


Pricing MS Products

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Agenda

- ◆ Why MS eliminated Suggested Retail Prices?
- ◆ What are Estimated Retail Prices?
- ◆ How does the Channel set prices?
- ◆ Price Waterfall - what, why, and how
- ◆ Price Waterfall - Demo
- ◆ Summary of terms

Today I'm going to talk about Pricing MS product.

I'll start by giving you a little pricing history and take you back to the days when we had Suggested Retail Prices and why we've gotten smarter and eliminated them.

Then I'll talk about Estimated Retail Prices which is what we use today to communicate our product values to customers.

I will also be covering how the distribution channel sets prices, the Price Waterfall, which is the tool we use to set the prices, show you a demo and review some common MS terms with you.



• *Why eliminate Suggested Retail Prices (SRPs)?*

- ◆ SRPs caused an inaccurate perception of MS prices - negative impact on sales
- ◆ Eliminating SRPs gave Product Managers increased flexibility for hitting optimum street price points
- ◆ No affect on actual Street Price

On July 1, 1994, MS discontinued SRPs. We did that for a couple of reasons.

1. No impact on actual street prices of MS products, it just changed the way we communicate the pricing and value of products to customers.

The street price was typically 64% of the SRP that we were publicly communicating.

Because MS products were perceived to cost so much more than they actually did, we were afraid that this was having a negative impact on our sales.

Also, since there was such a large discrepancy between the street prices and the SRPs, SRPs no longer served their original purpose of communicating what end users should expect to pay.

Prior to July 1, 1994, a PM would set an SRP for their product and MS's distributors would receive a 46% discount off that SRP.

This approach offered very little flexibility in hitting optimum street price points because the PM had very little control over the street price.

The SRP was really a meaningless figure that was causing more harm than good.



Estimated Retail Price (ERP)

- ◆ Communicates approximate prices to customers
- ◆ Based on actual street price research
- ◆ “High end of street price” - 90% of street prices fall under the ERP
- ◆ ERP is typically 5% - 10% higher than street
- ◆ Standard formula for all product types

Estimated Retail Price (ERP) is what we use to communicate approximate street prices to end users. It is also the price at which we sell products directly to end users.

When we eliminated SRPs, we hired a research firm to study the street prices for a wide variety of MS products.

We set the ERP formula so that the ERP would be higher than 90% of the street prices of MS products.

We knew that if MS states an estimated price for a product, customers are not going to pay more than that price because they feel like they are getting ripped off by the reseller.

We also didn't want to artificially squeeze the channel margins by quoting a price that the resellers couldn't meet. Then the resellers would be mad at us.

We needed to make sure the ERP is close enough to the actual street price to make it meaningful

ERP is typically 5%-10% higher than street price.

We have a standard ERP formula for all product types.

The use of Estimated Retail Prices is a much more precise method for maximizing revenue and hitting natural price points.

For example, with Window 95, we wanted to communicate a value under \$100. Under the SRP model, the disti price would have been \$79.20, since it is a percentage off of SRP. We know the street was going to be low because resellers were using Win 95 as a loss leader in an attempt to get customers into their stores and try to make their money from sales of other products. So, if the disti price was \$79.20, the street price would have been much lower than \$99. Under the ERP model, we can communicate a value of \$99, and still have a disti price of \$86. In effect, we saved approximately \$34M by increasing the disti price by \$6.80 while communicating a street price of under \$100.

ASK JOHAN ABOUT ACTUAL SALES PRICE OF WIN 95

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SRP/Street Price Example

		% Difference from Street Price
Office Standard Edition		
SRP	\$750	56%
ERP	\$499	4%
Street Price	\$479.95	0%
Distributor Price	\$405	-16%
Word for Windows		
SRP	\$495	55%
ERP	\$339	6%
Street Price	\$320	0%
Distributor Price	\$267.30	-16%



Channel Prices/ Channel Margins

- ◆ Channel prices
 - ◆ Function of desired margin and competition.
- ◆ Channel margins
 - ◆ Channel sets their own margins
 - ◆ MS has no impact
 - ◆ Reseller Rebates

Reseller prices are a function of competition and desired margin.

