

# *Strategic Analysis*

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## INTRODUCTION

Microsoft began humbly in 1975, with a vision by a 19-year-old Harvard drop-out, to see a PC on every desktop (Microsoft Company Capsule, 2003). Today, Microsoft is a dominating, and some may say domineering, leader in multiple industries. Microsoft is listed in the Fortune 100 and has amassed an impressive portfolio of resources, alliances, global operations, customers and critics. One of their newest, and most profitable, entries is Microsoft Business Solutions, their enterprise software division. Through analyzing Microsoft's goals and values, resources and capabilities, competitive advantage and positioning, place in the enterprise software industry, competitive intelligence, strategic alliances, global operations and diversification strategies, this paper will synthesize recommendations for Microsoft's continued operations in the enterprise software industry.

## GOALS AND VALUES

Identifying a firm's goals and values is an imperative first step to understanding its strategy and positioning. Mission and vision statements, and their accompanying goals and values, "shape [a company's] strategic posture" (Pearce and Robinson, 1997, p. 29) and "provide guidance in the process of strategic decision-making" (Business Vision, 2003, para. 1). Microsoft has carefully identified a vision and mission, and along with them, values and tenets that shape the company's strategy.

### **Vision and Mission**

The purpose of a vision statement is to create "a view of what the enterprise might become" (Grant, 2002, p. 60). It is a "guiding image of success" which serves as a "blueprint" for the company's strategy (What's in a Vision, para. 5). A vision statement is so important that Tom Peters says that visioning is an "essential component of high performance" (ibid, para. 2). Microsoft began with Bill Gates' "early vision of a computer on every desk and in every home," which "seemed like a fantasy to most people" (Microsoft's Tradition, 2002, para. 3). Although profit maximization is necessary for the business foundation, it is not the inspired goal for many successful business people. Bill Gates continues to work at Microsoft rather than simply enjoying his personal wealth, because his vision "extends beyond the desire for wealth" (Grant, 2002, p.59). Bill Gates' passion about technology advance reflects in Microsoft's corporate vision:

*Empowering people through great software – any time, any place and on any device.*  
(Microsoft Annual Report, 2002)

Whereas a vision is an encompassing statement of future success, a mission serves to “communicate the essence” of the organization to stakeholders (What’s in a Mission, para.1) and describes “what the company is trying to achieve” at the present (Grant, 2002, p. 60). Microsoft’s mission is:

*To enable people and businesses throughout the world to realize their full potential.*  
(Microsoft Annual Report, 2002)

Combined, the vision and mission explain why Microsoft exists, and sets it apart from its competitors in terms of what it is trying to achieve (Business Vision, 2003). It is important to note that this vision and mission are new to Microsoft. For 25 years, the vision was “getting a PC on every desktop,” but as technology has shifted beyond the PC, to phones, PDAs, televisions, wireless internet and other seamless connections, Microsoft updated their vision and mission accordingly (Goldberg, 2000). This is an agile and market-driven company.

### **Values and Tenets**

“Core values reflect the deeply held values of the organization and are independent of the current industry environment and management fads” (Business Vision, 2003, para. 7). Microsoft has “recently articulated” (Living Our Mission, 2002, para. 3) a set of values:

- Integrity and honesty.
- Passion for customers, partners, and technology.
- Open and respectful with others and dedicated to making them better.
- Willingness to take on big challenges and see them through.
- Self critical, questioning, and committed to personal excellence and self improvement.
- Accountable for commitments, results, and quality to customers, shareholders, partners, and employees.

Microsoft has also defined tenants which they describe as “central to accomplishing our mission” (Living Our Mission, 2002, para. 4):

- |                                    |  |
|------------------------------------|--|
| • Broad Customer Connection        | • A Global, Inclusive Approach                   |
| • Excellence                       | • Trustworthy Computing                          |
| • Great People with Great Values   | • Innovative and Responsible Platform Leadership |
| • Enabling People to Do New Things |  |

Microsoft’s vision, mission, and goals reflect their belief that they are a leader in technology innovation and human advancement. However, it is important to note that 99 percent of vision statements are never actually realized, at least according to Nigam Arora, a change management consultant (Vision Today, Reality Tomorrow). Therefore, Microsoft must strive to achieve their vision and mission through a carefully implemented strategy.

## RESOURCES AND CAPABILITIES

Identifying a firm's resources and capabilities, and thus its core competencies, is a vital step to establishing corporate strategy and to achieving profitability (Grant, 2002). Resources and capabilities, in order to be strategically valuable, must be "superior to those of competitors" (Competitive Advantage, 2003, para. 6). Resources include assets specific to the firm and capabilities are the ability to utilize these resources effectively.

### Tangible Resources

Microsoft's tangible resources include both financial and physical.

- Cash Reserves: Microsoft has approximately \$38.6 billion in cash and short-term investments (Microsoft Annual Report, 2002), giving them a large amount of financial flexibility.
- Operating Revenue: Microsoft reports revenue in 2002 as \$28.4 billion (ibid), an increase of 12 percent over 2001<sup>1</sup>. Microsoft ranks as number 47 in the Fortune 500 (Microsoft Company Capsule, 2003).
- Liquidity: Microsoft's current liquidity rating is 4.15, much higher than IBM's 1.21 and Oracle's 2.16 (Microsoft Competitive Landscape, 2003), indicating an enhanced financial standing, because their liquid assets significantly outnumber their short-term liabilities.
- Financial Leverage: Microsoft is currently not highly leveraged (1.28) because of minimal debt, therefore they have the option of pursuing further debt financing in order to finance growth, if necessary in the future (ibid).
- Location and Size: Microsoft's "palatial" corporate headquarters (Microsoft Company Scoop) in Washington account for almost 8.4 million square feet, and the company has additional locations throughout the United States and the world, totaling almost 17 million square feet (Microsoft Annual Report, 2002).
- Property and Equipment: Of Microsoft's total P&E, almost half, 44.5 percent<sup>2</sup>, is related to computer equipment and software. Additional holdings include land and buildings, totaling \$5.9 billion before depreciation expenses (ibid).
- Distribution Channels and Customers: Microsoft has established distribution channels for its products, including online vendors and retailers. Microsoft also has an established customer base.

