

Microsoft Memo

To: Mike Maples, Steve Bailmer, Pete Higgins, Jeff Raikes, Hank Vigil
From: Charles Stevens
Date: September 3, 1993
Re: Input on Pricing Discussion

Discussion on Pricing

(Includes feedback from JeffSa, MikeNe, JeffL, MikeDe, JacquesBa, CraigFi)

Criteria for measuring impact of different pricing schemes

- Revenue (total, per unit, per license, per CPU)
- Profit (total, per unit, per license, per CPU)
- Competitiveness (market share)
- Impact on competition (profitability)
- Impact on customers (demand)
- Impact on partners (channels)
- Impact on existing pricing mechanisms (e.g. reseller, Select)
- Transition costs (price protection, inventory)
- Legal
 - Implications for Manufacturing, # of SKUs, Cust Ser, Prod Support
 - Must consider major clusters: desktop apps, consumer, systems/tools, systems OEM, systems Retail (Office is first priority)
 - Worldwide pricing: we have no consistency today, difficult to implement/explain.
 - Risk of reducing price to lowest (US) level.

Objectives (Prioritize):

- Increase customer demand (make decision process easier)
- Increase market share
- Make it easier for partners
- ...without decreasing profitability

Pricing Framework: 3 possible models (can be combined)

- Cost-based
- Value-based
- Competitive-based
 - ..also channel-based (cost plus, variant of competitive)
- Life-cycle (initial price is only one component, should also consider upgrades, maintenance, training, support as part of total cost...)

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Software Pricing Today

- Competitive-based model; oligopoly where a few strong competitors attack each others' points of weakness with aggressive pricing that eventually spreads to other categories (e.g. Quattro - spreadsheet, Access - database, Ami - word processing)
- \$495 SRPs for apps unchanged in 10 years
 - PC prices have decreased dramatically (although in many cases people still pay the same, they just get more...)
 - not a value-based model
 - actual software prices paid are down by >50%
- SRPs are meaningless
- Monolithic structure (tower of Babel)
 - Upgrade, Competitive Upgrade, Intro Promos, other variations added
- Rampant SKU proliferation
 - >100 orderable SKUs for typical app (Word or Excel in US)
 - >1600 orderable SKUs, 98,000 SKUs in the system (US only)
 - no guidelines for creating SKUs or for discontinuing them
- Confusion for individual customers
 - delay buying decision, right SKU often not in stock
- Increased cost for reseller channels
 - increased obsolescence cost (and returns etc.)
 - higher inventory investment, reduced turnover
- Confusion for large customers
 - are they getting the best price? Select isn't always the best price.
 - confusion over multiple SKUs
- Impact on medium/small subsidiaries is compounded
 - not able carry most SKUs (how do they decide which?..)
 - or carry more SKUs than they should >less profitable
- Result: no competitive advantage, huge inefficiencies, decreased demand

One Alternative (EDLP - Every-Day Low Pricing)

- Price points are hypothetical (calculated to give us same avg. revenue per unit as we get know)
- Reduce SRP on FPP (Word, Excel) to \$249 street
- Eliminate competitive upgrades (pay FPP price)
- Reduce version upgrade to \$99 street (available for 99 days only)
 - enforce compliance checking
- Reduce Office Std FPP to \$375 street
 - Office version upgrade \$199 street (always available, by subscription)
- Eliminate SRPs (as we have done in Europe)
- Impact is revenue neutral (\$\$/unit) if discounts reduced to 34%, and same number of FPP units sold as FPP plus competitive upgrades today
- Competitive reaction: can copy although changeover is expensive or continue to push Comp Upg (but their FPP wont be competitive)

- Annick
- what is characteristic of an buyer

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Reduces customer confusion and # of SKUs: only two types of customers
(Microsoft and non-Microsoft)
Would need small decrease in Select "SRPs"
WalMart strategy vs. Sears

Other Alternatives (first 5 ideas: BillG)

Subset of apps free with Windows. (could include viewing and printing of full product)

Medium version is cheap (\$99) and used for OEM deals (new Borland strategy)

Pay \$100 (or X) per year for 5 years (or stop using). Updates included

Grouping more products together for a great price (Beyond Office with some flexibility)

Free use for 90 days (then pay if you keep it)

Subscription pricing (using CDs or download)

Leasing: similar to subscription and would probably be most effective applied to combination products (Desktop/Server/Developer) see below. Tax saving feature of leases not applicable to software. But MS could use competitive advantage (cash) to benefit.

"Software of the Month" Club (would work best for Consumer titles)

Frequent buyer programs

Empty boxes (resellers/OEM build their own bundles)

Intro pricing (e.g. Access, Publisher): but generally works best in consumer category or category where there is low penetration - encourages trial. this tactic can be combined with others e.g. EDLP above.

Microsoft Desktop/Server/Developer. Combine large number of products at higher price through Select and CD subscription. Say \$1495 entry price for all apps products (and \$200/year renewal). Leverage our complete product line. Still needs individual SKUs for customers who buy single apps (similar to BillG: Beyond Office). Could also be geared to specific segments: Small Business, Legal, Accounting, and include ISV products)

Combine version/competitive upgrades (with additional rebate for version upgrade) or FPP with rebate for competitive and version.

Look at other industries that have similar characteristics: telecom, long distance, etc.

Most ideas above are tactical and need to be combined or used with a solid foundation/framework: one that is consistent, efficient and easily explainable (and still flexible enough to allow these opportunistic tactical ideas).

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