

To: 1994 WWSMM Attendees
From: Joachim Kempin
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Subject: OEM Sales FY'95 Goals, Strategies, Facts

Goals:

1. Exceed \$1.5B in OEM revenues.
2. Ensure at least 80% of all new Windows PCs are being shipped as "Chicago PCs" by Q4 FY'95.
3. Increase total Consumer Applications and Mouse business to \$200M.
4. Transform two million or more naked systems into Microsoft licensed desktop operating system PCs.
5. Defend our Productivity Applications marketshare when needed.
6. Convince Solution Provider OEMs that Windows NT is the most suitable platform for their Intel server business.

1. Exceed \$1.5B in OEM revenues.

In order to achieve this ambitious goal in a market that might only grow 16% in FY'95 We will need to do the following:

- **Find more customers for Microsoft desktop operating system products.**
There are 6-8 million naked systems out there which are being supplied by pirated or counterfeit desktop operating systems. In addition, IBM is shipping PC-DOS and OS/2 preloaded systems representing a three million plus unit opportunity for the IBM team when Chicago arrives.
- **Increase Windows/MS-DOS ratio.**
The most growth potential presents itself by knowing that only 55% of all MS-DOS based systems are licensed for Windows (55% includes both retail and OEM units). In the Chicago timeframe - assuming that most systems will be 486s and 4MB configured units - we should be able to significantly increase this percentage.
- **Continue to develop an effective Authorized Replicator and Delivery Service Partner network**

We will continue to supply the royalty OEMs through Authorized Replicators whereby we will modestly expand our network and add CD replication capabilities as needed.

The smaller OEMs (less than 5K units) will be served through a network of DSPs. The key in making these DSPs work harder for us is to drive their marketing programs and feed them with leads. This needs a lot of local energy and focus. Nearly all subs need to significantly improve their local programs to fend off competition who might be cloning this system. We are most vulnerable here and should enlist our end-user group expertise when dealing with DSPs whenever possible. We will extend the DSP program to a selected number of Consumer titles. We will continue to deliver 5-packs through a network of Authorized Distributors to these DSPs. Expect us to enlarge the network in FY'95 to avoid shortages and have more competitive COGs.

2. Ensure at least 80% of all new Windows PCs are being shipped as "Chicago PCs" by Q4 FY'95 .

To help us to achieve this goal we will need a lot of TLC by the account teams and close-working relationships with other MS customer units to keep the OEM customers in our camp and enable them to be successful with our products. This being the number one priority for FY'95, OEM will support this goal by putting together a worldwide incentive program for account managers to sign-up the OEMs for Chicago. At the same time, we will create incentives for OEMs to ship Chicago on as many systems as possible through:

- Penetration pricing incentives built into our volume agreements (only for MS product).
- Advertising incentives/inclusions for key business partners if they get fully behind Chicago.

The last one should be considered not only on a corporate but also on a local level as well. Knowing that it doesn't take a lot to mention Chicago shipping OEMs in our ads, we could use something like this: "Update your PC to Chicago by buying our upgrade or buying a new Chicago compatible PC from OEM XYZ." We are not considering paying OEMs for "Chicago inside" trade ads because we don't believe in copying Intel's campaign.

To ensure broad Chicago availability, we will continue to work with component and system suppliers as well as key ISVs to have all the hardware and software ready when we ship so that end user demand will create the pull needed for OEMs to build and ship Chicago pre-installed PCs.

At the same time, I expect us to change our licensing policy to reflect the following:

- We are considering true volume pricing.
- Incentives when shipping greater than 80% of all Windows systems as Chicago systems.
- Restrictions of incomplete PC system shippers to sub-license.
- Enforced PGL for OEM pricing of Chicago.

Another issue that needs to be worked out is the CD-distribution of our Desktop Operating Systems. The questions are how to ship encrypted applications on these CDs and how to fulfill them when a purchase happens. A second open issue is how to encourage OEMs to ship the Microsoft OnLine code. Should we use this new service as a tool to provide basic support to OEM customers worldwide, getting more names and follow-on subscriptions?

3. Increase total Consumer Applications and Mouse business to \$ 200M.

Increase Mouse sales from 5 million units to 10 million units by selling cost reduced "Defender" Mice at premium brand value. Leave Carrera and House Mouse as a retail product, do use it to complement the Defender strategy if desired by key OEMs who want them as an upsell or channel specific opportunity.

The real windfall in this area should come from getting all the incremental dollars possible from systems and component vendors for bundled consumer CD titles. We believe that the TAM will be close to \$250M next FY'95. While our language/culture restrictions might reduce this to \$170M, we want at least \$100M from this segment and will fight over market share with every competitor assuming that the right CD titles are OEMable and deliverables are easily available through Authorized Replicators.