All of these tangible resources indicate that Microsoft has significant borrowing capacity, resilience, investment capacity and reserves.

### Intangible Resources

Intangible resources include technology, reputation and corporate culture. Microsoft's technological resources include its research capacity and intellectual property portfolio.

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<sup>1</sup>  $(2002-2001)/2001 = (28365-25296)/25296$

<sup>2</sup>  $2621/5891$

- Research and Development: Microsoft employs almost 700 people purely dedicated to long-term future-focused research, in five lab facilities throughout the world, investing more than \$5 billion in these research and development activities. Bill Gates commented, “Without basic research, we cannot create the technology foundations for future generations to build on.” (Bill Gates and Microsoft Research, 2001, para. 2 and 6) Additionally, 22,418 Microsoft employees, or 41.5 percent, are employed in research and development functions, showing dedication on the part of Microsoft to this important facet of their strategy (Fast Facts, 2003).
- Intellectual Property: Microsoft maintains a large patent portfolio. In fact, in 2002, Microsoft acquired \$25 million in patents and licenses (Microsoft Annual Report, 2002). Microsoft has so many patents and other forms of intellectual property, that there is now a running joke that Bill Gates has patented the numbers one and zero (Microsoft Patents, 1998).

In addition to technological resources, Microsoft’s primary intangible resources lie in its reputation and brand. The *Financial Times* ranks Microsoft just after Coca-Cola, as the number two most valuable brand name in the world (Grant, 2002) and Harris Interactive lists Microsoft as one of the top ten “best brands,” along with Sony, Ford, and General Electric (Taylor, 2001). Additionally, Microsoft’s reputation is another of its strongest resources. Even though Microsoft is often the company that CIOs love to hate (Koch, 2003) (usually because of their market dominance, not necessarily their products or core business), and is noted for its aggressive posturing among its competitors, *PR Week* notes that Microsoft actually ranks number one in terms of media reputation, including factors such as emotional appeal, vision and leadership, social responsibility and financial performance (Calabro, 2003). Additionally, *Fortune* ranks Microsoft as the number three most admired company in the world (Microsoft Company Capsule, 2003).

Microsoft’s culture is an additional intangible resource. It can be described as casual (The Student’s Guide, 2001), fun, team-oriented (Vault Reports, 1998) and intense (Microsoft Company Profile, 2003). Employees are valued for their contributions (Vault Reports, 1998) and “pride themselves on being hardcore; on believing fully in the firm’s vision for technology in the future and on being ruthless in competing with those who would block that vision” (Microsoft Company Profile, 2003, para. 3). Such a highly dedicated workforce, developed through a strong culture and identity, “represents a significant competitive advantage” (O’Reilly, 1989, p. 17).

Intangible resources are immeasurably more important than tangible resources because they are less easily copied by competitors. Microsoft is in a strong position regarding intangible resources due to its technological capacities, brand equity and cultural intensity.

## **Human Resources**

A company’s human resources can be measured in terms of its employee’s qualifications, commitment and compensation rate. While Microsoft typically pays about 20 percent less than its competitors, they intend to lead the

market “in terms of total compensation” (Vault Reports, 1998, p. 88). Microsoft employees do not work for Microsoft because of their compensation plans, but because of the intrinsic rewards of working for a well-regarded brand. Primarily because of its reputation for excellence, Microsoft has succeeded in attracting the best employees around the world. Microsoft recruits from only top-ranked schools, has its choice of talent from almost 400,000 applicants per year, boasts a minuscule four percent turnover rate, and is ranked as one of the 100 Best Companies to Work For (Fortune, 2003). Microsoft is able to attract and retain the best talent in the information technology business. Their employees are educated, dedicated and committed to their company, and this loyal and intelligent employee base is a very strong resource for Microsoft.

### **Capabilities**

Beyond identifying resources, a firm should leverage those resources into capabilities, in order to determine competitive advantage. Microsoft has many capabilities that enable them to use their resources effectively by being embedded in company routines, including:

- Financial control
- Capacity for decision making
- Dedication to continuous improvements
- Ability to identify and respond to market trends
- Research capability
- Management of mergers and acquisitions
- Speed of product development
- Brand management and promotion
- Engineering and technical know-how

Microsoft’s core capabilities allow the company to dominate the market and to shape the direction of the technological future.

### **Weaknesses**

In addition to this strong set of core competencies, Microsoft possesses some very real weaknesses, most related to perception and image as well as consumer preferences. Weaknesses related to perception include: resentment on the part of consumers to continually upgrade and license Microsoft products; the perception among consumers that their products are not as secure as others; and a reputation as a “category killer” regarding market domination. Additionally, IT purists, namely those in Silicon Valley, refer to Microsoft as “the evil empire” which has become too jaded and can no longer compete with the newer companies (Goldberg, 2000).

Microsoft’s weaknesses related to consumer preferences include: possible over-saturation in the market of their consumer software products; shifting market desire towards open source software; and developing technologies that allow consumers to be less tied to their PCs and the software that runs on them (ibid).

Microsoft must develop a strategy to defend against and manage these key weaknesses.

