

From: Carl Gullede
Sent: Wednesday, January 14, 1998 10:12 AM
To: Kurt Kolb; Mark Buick
Subject: FW: OEM OS pricing in the light of the <1k PC segment.

do we need a slide deck on "Selling the Value of Windows" ? I am inclined to think so.

OEM OS pricing in the
light of ...

-----Original Message-----

From: Joachim Kempin
Sent: Wednesday, January 14, 1998 9:20 AM
To: Ken Goetsch
Cc: Kathleen Graves; JKshort list
Subject: RE: OEM OS pricing in the light of the <1k PC segment.

pls see below

-----Original Message-----

From: Ken Goetsch
Sent: Friday, January 09, 1998 2:44 PM
To: Joachim Kempin
Cc: Kathleen Graves
Subject: RE: OEM OS pricing in the light of the <1k PC segment.

Joachim - a comment and an idea. (long email)

OS Comment first:

1) On the OS, I believe we should hold firm on our pricing and instead talk about the new technology that we are adding to the OS - at little or no additional cost to the OEM. We have long espoused that software may someday be more valuable than the hardware that runs it - we are getting closer to this every year and we should not be ashamed of this if our technology investment in Windows continues to grow. We should have the Windows NT and Win98 product teams help us with a PowerPoint that we can use every time this comes up. (emphasizes all the new stuff we are adding that drives users to buy PCs in the first place).

[Joachim Kempin] I agree

Application thinking:

2) I am new to OEM (first week), so maybe this approach has been tried and rejected. However, here it is.

OEM's and retailers are struggling to produce stripped machine's at under \$1k and we know the margins are slim. MS applications from Office to Works and all of the IMG titles start to make bundling these into the machine more difficult. As we see \$600-700 PCs, it gets even harder.

So, instead, we develop "packages" of titles that we offer to the OEM in an entirely new way. Essentially - there are two ways to morph the applications business (now) and in a few years when we have ubiquitous high speed pipes into the home. Item A) below represents what we could do broadly now without high speed access to homes - just some changes to the way we offer, price and fulfill applications. Item B) covers how this could transition in 2-5 years using cable modems and XDSL modems.

A) New OEM pricing model for applications.

As I understand OEM applications pricing - we want \$15.50 for Word 97 to a high volume OEM and it retails for \$109 normally. Unfortunately, even \$15 to an OEM on a stripped machine is a huge impact on his margins if they aren't sure it adds differentiating value. Same thing for the \$6.25 that we want for Encarta that sells for \$49-55 at retail. The problem is that without the MS application socket on the machine - we leave ourselves with none of the competitive immunity that we desire. We wake up one morning and find a large OEM or many bundling a new Grolier's or Corel Suite on all their low end machines. To compete, we end up killing our margin - or we see all those machines going out with competitor's games, reference and office titles. (As bad as they may be).

Instead, we offer the OEM the opportunity to bundle an entirely new pricing concept. We call it a 90-day rental and we promote it heavily as a way to "find out what you want and need" before you pay for the "complete" product. (The product time-bombs at the end of 90 days without the new key that only we and OEM can supply for that machine) We emphasize that this is "not a free trial" - but is a new rental model..The OEM pays for the first 60-90 days. The applications sold this way are very cheap (but not free) to the OEM and the OEM participates in a Web-site that we control that charges the consumer or small business via credit card at the end of the first or subsequent rental periods. Advantages are many.

We get every OEM to want to participate in this new program that pushes much of the pricing out of the PC at

purchase and instead gets the client comfortable with the product that he a) either "buys" at the end of the rental period - say \$12 for Encarta and the OEM get \$2 - we keep \$10 or b) he signs up for subscription to the product or the suite for 1 year and we bill his credit card for \$xxx per month. Advantages are:

- OEM gets to bundle a package of games, Home essentials, etc. for a very low price for the 60 or 90 days. Advertising value is high with our brands.
- The OEM only makes money on our applications if the buyer converts to purchase/rental - so they sell the product hard.
- The OEM also sells Internet access very hard and gets paid for this by the ISP.
- MS gets huge initial numbers of sockets filled and denies our competitors the room on the hard drive.
- If priced and distributed right - we greatly expand applications sales for MS and OEM.
- The consumer or SOHO customer loves the idea of buying Home Essentials at the end of the rental period for \$35 instead of the \$89 to \$109 at retail. The OEM gets a few dollars of this and we make more than OEM pricing. No way to get this special OEM price except from the OEM you bought your PC from.
- Piracy advantages - we link the ID of the processor to the rental version - it won't work on other machines - this only works on new OEM machines. The keycode we provide at fulfillment is linked as well.
- We maintain web linkage with our customers - we can send out small updates to applications or bugfixes direct to their email accounts. Affluent, web connected households would love this. Gives us a better data base than the registration database.

Disadvantages are:

- Possible low conversion to purchase rate? (However - much wider use of our products before decision is made to buy/rent).
- Costs to add encryption codes to applications. Product groups must buy-in.
- Cost to set-up and administer Web-site - OEM could fund this as distribution partner.
- Retail software channel would raise hell about being locked out of this opportunity. This is defensible with the OEM participating.
- Possible confusion as to whether customer is buying the application at PC purchase.
- Probably must have web-access (28.8) or better - otherwise, no way to efficiently provide keycodes. Could have phone-in, mail out keycode as last resort - but this is expensive.
- **[Joachim Kempin]** we have tried this once and the reaction was negative- reason was the fear of lawsuits from resellers and OEMs. Consumers might argue that they bought the stuff with the SW and didn't know it would be none functional later. We are thinking this through and might develop a 1 year program for DAD apps which might include a viewer so the work is not rendered obsolete. May be we should try the limited time game stuff again? Any comments?