Resellers get a cost from MS or from a disti and mark it up depending on what the competition is doing and how much they think they can make on the product. The large consumer demand for MS products coupled with the high level of competition for resellers who sell our products naturally drives the prices of MS products down. As a result, resellers often make less margin on MS products than they do on our competitors products. But since they sell more volume in MS products, they can often make the most money on the MS line.

Reseller competition drives margins down - not Microsoft.

Some people argue that if resellers have an extra high margin on a product, not only will they be more likely to stock the product, but they will also put some additional sales and mktg activities behind the product. While this might be true, trying to increase channel margins is a very indirect and uncertain method for obtaining these results.

A much more direct method of affecting reseller behavior is through rebates. The MS channel rebate program is an incentive program to encourage resellers/distis to focus on MS' primary goals and objectives. With a rebate program, MS gives each reseller a goal which is meant to be a stretch for the resellers to achieve. In other words, the goals should be achievable only if the reseller engages in incremental activities that would not have occurred without the rebate program.

Rebates are a % of the disti/reseller's sales.

Based on past experience, a large % of the rebates we give to resellers are incorporated into a lower street price. Therefore, we can get both the lower price point in the market AND the incentive to drive incremental activities.

QUESTION: Do we want to try to give additional dollars to resellers "as margin" and *hope* they will sell more of our software and use those extra dollars on incremental marketing of our products, or should we offer a sell-through rebate, only paid upon achieving and incremental sales goal?

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Price Waterfall - What & Why

- ◆ Gives logical, rational, and consistent relationships between derivative products across MS product lines.
- ◆ Increased efficiency for Product Managers
- ◆ Minimizes confusion for:
 - ◆ Resellers
 - ◆ End users



Price Waterfall - How?

- ◆ Enter the Full Package distributor price into the Price Waterfall
 - ◆ Use MSI Channel Margin research to help understand difference between distributor price and street price.
- ◆ Enter each derivative SKU that you need to create.

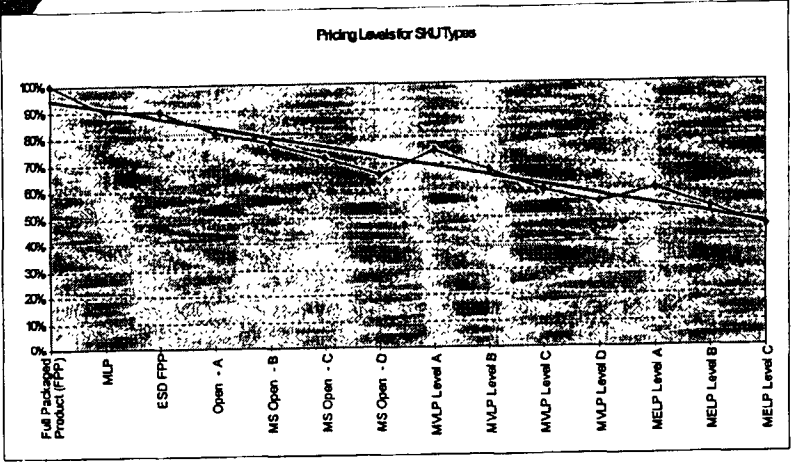


Price Waterfall continued...

- ◆ Price Waterfall calculates ERPs and Direct Reseller prices for all license types.
- ◆ ERP Rounding convention
 - ◆ If calculated ERP < \$100, then round to nearest \$4.95 or \$9.95
 - ◆ If calculated ERP > \$100, then round to nearest \$9.00



MS SKU Types





MS Volume SKUs

License Type	Min License Qty
◆ MS Open License Level A	20
◆ MS Open License Level B	200
◆ MS Open License Level C	1,000
◆ MS Select MVLP Level A	2,000
◆ MS Select MVLP Level B	8,000
◆ MS Select MVLP Level C	20,000



Price Waterfall - Demo



Summary of Terms

- ◆ SRP - Suggest Retail Price - Discontinued on July 1, 1994
- ◆ ERP - Estimated Retail Price used to communicate estimated prices to end users.
- ◆ Street Price - Average price that end users pay for a product - typically 5% - 10% less than ERP



Summary of Terms continued

- ◆ Distributor Price (disti price)- Price at which we sell product to distributors

- ◆ Direct Reseller Price - Price at which we sell product to direct resellers
 - ◆ Direct Reseller Price = Disti price * 1.0556