## **Superfluous Strengths**

In addition to acknowledging weaknesses, companies must also consider which strengths they possess that may be relatively superfluous. Microsoft's main superfluous strength is rooted in its financial leverage, which allows it to invest in a myriad of activities and innovations that are unrelated to its core competencies. Two examples are its alliance with NBC to create MSNBC and its creation of online travel guide Expedia. Microsoft terms this "betting on the future," assuming that investments in areas such as television and travel will reap rewards later, while critics term this "Microsoft's crapshoot" (Goldberg, 2000). If the company is able to leverage these type of investments into new growth technology, they will have successfully turned an apparent inconsequential strength into a new resource (Grant, 2002), but otherwise, they will be relying on a superfluous strength.

## **Appraisal and Implications**

After identifying key resources and capabilities, it is necessary to determine which are most critical and then to develop a plan for exploiting the key strengths while managing the weaknesses. In order to be key success factors, resources and capabilities should be sustainable, scarce, relevant, and not easily transferable or replicable.

Based on this assessment, Microsoft's key success factors are:

- Financial strength, flexibility and leverage
- Dedication to research and development
- Ownership of significant intellectual property
- Brand equity and reputation
- Knowledge of market trends and ability to respond quickly

While many companies have one or more of these factors, none have this distinct combination or the depth in each area that allows these factors to make a disproportionate contribution to customer value and firm efficiency. Thus, they are scarce and relevant to the market. Additionally, because these factors are highly intangible and deeply embedded within the values and history of Microsoft, they are largely immobile and not replicable by competitors. In order to truly leverage these success factors to continued growth, Microsoft must also continue to manage weaknesses.

## **COMPETITIVE ADVANTAGE AND POSITIONING**

Microsoft largely pursues a long-term positioning strategy of differentiation, emphasizing branding, software design, quality service and innovation, as opposed to a low-cost strategy, which emphasizes economies of

scale and reduction of input costs. A differentiation strategy, according to Michael Porter, “calls for the development of a product or service that offers unique attributes that are valued by customers and that customers perceive to be better than or different from the products of the competition” (Porter’s Generic Strategies, 2003, para. 7). Companies that pursue a differentiation strategy, such as Microsoft, are common in that they have access to research, highly skilled employees, a strong sales team and a reputation of excellence (ibid). Thus, in order to compete on differentiation and charge a price premium to consumers, Microsoft must insure that it creates and maintains uniqueness in the industry, in terms of both tangible and intangible product characteristics. Additionally, Microsoft must exploit their dedication to innovation.

### **Drivers of Uniqueness**

Drivers of uniqueness include both tangible and intangible product characteristics. Tangible characteristics of differentiation include product reliability, consistency, availability of accessories, sales service, speed of delivery and availability of upgrades. Intangible characteristics include social and emotional considerations and desire for status and identity. Additional drivers of uniqueness, which the firm maintains control over, include: intensity of marketing activities, embodied technology, quality control process and skill of employees. Firms competing with this strategy must also maintain high product integrity and consistency. (Grant, 2002) It is these characteristics which differentiate a firm’s offerings and for which consumers will pay a price premium. Microsoft embodies each of these characteristics, especially: availability of product upgrades, strong after-sales services, well-trained employees and an emotional connection to Microsoft products (particularly in always having the latest Microsoft product) in the minds of consumers.

### **Exploiting Innovation**

Because Microsoft competes in a technology-intensive industry, it is particularly important to explore how competitive advantage and differentiation are achieved in such a complex competitive environment, which includes factors of innovation, application of technology and control of industry standards. Essentially, innovation is the “commercialization of invention” (Grant, 2002, p. 333), not the invention itself. Therefore, a company such as Microsoft can achieve a large market share by not inventing much, but instead by perfecting and commercializing the technology appropriately. In fact, the point can be made that Microsoft has not truly invented anything (Wheeler, 2002), except the animated paperclip (Goldberg, 2002), but has instead been a perpetual follower in the industry. But, it is not enough to be an innovator; a company must be able to earn sustainable profits as well. Many

innovative companies are small and limited in resources, and they therefore struggle to turn a profit. Through its resources and capabilities, Microsoft has been able to continue to innovate (with dedication to research and development and the tacit knowledge of its employees), while being able to use its brand equity to also commercialize the innovations. Microsoft has succeeded in appropriating returns on their innovations primarily through patents and licenses, as well as through establishing industry standards.

Microsoft's competitive advantage is differentiation through a unique combination of tangible and intangible product characteristics as well as a drive to innovate and protect those innovations. Because of these drivers, customers have been willing to pay a price premium to own Microsoft products.

## INDUSTRY ENVIRONMENT

Not only must a company clearly understand their own goals, resources, capabilities and advantage, but they must be able to understand where they function within an industry environment. The nature of business is competition, and it is this context in which an industry analysis is performed in order "to develop an edge over rival firms" (Porter's Five Forces, 2003, para. 2). This analysis will begin with a description of the enterprise software industry and will follow with a break-down of the macro-level influences on this industry.

### **Enterprise Software Industry**

Microsoft competes in multiple industries, due to its diverse product line, including: desktop platforms, productivity software, internet access and video game consoles. The focus of this analysis will be on the enterprise software industry. Enterprise software is an attractive industry to firms such as Microsoft, given that revenue is double that of consumer software (\$200 billion compared to \$100 billion). Enterprise software is "any software used by an enterprise ... regardless of size," including customer relationship management (CRM), enterprise resource planning (ERP), human resource systems (HRMS), supply chain management (SCM), as well as accounting, financial, and ecommerce software. (Enterprise Software Definition, 2002) Applications serve to link the various business units of a company through automation, databases and web-driven technology, thereby creating "better-informed management, more efficient operations, lower costs, and higher profits" (Enterprise Software Overview, 2000, para. 3). Enterprise software is an expensive investment for businesses, and thus big business for providers, costing Fortune 500 companies between \$40 million and \$250 million for the initial investment, plus the costs of upgrades, which can cost up to 30 percent of the original price (Koch, 2002).

