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Date: 1/4/94
To: Joachimk; Jeffr; Bernardy; Chrissm; Richardf; Chasst; Jimalt;
Peteh; Bradsj; Rogerh; Pattys; Johnni; Mikeap; Dwilling; Jimm;
Johncon; Jona; Chrisgib
CC: Billg; Mikemap; Pam Edstrom; Mikebro; Mikemur
From: Steve Ballmer
Subject: FY 95 Business Planning

I want to summarize where we are and what I think we need to prepare strategically for FY 95 business planning. We need to start work now. We should use the regional directors' meeting and the exec retreat in early February to review key thinking. The follow up from those sessions will lead to planning memos in late march to the gm's around the world and the worldwide sales and marketing managers and country managers' meeting in Redmond in early April.

Planning must start with a view of business objectives and how we approach customers and partners. I will pick up with the work that the BOOP has been doing on missions and messages. The first section of this memo on missions is an update of a Billg memo based on BOOP input. It outlines the businesses we are in and their potential. We will communicate to customers and plan and manage these businesses. Below the section on missions is some work that I have done tying our businesses to our partners and customers. I call these our approaches to the business. They are the techniques we will use to build business and in many cases we find that customers and partners are interested in more than one mission. Lastly, is a section on how we manage a Microsoft of 15,000 people in these diverse businesses and with these diverse partners and customers.

We need to have a common view of our missions, their potential and our strategy to achieve that potential. I have listed a name next to each mission. I think the owner should prepare a memo of not more than 10 pages summarizing market size, key competitors and our strategy (product, marketing, price and business) over the next three years. These memos should also address key issues, dependencies, and share objectives.

We also need to have a common view of what customers and partners we will invest in to achieve the potential in our businesses. I have described each of these constituencies and some of the key issues we face in better addressing them. Our approach to most partners and customers spans more than one mission and we need approaches that answer customer and partner needs independent of any one Microsoft mission. In all cases, I do think that creating a sustained leadership relationship with influential partners and customers that includes products (from more than one business), information and support can be a key to our success. Again, I have listed a name next to each customer and partner approach. That person should create a memo of not more than 5 pages summarizing the key elements of our approach and key issues we need to address for FY 95 and over the next 18 months.

Managing this business is complex. We have discussed the need to better empower and train our people so they can move more quickly and decisively and with greater satisfaction. We have discussed the need for greater efficiencies in Microsoft as the world grows more competitive. Defining our businesses and approaches is a key start. Having a shared view of the interdependencies of these things is important in managing the company successfully. I have created a grid for all to fill out giving a view of the interdependencies and resource allocation tradeoffs between them. I think there are also five other management issues to address. I discuss those with some key issues and have listed a name next to each one. We need a memo again of not more than 5 Pages summarizing where we are and what we should do differently going into FY 95 and exiting FY 95.

Microsoft Missions/Businesses

The OOP took the action item of defining Microsoft Missions. The goal is to promote a clear understanding of priorities and messages. The idea should be that each mission has a clear leader who defines the marketing messages. The OOP will continue to get involved in making tradeoffs between the missions but we should make the criteria we use in making these tradeoffs as clear as we can so people can anticipate what kind of shifts will take place.

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The most important part of adopting these missions is how it will drive our marketing and packaging. Instead of having 100 independent activities with a view of independence we will ask every group how they help these missions. Likewise messages will be consolidated.

I will describe these missions in terms of fiscal 1997 goals/revenue. These numbers are reasonably optimistic in my view and can only be achieved by getting lots of synergy between our various groups.

