that we hold by one order of magnitude! This will be a galvanizing program for the company. The nature of our advertising will shift from a product feature centric one to a message where we are driving awareness of product(s) by convincing people to attend seminars. Direct marketing will play a huge role in driving attendance and we must become acquire a higher level of expertise. We have proven to ourselves time and again that the best lists to pull from are our own. Therefore, we should conduct an aggressive registration drive (especially for Windows, but also for Mouse and DOS 3 RUP) to increase registration rates and thus increase the number of names that we can target with direct mail and telemark.

Reflect for just a moment on seminar selling. We have the expertise to mount a significant seminar selling program both from a content and logistics point of view. Seminars will continue to span a wide spectrum (MCSA, MRSS, vertical, networking, developers, consultants, discovery fairs, EBU, user groups, etc). However, the primary message will be focused on Windows Computing. We should target 500,000 to 750,000 prospects through MCSA's and Discovery Days and an additional 100,000 prospects via MRSS's. If we can motivate 50% of the attendees to purchase an initial seed copy and convert that seed copy into 3-4 applications subsequently sold, we can potentially generate sales of over one million units of full retail product. This will significantly exceed the number of units for Windows applications in the FY92 Business Plan and significantly increase market share. There are obvious additional benefits in terms of the tag along effect: more Windows sold, more Mouse sold, more DOS RUP sold.

We must also investigate other mediums that will complement what we are already doing in print. First, we must shift the mix of print to broader business publications away from trade publications. We should maintain the level of advertising and editorial focus in the trade, but we need not add to it. Secondly, we must use mediums that optimize the cost to significantly increase the effective reach and frequency of key messages. Broadcast advertising is a significant opportunity for its obvious awareness and impact value, and because it offers us a media means to differentiate Microsoft. The use of broadcast can be targeted at the corporate decision maker with a Windows momentum statement that has a longer term value as we seek to become a strategic vendor to corporate customers. We could still maintain all of the merchandising value of broadcast to our field and reseller channel. Broadcast can provide air cover for virtually all other marketing programs that support Windows Computing.

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Improve the level of customer satisfaction. Providing world class customer service can and should be a competitive advantage. We need to firmly establish the importance of the lifetime value of a customer within Microsoft. Only then will we legitimately be able to establish credence to "the customer is king" with our customers.

Although we think (and may even be) that we are a customer driven company, we are too often thought of externally as a technology company. Ninety percent of what we communicate is product centric. Similar to the leadership that Bill provides from a product perspective and the vision encapsulated by the phrase "Information At Your Fingertips", Mike Hoffmann should take the charge on the second crusade that is focused on the customer. In addition, a inter-division task force will be formed that will be headed by Scott Oki.

The Decade of the Customer will start in FY92, starting with a baseline survey, identification of critical success factors, executive agreement on Microsoft requirements. World class customer service will not happen overnight. The process of incorporating customer service objectives as an integral part of every job within Microsoft will start with SMSD in FY92.

A critical area that has high visibility with customers is PSS. We will meet the technical support demand with high quality service at a controlled cost. We must establish systems that reduce the number of support calls (eg. better feedback loop to R&D), improve the efficiency of call handling (eg. better use of technology), allow customers to help themselves (better tools and easier access to information), and even out the lumpsiness of call demand (eg. distributing the call load).

Create a dynasty by investing in our people. The hyper growth that Microsoft has experienced places enormous pressures on individual skills. The pace of change associated with technology only exacerbates the need to re-invest in our people. We will support individual growth through cross functional development and job enrichment. We will promote from within. We will create development plans for all mission critical positions. We will consolidate all of the training currently in the division and integrate our training efforts to best address the needs of Sales, Marketing, PSS, ITIS, and International. We will develop a rigorous SMSD 'boot camp' that will provide a consistent indoctrination program for all new employees.

Focus on selling to corporate accounts. With the newly created Corporate Account Marketing Group, we will develop programs and policies that will help create, nurture, and maintain long term, mutually rewarding relationships with the most leveraged customers we have...corporate accounts. These relationships must embrace a new approach to establish Microsoft as a strategic partner. We must be involved in joint MIS planning. We must have flexible product/service offerings that can be customized for our most important customers. We must become a line item on the corporation's expense budgets!

We must market and sell what we have today to corporate accounts. This naturally includes Windows and the Windows applications. However, we will have to prepare ourselves to sell increasingly complex mission critical products: Lan Man, OS/2, SQL, Comm, Office Automation, Mail, etc.

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ITIS and MSU will play a very important role in establishing a strategic partnership with corporate accounts. MSU to provide technical training to internal corporate developers. ITIS to provide a variety of consulting services.

Gain scale economies by employing a global perspective. We will develop marketing and operational strategy and successfully implement programs and policies that help us gain economies of scale globally. We will work to ensure that we meet common corporate product priorities as well as regional revenue and profitability goals. Integration of marketing, sales, operations, and support services is a key factor to gain leverage...bi-directionally between SMSD and the subsidiaries.

Significant resources are currently directed at securing strategic relationships with the largest corporations in the world. We must get better at using Microsoft's unique strengths in terms of localized product, local support, and local marketing programs to leverage our ability to work with corporations on a world-wide basis. These global opportunities will only increase in significance and will require the coordination of HQ product, sales, and services resources with the individual subsidiaries where the business is actually conducted.

Apply our own technology to increase responsiveness, flexibility, and effectiveness. Similar to the leverage gained by investing in pc based technology that has resulted in the creation of MBS, WEBB, InfoMan, etc, we need to continue to enhance existing systems and invest in new systems that will lead to long term benefits and competitive advantage.

Maintain the level of profitability for the division. In a year where we will invest significantly to gain market share, it is unreasonable to also establish a goal to increase profitability for SMSD's finished goods business. However, we will strive to achieve 20% pre-tax, pre-NEU burdened operating income. On the services side (ITIS and MSU), we will increase pre-tax burdened profitability to 10% and 15% of net revenues respectively.

Working with the Product Divisions, we will focus, squeeze, and enjoin Cost of Goods Sold to less than 30% of net revenues. The 30% is far higher than the year-to-date actual that we have been running at and requires clarification. Starting with FY92, PSS costs will be incorporated into Cost of Goods Sold, thereby treating it as a specific product cost that tracks with revenues and also enhances visibility to the Product Divisions.

PSS costs will likely exceed 7% of net revenues at end FY91 run rate. Since we are still behind the demand curve, it is anticipated that PSS costs as a percent of net revenues will increase further in FY92. Offsetting this increase in costs, there is a very real potential to operate traditional CoGS (product costs, royalties, M&D allocation) at 20% for the year: our product mix should shift to higher end Windows applications, price will be increased for Mac Word, the M&D allocation should decrease further as International picks up more of the purchase price variance and we are better able to use 100% of the capacity thereby reducing manufacturing variances.

Operating expenses will likely increase from FY91 levels with the investment spending that will occur behind the drive for increased Windows applications market share. SMSD's operating

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expenses will be capped at 35% of net revenues. With year to year revenue growth in the 30 - 35% range, we will hold head count growth for the division to 20% over FY91 go out. Virtually no additional head count will be made in the networking business for FY92. Significant growth is anticipated for PSS in an effort to meet demand for services.

If allocated expenses track FY91 actuals (approx 14% of net revenues exclusive of PSS), we should be able to reach the 20% pre-tax operating income goal.

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