Microsoft entered the enterprise software industry in 1993 with the introduction of Windows NT (Key Events in Microsoft History, 2003), and has since grown their enterprise software division into Microsoft Business Solutions. Microsoft entered this industry in order to maintain financial growth once the consumer software industry became saturated with their products. Microsoft's enterprise software revenues in 2002 were \$5.11 billion, a growth of 25 percent<sup>3</sup> from 2000. Almost 20 percent of Microsoft's 2002 revenue was attributed to this industry segment<sup>4</sup>. (Microsoft Annual Report, 2002) Microsoft's products in this arena include: Windows Server, .NET, SQL Server, developer tools, integrated business software applications and consulting services. Microsoft bases much of their enterprise software on their .NET infrastructure, "which is designed to facilitate a simpler connection of disparate systems and improve integration with external Web services such as credit checking, analytics and marketing automation services" (ASP News, 2003, para. 3).

### **Porter's Five Forces Framework**

By identifying key attributes of an industry, "we can determine which macro-level influences are important for the firm and how they are likely to affect the firm's relations with customers, suppliers, and competitors" (Grant, 2002, p. 67). Michael Porter's high level Five Forces framework can be used to analyze the attractiveness of an industry. The Five Forces include: (1) industry rivalry, (2) threat of new entrants, (3) threat of substitutes, (4) bargaining power of suppliers and (5) bargaining power of buyers. "Complementors" is often added as a sixth force.

(1) Industry rivalry: HIGH. There is considerable rivalry within the enterprise software industry. The intensity of industry rivalry within the enterprise software industry is affected by several factors: (1) the concentration of competitors, (2) diversity of competitors, (3) product differentiation and (4) price differentiation. First, there is a high concentration of competitors within the industry. Several large multinational vendors and a handful of smaller localized firms compete in the enterprise software industry. Industry leaders are Oracle, PeopleSoft, Baan, J.D. Edwards, and SAP, which together comprise over 60 percent of the market (Madden, 1998). By one count, there are over 10,000 vendors currently competing in this industry (Enterprise Software Definition, 2002).

Second, the companies within the enterprise software/server platforms industry are very diverse. Many of the companies have very specific skill sets that concentrate on segments of the industry while a few have very general skills that apply across the board. Since the edges of the industry are not clearly defined, several of the

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<sup>3</sup> Revenue in 2000 was \$4.08 billion

<sup>4</sup>  $5183/28365 = 18.3\%$

larger companies not only produce and consult on hardware and software, but also manufacture operating systems, general computer software, and development platforms.

Third, there is considerable product differentiation within the industry. Enterprise software applications can be tied together in a myriad of ways and run on various platforms. The products are differentiated by being focused on different size enterprises, levels of customizability, and varying deployment and development times. Fourth, considerable variation in price exists within the industry and there is a significant amount of price competition. The boundaries of the industry are blurred and companies tend to fluctuate their pricing schemes depending on the total number of licenses purchased. Prices vary depending on the size of the client, the client's existing systems, the types of software required, the amount of consulting required, the amount of training required, and the amount of technical support required.

(2) Threat of New Entrants: LOW. For several reasons, the threat of new entrants to the industry is somewhat low. First, the capital requirements to enter the industry are very large. The cost to design and develop enterprise software is extremely high due to the large amount of time it takes to do so successfully and the limited availability of people who possess the required proprietary knowledge. The software development process is quite long and expensive due to the reality of the software development lifecycle. There is also a limited amount of skilled personnel who can successfully develop and consult on enterprise software. Such skilled employees also come at great expense. Second, the companies within the industry have already achieved economies of scale, thereby reducing the potential profit that a new entrant could obtain. In general, the companies within the industry have already achieved absolute cost advantages because of the length of time that they have been participating in the industry. Third, there is considerable product differentiation within the industry. The major companies have very strong brand names and tend to invoke strong customer loyalty. Compatibility issues also play a role in loyalty because of the high switching costs associated with changing vendors. Lastly, proprietary knowledge and existing intellectual property are important components of competing in this industry, which inhibits new entrants.

If a new company were to attempt to enter, the major players would most likely react immediately. Since the technology used in the software industry requires it to be compatible with other software and continue to be supported, the existing companies could intentionally create compatibility issues by altering their platforms or halting the support of platform or hardware. However, if a new company had a promising piece of software or skilled employees, it is most likely that one of the major companies would takeover the new firm in order to acquire the technology for themselves.

(3) Threat of Substitutes: LOW. There are few substitute products that compete with enterprise software. The old way of maintaining and sharing company information was manual paper archival systems or printed reports from separate databases. The modern way of connecting all of a business's information requires enterprise software. A business could continue with building multiple disparate systems, however, they would never be able to achieve what an enterprise software business solution could provide. Therefore, enterprise software is more flexible, scalable, and less expensive than the older types of solutions. The near absence of modern substitutes in the industry is a good sign for the companies within the industry.

(4) Bargaining Power of Suppliers: LOW. Within the industry, the bargaining power of suppliers is quite minimal. The main reason is because there are few suppliers with whom the companies must negotiate. The fact that enterprise software applications are an intellectual and intangible product rather than a physical product minimizes the number of suppliers required. The main type of supplier that an enterprise software company most likely has to deal with is one that physically records the media. Since the cost of physically transferring the software to media is minimal, the media producers and manufacturers have little effect on the industry as a whole.