Windows (All desktop OS) (Brads)

I put this mission first because of our present position and my view of the long term potential and benefits to other businesses in terms of branding, distribution and setting standards. Other product groups will contribute bits to help it achieve its goals. If we have a competitive crisis on multiple fronts this one is first priority. We will be splitting Desktop Windows into 2 recognizable SKUs in order to optimize the use of the OEM and Retail channels: Base and Premium are the placeholder names. I think that by 1997 we could sell to 36M new machines (note the distinction between machines and users). Revenue break down will be: 36M base OEM @\$30, 10M premium OEM @\$30, 12M premium retail @\$60 and to upgrade 15M installed base machines with the premium retail SKU @\$60. This would generate a business of \$3B which is a dramatic increase over our current FY93 business of \$327.5M Windows retail, \$263.1M DOS upgrade, and \$540.5M DOS/Windows OEM (total of \$1.13B). The growth is a combination of additional machines, premium sales to new users, and the increase in size and penetration of the installed base. NT needs to be made part of the 2 SKU strategy without special pricing because of its strategic role. Certainly IBM OS/2, Apple System 7 OS and Novell DOS are the key competitors for this mission.

At Work (Karenh)

I view AtWork as a separate mission and I expect that by 1997 it will be generating 4M @\$25= \$100M. AtWork should broaden out to include other subset intelligent devices like in-car. This mission has various and sundry competitors. Karen Hargrove should highlight who she thinks we need to watch most closely in the field.

Office (DAD) (Pete)

Today this business, including both Mac and Windows, is \$581.7B and represents 34% of our desktop application sales (total=\$1,727.3B). We could not support our worldwide sales and marketing organization without this business. Our competitors, Lotus in particular, are challenging our leadership in this field. Borland and others are challenging our prices. A combination of price pressure and saturation will limit the growth of this business. Out of a total of \$1.8B in sales in 1997 I would expect it to be made up of: Competitive upgrade/upgrade: 2.3M @\$100, Office upgrade 3M @\$150, new product standalone 2M @\$200, new Office 2.4M @\$300. We will need to constantly add to the appeal of the Office product. I do not expect the add-on business to be a substantial source of income. The only business which I see as staying separate from the Office push is Project.

A breakdown of the FY93 Office sales in terms of Mac v. Windows, and US v. International, and as a percent of DAD sales is as follows:[†]

Office	Int'l	% DAD	US	% DAD	WW	% DAD
	\$19.2B	18%	\$54.2B	34%	\$73.4B	28%
	301.1	34%	207.1	41%	508.2	37%
	320.3	30%	261.4	39%	581.7	34%

The key competitors for this mission are clear Lotus, Lotus and Lotus followed by Borland/WordPerfect. This mission should understand everything about Lotus as a company.

Server (OS, DB, Comm, EMS, Admin) (Jlmal)

I believe that once we have an installed base the opportunity to receive annual income from server customers will be very significant. By including server components of database, mail, communications, systems management, development tools and anything else we do in this category I see it becoming a

[†] DAD totals include Office, since Office is allocated to DAD products (43% to Word, 42% to Excel, 12% to Powerpoint, and 3% to the WGA product Mail)

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business of \$1B made up of maintenance .3M @\$500 and new servers 425k@\$2000. I think our pricing will be fairly complex in terms of computing a license fee based on the services being chosen and the capacity of the server so some servers will end up paying us as much as \$20k. This business will get a lot of its revenue from the breadth of server services. This mission must understand UNIX, Novell, Oracle, and Notes as competitors. They should have a total understanding of Novell as a company.

Consumer (Pattys)

Although some of what we consider consumer products today will move up to be part of Office, a number of add-on products that will be included on the Desktop Operating System CD will sell well enough to make up the difference and I include those products in Consumer. Works should move to be part of the Desktop business once we have Utopia. Consumer needs to sell 1.0M retail @\$100, 5M retail @\$50 and 10M OEM @\$15. This business will have to pay royalties on a number of its titles. We will still have a hardware retail business and hardware design licensing business which should contribute \$200M although a few more or less hit products could make a big difference in that result. When hardware features get to be very widespread some software developed in this group will move to the Desktop operating system. Any low overhead "opportunistic" businesses we get into should be included here. There will be many competitors in this business. Patty will need to decide who is state of the art so we form a complete model of their actions by collecting all possible data from the field and feeding that in.