B) Long term impact of high speed access.

We know that the value of CD's and DVD's will be impacted greatly as high speed access is widely available. As this occurs, with this new model already in place, Microsoft is perfectly positioned to offer a very high-performance combination of on-line and off-line (DVD) applications. We can refresh games, reference titles and office applications monthly or quarterly in return for an ongoing revenue stream billed to the user's credit card. This can be sold by the retailer or OEM at the point of purchase and we would need to involve these channels in fulfilling the product in return for a bounty or transaction fee. This moves us toward a model where the PC and fulfillment server are linked so that neither the user or MS cares if the application or content is delivered over the web from the server (Java model) or is downloaded to the PC for local use. Piracy is even more controlled in this model, because it becomes important to identify the user and his machine at every on-net use.

[Joachim Kempin] this is in theory great, but does not hold up WW. The US and certain parts of Europe are way ahead but only in the metropolitan areas and these solutions need better service coverage. 5-10 years from now with the right bandwidth this might come true. In addition you have to consider size and reliability during transfer. There is no alternative to a CD today and I am not even touching on the piracy aspect of this- how do you fight abuse?

This model applies to our corporate users as well and really drives us to an on-going revenue stream with less concern about big software releases and the hurdle that we must make every time a new OS or application "ships". Users love it because they get constant refreshes of the new and latest software - we make more money and drive piracy way down.

Does this make sense?

Thanks,

Ken

-----Original Message-----
From: Joachim Kempin

MS-PCA 1483389
HIGHLY CONFIDENTIAL

Sent: Tuesday, January 06, 1998 10:00 AM
To: OEM Personnel Sales Communication; OEM Personnel Sales Communication - Intl.
Subject: OEM OS pricing in the light of the <1k PC segment.

"I need an OS price between \$20-25 to meet these new price points" So drop your prices MS to accommodate us and "grow" the market. This is what I have been hearing from OEMs for some time. So don't feel bad- I am hearing it as well.

My answer has been and will be the following. We provide value in our software which is key to running most PCs and we see no need to change our pricing for now. Regardless of the price for a PC we provide the same value. We have tried in the past to base our prices on OEM pricing and we all learned that this means a total mess- what price is the question, their selling price, their cost etc. AND most important what is it based on- the total system with monitor without monitor, with floppy or without etc. etc. Another way would be to price our OS on processors- we did that once as well, but there were only 3 around compared to probably 25-30 today and their prices are dropping faster than ever. Again whatever we do there we could not follow and we could not do it right.

At the end we would like to get the same amount of money from the OEMs and would they be willing to pay \$100 for win 95 for Pentium 2 300MHZ PCs to get \$25 for Pentium 166 MHz PCs? This is totally unrealistic in particular if more and more components get stripped off the base PC and sold as add-ons and might even be kept when systems get replaced. Think about what the USB technology might allow for one day.

I firmly believe OEMs have the ability to price PCs with our current OS prices properly and sell them below 1k\$ without us having to lower prices. Intel gets more than we do and they just deliver some software on silicon- and not a lot of it. We are not in the way to achieve new price points and/or stall markets- do not feel bad about resisting this. We are less than 10% of the total system price - just remember that. And by the way, CE is not a solution for this- because it is not compatible.
Any other thoughts, just send me mail.

MS-PCA 1483390
HIGHLY CONFIDENTIAL

From: Joachim Kempin
Sent: Sunday, January 11, 1998 5:17 PM
To: OEM Personnel Sales Communication; OEM Personnel Sales Communication - Intl.
Subject: OEM OS pricing in the light of the <1k PC segment- more input and good thoughts from Carl

-----Original Message-----

From: Carl Gulledge
Sent: Wednesday, January 07, 1998 10:51 AM
To: Joachim Kempin
Subject: RE: OEM OS pricing in the light of the <1k PC segment.

Windows is one product - We don't offer a junior version of Windows. Our unified product model benefits everyone by instilling developer and consumer confidence. ISV's can be certain that their apps will run - users can buy applications with confidence.

The value of Windows is independent of PC price points. Windows offers the same level of capability and value on inexpensive PCs as it does on expensive high performance PCs.

Windows Scales - in other words, users that buy inexpensive low configuration PCs are not stuck there. In fact many will invest over time to enhance their PC's performance and/or capability. Windows of course improves in performance with the hardware and in capability when these upgrades are made. This is a tremendous consumer benefit. Imagine the level of consumer dissatisfaction we'd create if we put governor in the product to contain performance for specific price points.

MS continues to invest in Windows to add incremental value in each release. This value often opens new markets, enables new peripheral capabilities, increases productivity, reduces support costs, etc. MS continues to invest heavily in the PC platform via PC9x and evolves the Windows family of operating systems to support this innovation.

Summary: Users want full functionality from Windows and the ability to upgrade their PCs. It is misguided thinking that asserts that people who pay less for a PC want less from Windows. Our response continues to be to provide a single feature-complete Windows product for the consumer market place. Developers and consumers alike enjoy the confidence this approach. Given that our product is full featured and its performance scales with the HW we believe that our pricing continues to be very reasonably priced for both low and high end desktop PC configurations. Not to mention the fact that the one size fits all offering creates efficiencies in reporting and management of OEM licenses. OEMs that want to develop systems with a subset of Windows functionality and no backward compatibility should consider developing around Windows CE.

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Sent: Tuesday, January 06, 1998 10:00 AM
To: OEM Personnel Sales Communication; OEM Personnel Sales Communication - Intl.
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