(5) Bargaining Power of Buyers: LOW. The bargaining power of buyers within the enterprise software industry is fairly minimal for several reasons. First, the concentration of buyers is growing quickly; however, they are a very diverse and non-unified group, because they all have different backgrounds and needs. Second, more companies are deciding that enterprise software is a necessity for their business. Therefore, they are often willing to pay the going rate. Lastly, there are extremely high switching costs from one supplier to another, due to the high cost of the related infrastructure for these types of systems.<sup>5</sup>

(6) Complements: HIGH. There are many types of complementary products related to the industry. Complementary products "have a positive impact on value" (Grant, 2002, p. 90). In general, most technology products are complementary in the sense that they add functionality and therefore value to the user. The software industry thrives on complementary products by adding functionality and flexibility to existing products. Since the software and hardware must interact with each other and be compatible in order for the user to gain the benefits of the products, many companies within the industry share their source code with other manufacturers so that third party companies can build add-ons that are compatible (Graber, 2003). For example, "Microsoft shares Windows code with governments, companies and educational institutions under various programs that are part of its Shared Source Initiative" (Evers, 2003, para. 10). In 2001, Microsoft released the source code for the Windows CE

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<sup>5</sup> Much of the industry information provided within the Porter's Five Forces framework is from authors' personal knowledge

operating system. By doing so, Microsoft has given companies the ability to develop software and innovative products using Windows CE. (Windows CE 3.0, 2001)

The enterprise software industry is highly fragmented and intensely competitive, therefore shakeout is inevitable in the next few years (Porter's Five Forces, 2003). It is also a growing industry, that is growing even quicker than many industry analysts initially predicted (Evans, 2002). Microsoft's strategy will need to involve not only how to compete in such a fragmented yet attractive industry, but also how to survive when the shakeout occurs.

## **INTRA-INDUSTRY ENVIRONMENT AND COMPETITIVE INTELLIGENCE**

The intra-industry environment of enterprise software is rapidly changing. Cooperation, deterrence, commitment, and signaling are all commonly used tactics within the industry to improve, steer, and shape the industry. This industry is also highly segmented.

### **Cooperation**

In general, technology requires the use of cooperation between companies. Because technology changes so quickly, standardization is a very important aspect of cooperation. If a company were to create a great product that was unique and did not interface with any other technology, it would be useless. Standards allow for consistent development and let customers know that what they are purchasing will interface with other products. For example, "Microsoft has united with partners and competitors, including rivals IBM and Sun Microsystems to support web services standards" (Dougherty, 2003 p. 30).

For example, Microsoft's .NET Framework and the collaboration between IBM and Sun Microsystems on Java in the web services arena is the latest technology. It is predicted that by 2005, two-thirds of all software will be distributed using one of the two technologies. Both .NET and Java use Extensible Markup language (XML). XML is a standard that is maintained by the World Wide Web Consortium (W3C). Both Microsoft and the IBM/Sun Microsystems collaboration work with the W3C to shape what new XML standards will be. This furthers the technology and generates standards that benefit the entire industry. (Computer Software Industry, 2003)

### **Deterrence and Commitment**

At times, the use of deterrence and commitment within the industry are commonplace. Companies use licensing, compatibility and proprietary issues in the power play to shut out others from making claims of market share. For example, several years ago when Microsoft prevented Netscape Navigator from shipping with newer

versions of the Windows operating system, they were deterring consumers from using Netscape's product. Also, when Microsoft did not include the Java Virtual Machine (JVM) in Internet Explorer, they were deterring consumers from using it and promoting the use of their own Active-X technology. For deterrence to be effective, it must be backed by commitment (Grant, 2002). Both Microsoft and the IBM/Sun Microsystems collaboration have committed to the future of web services. Since both groups are so powerful and they have each staked their claim in the web services arena, there will most likely be no new competitors entering with a new technology to compete with web services over the next few years.

### **Signaling**

The industry as a whole uses signaling to selectively communicate to competitors. Typically, the larger software companies such as Microsoft will release information in an attempt to influence other companies within the industry. They do so for two reasons: (1) to attempt to steer a company in a certain direction and (2) to misinform or deceive a company into thinking that they will be performing a certain action.

### **Segmentation**

The enterprise software industry is a complicated one with thousands of customers. On the demand side, there are three main segments of the industry, based on customer size:

- Large: Companies with more than \$1 billion in revenues
- Midsized: Companies with \$50 million to \$1 billion in revenues
- Small: Companies under \$50 million in revenues  
(Hamerman, 2002, para. 7)

Microsoft has chosen to compete primarily in the midsize and small segments of this industry, offering applications to mid-size and smaller companies, with revenues of between \$50 million and \$250 million (Hamerman, 2002).

David Thacher, general manager of Customer Relationship Management at Microsoft Business Solutions, says that a key mission of Microsoft is to "give midmarket businesses the tools they need to succeed on their terms, their schedules and their budgets" (ASP News, 2003, para. 4).

On the supply side, the industry is segmented into four major categories:

- Tier 1: Full service vendors that create complete end-to-end solutions
- Tier 2: Vendors which focus on one major functional application for certain industries (such as HRMS)
- Tier 3: Startups that focus in niche solutions
- Consulting: Firms which assist clients in integrating their new business enterprise solutions  
(Enterprise Software Industry, 2003)

Microsoft competes in the Tier 1 segment, as it offers applications in every major area, including consulting services, and for customers in every major industry.