On-line systems (Russa)

This will start up by the end of 1994 and optimistically could grow worldwide to have 3M customers paying an average of \$100 per year by 1997 for a total of \$300M. A substantial portion of this will be spent paying for communication infrastructure. In some countries we will have to joint-venture our narrowband service with the local PTT. We plan to offer our on-line service in many different forms. Our on-line service will become a key tool for staying in touch with and supporting customers therefore it is strategic for all of the businesses shown above. AOL, Compuserve and Prodigy are the competitors here but of course we will continue to cooperate with those people in other parts of our business.

Tools (Rogerh)

This is another business that will end up giving a number of bits to the Desktop applications group. In particular end-user database and some level of Visual Basic will be built into Office. I do see an opportunity to merge our various developer programs along with our tools marketing and end up with a subscription type business using CD and premium on-line services which could generate \$200M without giving up our strategic goal of making it easy for ISVs to work with us. Selling new tools including updates and enhancements that extend Office programming should generate 1.5M@\$200. Due to the need to combine our relationships with ISVs into one group I see the tools group having a lot of strategic as well as revenue goals. Borland and Powersoft are the key competitors and this mission should understand everything about Borland as a company.

Workgroup

I do not think there is a workgroup mission defined by itself. I think the server pieces are part of the server mission. I think the client pieces are part of the Desktop applications and Desktop operating system businesses.

Advanced Consumer Technology

By 1997 I doubt we will have measurable revenue from this business. Its mission is to define the wallet PC, and TV PC and servers required in order to set the standards in these businesses. The relation to our other businesses will be very strong but will be defined based on the requirements of these markets.

Summary

Summary	FY '93	FY '97
	\$1.1B	\$3.1B
	1.1	1.8

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	0.2	1.0
	0.4	0.7
	0.28	0.5
	0.0	0.3
	0.0	0.0
	0.67	0.0
	\$3.75B	\$7.4B

Microsoft Business Approaches to Partners and Customers (Steveb)

I use for this section two sets of terms— one that I define for companies who are our partners and customers and one that comes from the research group that characterizes users (end users and computer professionals). I will ask Jimm to forward his memo on user taxonomy for those who have not seen it.

One of my key hypotheses in this section is that there are leading edge people and companies in all areas that we need to maintain a relationship with. The relationship could be 1:1 or 1:many but these people influence our business profoundly and will for some time to come. I take the approach that MS should appear where they would expect us to as a single company with consistent business approaches and messages and strategies. We need to have a way we think about making products available to them over time (annuity products in some form in all missions). We need to have consistent ways we publish information to groups of partners and customers, talk with them, listen to them, and support them when they have problems. These relationship approaches will well serve us over time.

OEM (Joachimk)

We have relationships with OEM's that we manage and maintain and care for with the greater good of Microsoft in mind. We do have separate pricing and strategies by mission for sales to OEM's but we use similar licenses and pricing schemes, and logistics schemes whenever we license OEM's software in an attempt to keep the relationships simple. Our relationships with OEM's are and should be an even greater asset for the company over time. We need to manage better relationships with OEM's that are multifaceted— hardware makers as well as potentially resellers, ISV's and SP's.

Resellers (Mikeap)

Resellers encompass mass merchants, superstores, corporate account resellers, mail order resellers and our fulfillment companies. Resellers both buy and sell our products. Our general strategy is to sell directly to fewer resellers and have distributors where it is more efficient handle the actual selling and logistics. In all countries, a small percentage of all resellers account for a large percentage of all volume. We want to manage these relationships to really enhance sell through of our products. We want our breadth of products to be an asset that allows us to build relationships that are unique versus competition. There is no reseller who wants to resell products from only one mission. We need an approach to reselling our products and working with resellers that is mission independent. We need to decide which resellers to have co-merchandising relationships and at what level to fund them. We need our resellers to be a source of real time data on how well are products are selling versus competition. We need to decide how to reach and excite resellers with whom we do not have a co-merchandising or direct contact relationship. We need to decide whether we want to do outlet detailing of high volume outlets and if so how (ourselves, third parties?). There are emerging new resellers types like business telemarketers. We need to invest in new channels in ways that show leadership but are appropriate to volume potential. There are many resellers of our products in every country in the world. There are very few pan-country resellers today but we anticipate more over time.