To achieve this goal, we will have to look for opportunities at all tiers. Sales to large customers and component suppliers are different from the traditional OS sales. Customers normally earmark a certain amount of dollars within their desired budgets for software titles without endangering certain well-known price points. Quality is less of their concern than having a set of products that will look attractive enough to a consumer to make a buying decision in favor of their systems or components. Price will be of the essence when selling. A high price policy will mean that competitors will get a larger share. In FY'95 we are facing a particularly difficult situation when transitioning Works customers to Utopia. We will design an attractive combo offer for OEMs to obtain more \$\$/unit instead of just replacing Works with Utopia.

For the smaller customers, we need to put a number of attractive consumer bits on 2-5 CDs and make them available through the DSP channel. The key here is not to cannibalize retail sales, but to get as many available dollars as possible. This could be attained by adding lesser valued titles to maybe one attractive title and having a promotional pricing for these

combinations without undercutting the retail price of the more attractive title.

Another consideration is a totally customized CD approach, whereby an OEM teams up with MS in the retail channel and certain combination packages are offered through the channel in a co-branded fashion. The revenue of these activities should go to the end-user unit whereby OEM will be the facilitator of the opportunity to the channel partners.

4. Transform 2 million or more naked systems into Microsoft licensed Desktop Operating Systems PC's.

We need to improve our field organization and add the proper marketing expertise to achieve this goal. At a minimum, each subsidiary needs to obtain and maintain an active prospecting database and define the right marketing programs to work with the DSPs to gain "naked systems" share. To complement this drive, an effective anti-piracy program needs to be in place in all key subs. This needs to include test purchasing and fast tracking procedures as well as legal response teams to actively go after violators of our policies. OEM is willing to participate in funding such a program as part of the DSP marketing effort. I am convinced that these two programs, together with the proper staffing levels in each sub, will enable us to make significant inroads into this market segment.

5. Defend our Productivity Applications market share when needed.

It is not our strategy to sell Productivity Applications through the OEM channel on a royalty or white box basis. We strongly believe that we should stay away from these deals until forced by competition. In any case, I would argue that white box agreements are bad business because they are just a manufacturing nightmare, encourage counterfeit operations and hide the global threat. OEM royalty deals are the better way to go and these should only be closed after escalating them to the person responsible for End-user business as well as the OEM director for a certain area. These two should work together to make the right decision. Nevertheless we will always try to talk the OEMs out of these deals, persuade them to do a consumer bundle instead and escalate fast if the competitive threat still exists after trying hard.

6. Convince solution provider OEMs that NT is a most suitable platform for their Intel server business.

The server business is very important to Microsoft. But the right channel to sell these products through is the VAR channel and not the OEM channel. At the same time, there are several OEMs that qualify as VARs as well as OEMs. The top nine consists of: NCR, IBM, DEC, HP, Unisys, SNI, Fujitsu, ICL & Olivetti.

All of these OEMs have an entrenched interest in selling their proprietary UNIX solutions over the NT-AS solution. Only over time will we be able to convert some of this business to NT-AS. We in OEM won't give up convincing these OEMs that all of their new applications should be written to the NT-AS platform but we understand that this won't happen fast, or

only when customer demand exist. This means that we will have to rely on the organization customer unit to help us to turn these OEMs around by evangelizing their key customers.

In the meantime, we will focus on persuading the Intel PC division of these OEMs to take a more proactive role in actually competing with their own UNIX division. By doing this, we might be able to score visible design-wins which might persuade these companies to decrease their investment in their UNIX divisions.

To battle Lotus Notes we will engage with all these OEMs into an EMS campaign trying hard to convince them that EMS is not only the superior solution to Lotus Notes, but a great stepping stone towards Cairo which we expect to ship in the second half of CY'95. In particular, when OEMs are planning to implement Notes networks inside their companies or as a bases for their reseller networks we should escalate fast and involve the organization business unit in MS to change the tide.

The other opportunity that exists is in the smaller OEM tier which mainly consists of system assemblers who are VARs at the same time. We will need to work closely with the Solution Provider group to explore how we can facilitate better sales through this channel. As we understand, they are mainly servicing small businesses and are selling productivity applications (Lotus) as well as networking solutions (Novell) in addition to systems and desktop operating systems. A program is urgently needed and should be supported by OEM and the Solution Provider group.

OEM Staffing

We will add a certain number of people in the field offices to support key OEM relationships on a worldwide basis. The accounts to be considered are the six largest U.S. customers as well as certain Solution Provider OEMs. These new account managers should be responsible for improving our local relationships and guard against competitive App deals.

OEM Marketing

Shortly after we finalize the forecast, we will tell the subs how much marketing funds they can expect. As a rule, subs should spend their money mostly on supporting DSP programs and some money should be allocated to support key OEMs when doing Chicago or Consumer Apps bundling promotions.