Understanding the intra-industry environment has important strategic implications. Microsoft's strategy in differentiating itself from the competitive landscape is to capitalize on the fact that most businesses run Microsoft desktop products already, and would most likely want to have their enterprise systems easily tied to their desktop solutions. For example, a smaller company would likely rather have a CRM system that can be tied into the Outlook systems their sales consultants were already using. (Hamerman, 2002). In order to develop this positioning strategy, Microsoft had to have a clear picture of competitive intelligence.

## STRATEGIC RELATIONSHIPS

Strategic alliances are "unique organizational structure[s which] enable cooperation between companies" (Gomes-Casseres, 2000, p. 1). They help to spread risk, mitigate costs, and shape future opportunities (ibid). In today's highly specialized, yet also seamless, competitive landscape, alliances have become a necessity (Doz and Hamel, 1998). Microsoft maintains many partnerships and alliances to help further its goals.

### Microsoft Partners

Microsoft maintains strategic alliances with firms for multiple reasons and in multiple industries. For instance, Microsoft and UUNET have signed a number of agreements, enabling UUNET to add value to its products and services, and promote the growth of Internet commerce through joint efforts with Microsoft (UUNET Annual Report, 1995). Additionally, "Microsoft has been investing in a slew of companies offering competing solutions to address the coming convergence between the TV and the PC" (Gomes-Casseres, 2000, p. 2). Microsoft has also formed an alliance with JDA Software Group Inc., to deliver .NET to retail, wholesale and consumer packaged goods industries. "The result will be a seamless sharing of data" (Microsoft Forms Strategic Relationship, 2002, para. 8). Another recent alliance is with ScanSoft. Microsoft has licensed the image segmentation, compression and viewing technology from ScanSoft while ScanSoft gets the benefit from Microsoft's electronic document creation and sharing (Microsoft and ScanSoft, 2000).

### Enterprise Software Alliances

In the enterprise software arena, Microsoft maintains four significant alliances: IBM, Fujitsu Seimans, Citrix, and HP. Each provides cospecialization benefits for both Microsoft and the partner. Microsoft's Business

Solutions group explains that “the decision to work closely with these companies is based on IBM as the world’s largest information technology company, Fujitsu Seimans’ powerful commitment to the mid-size market, the outstanding products from Citrix, and HP with their unique and extensive IT partnership experiences” (Microsoft Business Solutions Partners, 2003, para. 3).

- IBM: The alliance with IBM allows Microsoft enterprise applications to run on IBM servers. For customers, the benefit of the alliance is that “all parts of your solution hardware, software, and middleware will install quickly, start up easily, and run reliably” (ibid, para. 8).
- Fujitsu Seimans: This alliance means that Microsoft solutions are tested on Fujitsu Siemens PRIMERGY servers, allowing IT consultants to “meet their customers needs regarding performance, availability, and security” (ibid, para. 13).
- Citrix: “The combination of Citrix and Microsoft Business Solutions can streamline a customer's organization by giving the entire enterprise access to business-critical information, enabling central administration and reducing the costs associated with reaching remote sites” (ibid, para. 16)
- HP: This alliance has succeeded in jointly developing the HP AXAPTA Sizing Tool (ibid).

Additionally, Microsoft maintains an alliance with Dell which is designed to help “businesses reduce the complexity and cost of deploying a server based environment” and to “create a comprehensive and integrated set of distributed computing services” using both Dell and Microsoft technologies (Dougherty, 2003).

In addition to alliances, Microsoft has made a number of acquisitions to further its role in the enterprise software industry, including Navision and Great Plains (Hamerman, 2002). Microsoft Business Solutions has a stated strategy: “To be the leader in providing high value interconnected business solutions to small and mid-market businesses through a global network of partners dedicated to lasting customer relationships” (ibid, para. 17). They have surmised, therefore, that to achieve market leadership, they must establish strategic partnerships.

## GLOBAL OPERATIONS

Globalization is one of the most important forces currently changing the competitive landscape (Grant, 2002). By its nature, software and information technology are global industries, and Microsoft is no exception.

### Global Presence

Microsoft has been a player on the international scene since 1982 when an office was opened in the United Kingdom. Three years later, in 1985, an Ireland site became the first non-US location of a Microsoft production facility. (Key Events in Microsoft History, 2003) As of June 2002, 34 percent of Microsoft’s employees work outside of the United States and 27 percent of total revenues come from international sales. Microsoft operates three

regional headquarters (Asia, EMEA<sup>6</sup>, and Eastern Europe), two internationally-based research labs (China and United Kingdom), and has subsidiaries in 78 countries (mainly sales offices), supplying products in 26 different languages. (Fast Facts, 2003) Analysis suggests that Microsoft operates a successful transnational strategy of local responsiveness and global integration. Microsoft responds to local needs when creating specific language versions of their products as well as responding to local needs (for example, in China, a user can transfer MS Word characters from simplified Chinese to traditional Chinese, and vice-versa<sup>7</sup>). Further, Microsoft manages its global business on an enterprise-wide scale, providing identical functionality and source code regardless of the location.

### **Enterprise Software Global Presence**

Despite twenty years of international growth in consumer software, Microsoft's enterprise software is far from having a global presence. While the Business Solutions group boasts that enterprise software solutions are available in over 120 countries (Worldwide Locations, 2003), 90 percent of the Microsoft's business in enterprise software comes from North American and European clients. Microsoft is making acquisitions and alliances in order to boost their international presence. The recent acquisitions of Navision, a Danish company, and Great Plains, which has an HRMS product in the UK and a financial product in Germany, will help. (Hamerman, 2002) Additionally, their alliance with Fujitsu creates collaboration between the companies "on global promotion and development of Microsoft's .NET Enterprise Server products and Fujitsu's COBOL development tools" (Fujitsu Software Corporation, 2000).