ISV's (Jonl)

I will use the word ISV to describe any company that creates software but will have little interest in broadly supporting our server or DAD missions with their technical work and their marketing efforts. They may well

† Includes: WGA which moves to Server, non-Office DAD applications which move to Office, miscellaneous, and rounding.

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use our tools. These people have helped us establish Windows. They are important to our image. They reside primarily in the US. Most international ISV's and the rest of the US ISV's I will refer to as SP's because they can help our server or DAD businesses. This group needs an integrated view from MS on how to profit from our products. They are most interested and most help our desktop OS business but they rely critically on our tools. We could affiliate ISV approaches and management to either the tools or OS business. It does not need to be mission independent like the approach to the partners listed above.

Solution Providers and Computer Professionals (Johnni)

This has been a year where we have focused on these companies and the computer professionals that they and large organization IT departments employ. They are Novell's key asset and are becoming an asset for Lotus. We believe they will be vital if we are to succeed in the server mission. We need approaches to these people that help them see how to successfully and profitably serve customers with our product line. This is a year where we need to really help SP's and computer professional understand the customer scenarios where our products uniquely make sense. They will count on us to promote their work and to help make their association with us valuable. I think their work will help the desktop OS mission, the DAD mission and the tools mission in addition to the server mission. However, our server aspirations are the only justification for our high level of investment.

We need to really be successful with SP's in key vertical areas for large, medium, and small organizations. There are many worldwide SP's and we should take a worldwide approach. Our approach to solution providers should let us approach firms from one man on up. These smaller firms will be especially key in driving servers into small and medium business.

We must also have a relationship with the relevant individual computer professionals that work for SP's or IT groups in organizations. We are trying to establish such relationships through MSIN, the MCP program and annuity products targeted at this constituency. This group should be a source of invaluable product feedback if we capture it usefully. These people are technical but they are also influential end users often times.

Organizations (Johnni)

We need a strategy for creating messages and on-going relationships with organizations. While we will only call directly on the large organizations, our strategy must also encompass small and medium business. We must have marketing approaches to reach out to that group. The messages must include not only technical messages targeted at IT people but also messages about how our products and those built by SP's on our foundation enhance organizational effectiveness. This will accompany our personal productivity story. We need to enlist the support of many more SP's in vertical areas. We should co-promote those solutions through marketing and direct sales activities as appropriate. We need to continue to expand the role of MCS as a partner to the largest of these organizations and the SP's who serve them. We need to create an on-going relationship that has an information component as well as a procurement component. These messages and relationships must synthesize what our products can do cross mission. We must not lose DAD product standardizations in the accounts we call on. We must be flexible and quick to respond to customer issues like price.

End Users (Jimm)

We are working on a strategy to establish regular relationships with end users. These relationships must include information and support as well as product. This makes the creation of annuity offerings vital for end user oriented products as well as technical products. The relationship should be with the customer and make sense regardless of whether the customer owns products from one mission or many. This will save us cost and present a more consistent face to the customer. The program being rolled out now focuses in on DAD and desktop OS but will be broadened to Consumer. We call it Microsoft Plus. There are issues of reg base management and usage and direct mail that all go into this. We should have a relationship that lowers our cost and increases the likelihood of repeat purchase.

