

From: Joe Firmage [remote]
To: BFRANK, FORTUNE.SJF-MAIL2.MARY BURNSIDE, FORTUNE.S...
Date: 5/25/95 11:27pm
Subject: High-Stakes Strategy Decisions

All:

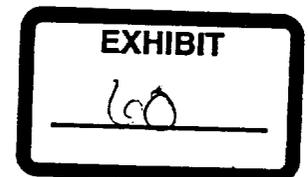
I want to put down a few key observations for you to think about through this difficult decision. Remember, I'm pressing hard on this because I have a strong opinion and this is what you pay me to do...

First, let me present my view of the fundamental BUSINESS challenge that confronts us, then I'll talk about the PERCEPTION challenge. I'll conclude with my observations of what we should do in response to these challenges.

The Business Challenge

Ten years from now, the software market will have matured considerably. Like in every other mature market, there will be very few very large players. There will probably be between 3 and 5 \$10 billion+ general purpose software companies, and every other software company will be a niche player. By that time, it will have become impossible for a niche player to rise to the first tier (how long has it been since a completely new auto company emerged? – it's a reasonable analogy given the growing complexity and expense of software platforms). The opportunity to build such a large multi-product company comes along only during worldwide paradigm shifts: during the industrial revolution, communications revolution, mainframe computing, personal computing -- once every 30 years or so. And it is not historically reasonable to suggest that these companies will not compete with each other – that there could be significant product differentiation between such large commodity-product vendors in the same overall marketplace. When we're dealing with sub-\$1000 ASPs, there simply won't be \$10 billion protectable product markets.

Given this view, I will strongly argue that one of two things will happen to Novell. Either it will become one of these few large general purpose software companies or it won't. If it does not do so by itself or through acquisition (of Novell or by Novell), then its present lines of business will stagnate and either sink into niche markets (like a directory service market) or disappear altogether. In either case where we fail to become a large general purpose software company, Novell's shareholders will have lost tremendously.



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Microsoft knows that Novell has the potential to become a long-term major player in general-purpose software, and REGARDLESS of whether we position ourselves in that way, Microsoft knows that we're in that position, and will stop at nothing to destroy us. Bob, you mentioned that positioning Novell as a general purpose software company puts us in front of the Microsoft machine. The reality is that we're already there, and that we're the only truly serious obstacle in front of their machine. With Microsoft having all but won the desktop OS, our applications and network servers are the ONLY upsizing products that present serious competition for Microsoft. If we step back from the challenge, several things will happen:

- Those aspects of our business that can't be repositioned, such as applications and application servers, will be quickly overrun, and our top line revenue will seriously suffer. Will it then be easier to grow the remaining businesses?
- The industry will have lost the only platform lightning rod seriously threatening to Microsoft, and all major Win32-related developer interfaces will become de facto standards, including OLE, MFC, and WOSA.
- All of our remaining technology strategies will have to be redirected around Microsoft interfaces, including our global network access, network services, and groupware. This will leave all of our products subject to plug-and-play replacement as a result of nonexistent developer investment in 'red' interfaces.
- We will remain subject to anti-competitive pricing maneuvers for our then-very-replaceable redirected products.

I believe that Novell is better positioned than any other software company to join Microsoft over time as one of the few, large, general purpose software vendors. The question is, even if Novell is better positioned than any other company, is that good enough? If it isn't good enough, then our industry will head inexorably towards domination by Microsoft and an eventual breakup of Microsoft into two or three baby Bills. In that scenario, whatever survived of Novell could stand in a good competitive position at that time. Obviously, however, no company wants to rely on the breakup of Microsoft as the basis for its business plan.

The Perception Challenge

Business customers have usually wanted and always deployed vertically integrated solutions for mission-critical information systems. The upsizing PC industry has enjoyed the temporary luxury of a clear separation between network, operating system, development tool, and

application strata. This clear separation is rapidly dissolving because of (1) the need for vertical integration between these layers, and (2) technologies that achieve it, such as OLE and WOSA. And analysts, particularly financial analysts, have not observed the impact of this on software companies. There is a severe perception gap between what customers are wanting to deploy and what financial analysts are expecting to see emerge from software vendors. Analysts would like to see Novell "focus on the networking business and own that market". **WHAT THE HELL DOES THAT MEAN?!?!** In the upsizing PC sphere, (1) applications are becoming interfaces to network resources, (2) business logic is moving into the network, and tools need to be able to build that network-resident logic, (3) the network is extending to non-traditional computing devices, and (4) local networks need to be connected together. Therein lies a simple, one-sentence justification for our applications, tools, embedded systems, and global secure network businesses. **THESE ARE ESSENTIAL ELEMENTS OF TOMORROW'S NETWORK.** Since Microsoft will not address Novell network servers in ANY of those respects, we must get into those businesses, get out of those businesses and into something completely new that can't be killed by inaction or hostile action from Microsoft, or die. **Analysts don't understand that Microsoft applications and tools simply CANNOT be leveraged over the long term by Novell to support the evolution of NetWare networking.**