### **Barriers to Globalization**

Before globalizing their enterprise software completely, however, Microsoft must face two particular obstacles: barriers to trade and the localization of their products.

Barriers to trade. Because of Microsoft's policy of not opening source codes of their products, many international governments have shied away from allowing Microsoft products past their borders. These governments share concerns that without the source code, they may have international security issues. The most recent example happened in China. Both the defense department of China and the Beijing City government decided to choose the Linux system instead of Microsoft because of the security issues. (Why Gates Provides, 2003)

Localization of products. Two major items need to be considered when exploring localization of enterprise software applications: language needs and the complexity of business solution packages. Local subsidiaries in each

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<sup>6</sup> Europe, Middle East, Africa

<sup>7</sup> Author's personal knowledge

country or region are now responsible and capable for the language transfer of the products. Furthermore, the factors involved in solution design including solution deployment and customization, integration with current applications, and hardware set-up and optimum, are achieved internationally only through alliances with companies such as IBM. (Gates Pushes Better Support for Hardware, 2003)

While Microsoft faces challenges in expanding its enterprise software globally, it has succeeded on an international scale in the past, and an international scope is necessary.

## DIVERSIFICATION AND MULTIDIVISIONAL MANAGEMENT

“A company’s conceptualization of its business scope may change radically over time” (Grant, 2002, p. 444). Microsoft’s goals have evolved from being simply a software supplier, to being a firm that has attempted to epitomize the new developments in seamless technology, including networking software, information services, entertainment, and more. Microsoft has diversified into a number of areas in order to mitigate market saturation, as well as to achieve market power.

### Product Lines and Divisions

Microsoft’s primary product lines currently include:

- Business Software
- Development Tools
- PC Games
- Home Productivity
- Hardware
- Xbox Games
- Operating Systems & Servers
- Internet Technologies
- Kids
- Reference Software
- Macintosh Products
- Xbox Hardware

Subsidiaries include Avandade, Microsoft Network (MSN) and MSNBC. (Product and Technology Catalog, 2003 and Microsoft Company Capsule, 2003). This break-down is a far cry from Microsoft’s beginnings as nothing but a “supplier of microcomputer operating software” (Grant, 2002, p. 444). The diversification into the world of video games and video game consoles is particularly interesting.

Xbox Development. Microsoft introduced their first PC game, *Age of Empires*, in 1997. Because of the success of the *Age of Empires* series, Microsoft decided to completely enter the gaming industry in 2000, with the introduction of Xbox hardware through the acquisition of Ensemble Studios Inc. (Planetxbox, 2003) Microsoft views this as a strategic move to compete against Nintendo and Sony, and also to encourage more sales of PCs (Thurrott, 2003).

The move into the enterprise software industry is another example of Microsoft’s diversification strategy.

## **Motive for Diversification**

Microsoft has made a strategic move to be less dependent upon the PC, as that industry, and the industries related to it (such as desktop software) mature and eventually decline. This is reflected in the evolution of its mission statement, its dedication to research into new areas of technology, and its diversification into a wide variety of industries and product lines. “By transforming itself from a traditional software provider to a broader technology services company -- fueled by its .NET initiative -- Microsoft hopes to position its operating systems, software, and services as a de facto standard for accessing, communicating, and doing business over the Internet” (Microsoft Company Capsule, 2003, para. 4). Microsoft believes that it has extended its market power through this diversification and that it will achieve higher revenues in the future, as PCs become less popular. Bill Gates recently addressed the question of diversification:

“We’re sitting at a pretty interesting juncture. Handwriting recognition, speech recognition, B2B, easy inter-operability, decent development tools: All of these things we’ve dreamed about for the last 20 years. But it’s only now that the right level of power in the systems and the right kind of R&D to take on these tough problems is really in place.” (Chan, 2002, para. 13)

According to Gates, then, diversification is a logical progression from where Microsoft has come. While varied, their product lines and divisions have a common linkage which answers the question “What business are we in?” (Grant, 2002, p. 479): empowering and enabling consumers through the use of technology.

## **Managing the Corporate Portfolio**

Microsoft successfully manages their diverse product lines through a classic M-structure, headquartered in Redmond, Washington, with specialized divisions to manage various product lines and geographic locations. A look at Microsoft’s executive team reveals the depths of their commitment to M-structure. Some of the titles represented include:

- Chief Executive Officer of Europe, Middle East and Africa
  - Corporate Vice President, .NET
  - Corporate Vice President, Home Products & Services Division
  - Corporate Vice President, Mobile Devices Division
  - Corporate Vice President, Network Service Providers
  - Corporate Vice President, Windows Client Group
  - Corporate Vice President, Home and Retail Division
  - Senior Vice President, Microsoft Business Solutions
  - Chief Xbox Officer
  - Corporate Vice President, Developer Tools
  - Corporate Vice President, Windows Management
  - Corporate Vice President, MSN
  - Corporate Vice President, Tablet PC
  - Corporate Vice President, Microsoft Office
  - President, WebTV Networks
- (Microsoft Executives, 2003)

These executives are empowered to make decisions at the divisional level, easing “the information and decision-making burden on top management” (Grant, 2002, p. 475). Microsoft’s divisional portfolio is a carefully managed

balance of products which includes some that are weakening (such as the Xbox), others that are growing (such as Business Solutions), and still others that are stable “cash cows” (such as the Windows Operating System and Microsoft Office products), which help to feed the others.

The enterprise software division, Business Solutions, can be considered a “star” according to BCG’s matrix and in a “build” stage on GE/McKinsey’s matrix. The division has grown quickly and is poised to continue to grow, especially with the support of Microsoft’s other existing product lines.