Support— End Users (Dwilling)

I could treat support as part of our strategy for end users and SP's/computer professionals. However, we have so many people in MS working in support that I wanted to call these strategies out separately. In the MSN framework defined last year we have four clusters of products (corresponding to the server, tools, desktop OS, and DAD/consumer missions) and three service-levels. The two lowest service levels for the desktop OS and consumer/DAD clusters we refer to as end user support. All tools and server support as well as all premier support I will refer to as computer professional support (including internal IT as well as SP people). In some senses we can and do have separate support policies for each mission which can

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evolve but they remain coherent for us to manage and explain to customers. We also need to get even better product feedback from PSS on all products and from both customer types. In the next 12 months we need to work to get more value in our marketing of DAD products from our quality support and liberal support policies in the US. We need to decide where we go with DAD end user support elsewhere in the world. We need to make sure the policies and tools we put in place last year really work.

Support— Computer Professionals (Dwilling)

We need to show a lot of innovation in this area this year. We have to make paid for support on advanced systems products work. We need a defined support policy that IT professional can count on. We need to decide what unique role there is for third party support centers and what unique benefits accrue to SP's and MCP's. We need to explain our policy of bug publication and our strategy for bug resolution. All of these things must be done across more than one mission in a way that is explainable if not identical (which it will not be) cross missions. This is a key part of our message to SP's and IT people.

Transaction Processing Strategies and Distribution (Mikeap/Johncon)

Distributors are in some cases marketing partners for us to communicate with resellers who we would not otherwise have direct communication. First and foremost however, they are logistics partners who help us reduce the overall costs of shipping product and billing. We have recently introduced a number of elements in our marketing mix that must be ordered, paid for, and shipped that are not classic SKU's. This includes SP program enrollments, subscriptions for information and product, OEM licenses and we must push to make sure we have the right infrastructure internally or with partners to manage costs of these programs to a minimum. We need to think creatively about how we structure our disti and other transaction partner relations to further reduce costs or increase service. Our fulfillment partners do fall between disti's and classic resellers. We need to think through even more how they relate to other resellers and what their role is in helping us reduce costs. This is also a year where we need to put in place the logistics infrastructure to manage subscription/ annuity offerings as well as lock and key products.

Image (Pam Edstrom)

Every product benefits from a strong positive and pervasive image for Microsoft. That image touches what all constituencies think of us— end users, organizations large and small, partners, SP's etc. etc. We do not proactively manage our image today. We should. We all feel the heat of the negative aspects of our image—the non innovative bully. We also all see the positive impact of being viewed as a leader and innovator. We must extend the positives and reduce the negatives. We need a clear strategic owner of our image to accomplish these goals. We also need more spokespeople for the company to continue to broaden our image and free more of Bill's time for other issues. This does not obviate the need for each mission to communicate through advertising and PR to customers about its products, their uses, and their benefits. That communication should reinforce and benefit from a corporate image. That communication should also be consistent with messages from other missions and other integrated messages to customers and business partners.

Management Issues

Interdependencies

Each mission depends on these approaches to a greater or lesser extent. Also, some missions depend on other missions. For example, our aspirations in server software depend on leveraging our position in desktop OS software. I have prepared a grid that crosses the missions against the approaches and the missions. Rate the importance of the approaches and other missions to our various missions. It gives a sense of interdependency. I have also shown the headcounts and marketing budgets focused on these businesses, customers, or partners (in a 1:1 sales, 1:many sales or pure marketing sense) in the US. I ask the regional directors to do this for their regions. This gives us a sense for the complex resource tradeoffs we are making very where in the world. Do people think these numbers are surprising? we will share our mutual views and be able to discuss at the retreats.

P&L's and Resource allocation (Steveb)

Today the fundamental tool we use in sales, marketing, support, and operations resource allocation decisions is a country or sometimes regional P&L. We can decide the P&L will be higher or lower but we generally do not look at the businesses by mission or customer or partner for this purpose. The exception is the OEM business where we really look at sales of desktop OS' to OEM's separately for resource

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allocation. Does this approach need to evolve for our more complex business? Does it focus our senior thinking in the right way? Does it encourage sharing things in the right ways? This is how we "measure" people. Is this right and is our business/ resource planning process effective? Should we use mission P&L's or customer or partner P&L's more than we do today? Should we allocate resource cross country borders in some ways to encourage more global shared approaches? I think this is a very complicated question we need to agree on. I think we need to update this system. It must reflect the complexity of our business and encourage more specialization than we encourage today BUT not at the expense of the good business thinking which the current system promotes. We need to consider not only the tools but the process we use for resource allocation which is the fairly formal today in terms of business planning and mid year reviews with strong accountability for revenue, share, and profit goals in the process.