One can legitimately argue whether Novell should externally position itself in the beginning as a "general purpose software company". But regardless of that decision, it can't obscure the internal understanding that the **NETWORK IS BECOMING GENERAL PURPOSE IN FUNCTION.** Hence the rise of solutions beyond file and print: client-server, groupware, application servers, OLTP, etc. The reality is that Novell has invested **HEAVILY** over the past three years in being a general purpose software company that competes in all horizontal PC software markets except the desktop OS and databases. Our external perception problem boils down to this: our strategic moves over the last three years could not possibly be rationalized without the understanding that we do, in fact, intend to compete in every major PC software market except desktop OSes and SQL databases. Since we have not asserted this with force to analysts, it is not surprising that they find our application server and applications strategies confusing. Selling software ranging from a Marilyn Monroe CD to a UNIX application server is not terribly justifiable without a corporate assertion that we'll compete for a leadership position in a broader software marketplace than file, print, and directory.

What Do We Do Now?

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I believe that if we answer two basic questions, we will be able to determine which steps we must take from here:

First, will it be easier to grow beyond \$2 billion (1) as a general software supplier realizing the need to change analyst's perceptions, or (2) as a network services company that has to find a way to move out of Microsoft's headlights? Second, can we outperform the market, and thus retain our relative position in the industry, alone?

I believe that the answer to the first question is clear: however difficult it is to improve the standing and understanding of Novell with analysts, it is vastly simpler and less risk-prone to do so than to step away from direct confrontation of Microsoft in our key business initiatives. Without direct confrontation on applications, we will not gain applications market share. Without direct confrontation on application servers, we will not gain application server market share. Pursuing a direct confrontation does not mean that we should not spin our message from a different angle, with our own unique value proposition, but it does mean that we must assert that our market share gain is Microsoft's loss, and that that is our objective.

If Exec. Staff believes differently -- that we should get out of Microsoft's headlights -- then we will have to completely reexamine our corporate strategy, begin to deemphasize our prospective role as an application and application server vendor, and start looking much more seriously at partnerships with Microsoft for NT and with companies beneath us in the food chain, such as Cisco.

The answer to the second question is unclear. Maybe you all have a stronger opinion than I do at this time. I do believe, however, that the next six to twelve months will clarify the answer. We should be prepared to enter into discussions with AT&T or Oracle at the first moment we conclude that the sheer fiscal strength of Microsoft yields an impossible challenge for our business pursuits.

In any case, the fiscal strength of Microsoft may be a reason to get acquired, but it is NOT a reason to step away from the plate. But if we don't grow the businesses we're in today, we will die. And I really sense that we're on the verge of giving MS a run for its money in some key areas. We're holding our own with NT given the strength of 4.1. We will lose some market share there until our application server is integrated and covered with tools, but we must accept that owning 50% of the growing NOS-AS market is better than owning 100% of the

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saturated NOS market. PerfectOffice is doing well in a market that could not possibly be more competitive, and we're setting the bar in terms of making applications leverage the network. We're close to achieving a cement-hardened position between computing and telecommunications via NCS, a position that will be seriously jeopardized if we fail to step up as a full platform and applications supplier (don't imagine for a minute that we can make a business with NDS if NetWare fails as a platform and our applications division falls).

Here are my recommendations:

(1) We should proceed with Borland as planned, with the announcement slightly delayed as follows.

(2) We should plan the rollout of a refreshed corporate strategy for late June or early July, into which the Borland announcement will be integrated as one part (hopefully reducing by some margin the initial negative stock impact). The strategy should be tested under contract with two key analysts sufficiently in advance to make use of their observations.

(3) The corporate strategy should be directed at (a) the "refocusing" of our efforts on NetWare 4.2 and 5.0, reflected by our reorganization and the new Gemini product plan, and NetWare's future as a UNIX-compatible general purpose network operating system, (b) a comprehensive enterprise client-server platform strategy based upon NetWare, covered by Net32 interfaces, frameworks, and components, and leading-edge middleware and development tools that will enable developers to build solutions that will run on all Win32 and Net32 network nodes, (c) network-enabled applications that will connect people to each other through the network, and (d) secure global network services that will soon be able to link millions of LANs together into a global LAN. We should present the strategy using consolidated brands for the product lines. This can make a MAJOR difference in the clarity of our messages.

(4) Immediately following the main rollout event, we should allocate sufficient time for a top-level executive communication team led by Bob Frankenberg to hit every major analyst for one-on-one discussions through July.

The future of the company depends uniquely upon the decisions made and actions taken this summer. Of course, if you don't agree with my arguments, then I strongly suggest that you don't follow my

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recommendations. The success of my recommendations or those of anyone else depend fundamentally upon buy-in from all key executives to the underlying rationale.

Thanks for taking the time to read this stream of consciousness. By the way, I've faxed over to your offices a Microsoft brochure that describes their new Solutions Platform tools suite. Take time to read it and you'll grasp the depth of the challenge to our platform business....

Joe

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