Measurement, Training and Information (Jeffr)

Our view of business missions and approaches plus a P&L resource allocation system will drive organizational decision by resource owners. These may vary by business or approach or geographic area for good reason and has little to do with the overall basic organization we have in place today. Whatever though the specific organizational form, we will have people as I indicated on the grid focused either on missions or customers or partners. What tools will we give resource owners to measure these people, to train them, and to keep them informed of important developments in their areas (and not burden them with unnecessary information from other areas)? How do you measure the effectiveness of a field specialist in a given mission? How do you measure the effectiveness of a reseller sales person? How do you measure the effectiveness of someone doing seminars? In some cases we may decide the answer is these measures cannot be very individual but we need a thought out approach. The approaches and missions define areas in which people work but we need to train and inform those people to measure them. We should think through how we train and inform people differently and similarly based on whether they are a mission specialist, a reseller specialist etc. Today we treat the sales force as the sales force although there are many specialties.

Globalization (Joachim)

In revamping the resource allocation and measurement systems we need to explicitly think through how we can avoid redundancy around the world. Our sub system has taught me the value of good entrepreneurial P&L driven approaches to business. We may want to run more businesses like the OEM business. If so, how would we do that? What additional sharing would we get? What greater level of expertise and faster decisionmaking might we get? How do we keep ownership and entrepreneurialism? I think the grid again serves a guide. We must understand how global we wanted our approach to each cell to be and how that fits with the resource allocation/P&L model.

IT Tools

One area of great interest to many people is the IT tools we give our people to do their jobs. Today no one feels they are very state of the art. Our business missions and business approaches should key development of these tools. I think we will focus on six key systems: 1) management reporting and measurement; 2) customer relationship management (organizations and end users, 1:1 and 1:many, product ownership, marketing, support and information relationships); 3) customer and partner communication and information systems; 4) operational systems for orders, distribution, manufacturing etc.; 5) other accounting systems, and 6) SKU and pricing management.

Overlaps and Complexity (BOOP)

There are also some issues that remain vague even with the missions and approaches laid out above. Can we clearly separate ISV's and SP's? Where in the company do we manage each? How do we create cross mission SKU's if that seems a good idea? Paulina will lead focused resource in WPG doing program management looking at cross mission customer scenarios and technologies. We must make sure that the group responsible for SP's and organizations acts as an effective marketing partner to those program managers. How do we ensure that groups do not unwittingly create more work or more complexity than other groups can handle? SKU proliferation is such an example today. There will be such examples and we must effectively resolve them.

Planning Schedule and Next Steps

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As people create the memos described above please try to think broadly about the other interactions and dependencies on other topics discussed herein. Think globally, think about our missions, think about our customer and partner approaches.

I want to use the regional director's meeting primarily for discussion of business and management approach with some discussion of our mission strategies. I think the exec retreat should focus on the memos about mission, and management. Our goal in the director's meeting and retreat should be to give feedback to the authors which allows them to refine and make more succinct their thinking. I will also need enough input to write my memo on FY 95 priorities and plan process.

We will publish the succinct memos with my summary and regional input prior to the April WWSMM and country managers' meetings. I would like to reconsider the current dates for the product marketing meeting scheduled. They may all make sense but it might be more effective to hang these all on the coattails of the WWSMM. I know of Feb. meetings for Consumer (in Amsterdam) and Systems (in Redmond) in addition to an SP meeting, an Office meeting and a database meeting in May. Should we put them all in April in Redmond? I will ask Chasst to consider.

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