This diversification has made Microsoft more attractive to investors ever since the antitrust ruling (Kawamoto, 2001), and as long as Microsoft utilizes its resources and capabilities in new areas, and continues to manage them appropriately, diversification will continue to be a winning strategy for the company.

## CONCLUSION AND RECOMMENDATIONS

Microsoft’s entry into the enterprise software industry is consistent with their mission of enabling businesses to realize their full potential. Further, they have successfully leveraged their core competencies of financial stability, research capacity and brand equity to survive in this aggressive and segmented competitive landscape. Because the enterprise software industry is growing, and Microsoft has had a strong showing so far versus major competitors, it is recommended that they continue to compete in this industry while sustaining their competitive advantage and brand equity. In order to navigate successfully through upcoming trends in enterprise software, several recommendations have been developed based on the preceding analysis, related to managing weaknesses and investing in growth.

### Trends in Enterprise Software

In the upcoming years, Microsoft Business Solutions will need to respond effectively to the following trends:

- A likely shakeout and industry consolidation;
- Continued growth in enterprise software as businesses become more web-centric;
- Move from proprietary software on desktop PCs to open source software on multiple devices (phones, PDAs, televisions, etc.)
- Emergence of new networking technology such as .NET.

By developing strategies which react to these trends, as well as managing weaknesses and investing in growth, Microsoft will be well-positioned for future advance in enterprise software.

## Managing Weaknesses

While investing in growth, Microsoft must also acknowledge their weaknesses and work to manage and minimize them. They have successfully begun to address weaknesses in many consumer preference areas, such as the over-saturation of the consumer software area by diverting into enterprise software. Significant weaknesses related to perceptions and security must also be managed.

Migrate perceptions and re-brand. While Microsoft has successfully begun to alter its reputation among consumers, many IT purists and CIOs remain leery of Microsoft products because of their image as “the evil empire.” To manage this weakness and repair their tarnished image, Microsoft should re-brand as a company that serves to make business function easier and seamlessly, through enterprise software solutions.

Address security concerns. As technology becomes more seamless, and as devices outside of the PC are used more extensively, consumers are becoming more concerned about security, especially in the enterprise software area. Microsoft is poised to shape consumer preferences in this area, but to do so, will need to spend considerable revenues in researching and responding to security concerns.

## Investing in Growth

Because enterprise software is a “star” for Microsoft, and ranks in the “build” category, they should use their cash reserves and revenue generated from desktop software (“cash cow”) to invest in growth, while divesting of their “dogs” (such as Xbox), so that more cash can be devoted to enterprise software. Microsoft is in an enviable position to spend the money necessary to compete effectively in the industry. By innovating, creating demand, investing in competitors and going global, Microsoft will invest in growth.

Innovate. Microsoft should continue their tradition of innovation through applying this tradition to enterprise software, especially through .NET. Suggestions include:

- Create an educational version of their enterprise software products that can be licensed to colleges and universities. This slightly less-functional software would allow students to learn Microsoft solutions prior to graduating while providing Microsoft with a base of committed customers.
- Develop enterprise software that is not platform dependent, so that Microsoft solutions can be used on multiple systems. This is in line with their vision of creating solutions that can be used any place, anywhere, and on any device.
- Develop enterprise software that can be viewed on PDAs, phones, and other mobile devices. Currently, the Office products have been developed for this use, but enterprise software has not. By building this functionality into business solutions, Microsoft will be able to take one step further to their vision.

Besides developing these new technologies in-house, Microsoft should also research the viability of making further strategic acquisitions to expand their offerings. By responding to market needs for further innovation, Microsoft will be able to build robust applications that will allow them to be poised for future growth.

Create demand. Microsoft already has an established customer base but can create even further demand by specifically targeting client companies in industries that do not traditionally use enterprise software. These companies rely on Microsoft desktop software, and may be willing to jump to enterprise software with a trusted brand such as Microsoft. As the only enterprise software vendor who can offer complete end-to-end integrated products, from email and productivity software, to platforms, servers, and applications like CRM and SCM, Microsoft has a unique opportunity to leverage their penetration of the desktop software market into further demand of their enterprise software products. A further strategy to create demand is to continue to enhance their current applications so that current customers become future customers through product upgrades.

Invest in competitors. Because of a likely consolidation in the enterprise software industry, Microsoft should be poised to invest in, ally with, and possibly acquire, competitors. It is recommended that Microsoft strategically focus on smaller niche companies that provide products in areas they are currently lacking, or who compete in segments that Microsoft does not currently.

Move further into global markets. As has been mentioned, Microsoft has operations in almost 80 countries, yet their enterprise software is sold primarily in the North American and European markets. To further grow this division, Microsoft needs to penetrate Asian markets. To achieve this, Microsoft should research potential Asian opportunities and then develop enterprise software that is specifically marketed to companies in this region. They should also continue entering into alliances with other vendors that allow both partners to maximize on the benefits of reaching into this market. Additionally, Microsoft will need to continue to be flexible about releasing their source codes in order to appease Asian governments.

By staying true to their vision of empowering and enabling consumers through technology, Microsoft has become a strong competitor in the enterprise software industry. Their strategy of divisionalized management, hedging through investing in multiple businesses, and focusing enterprise software on small and mid-markets has succeeded, and these strategies should be continued. When combined with the recommendations above, Microsoft will become a formidable force in the enterprise software industry, and thus survive an eventual shakeout. While most likely not dominating this industry as they have in desktop software, Microsoft will be able to leverage their core competencies into a key advantage against their competitors.

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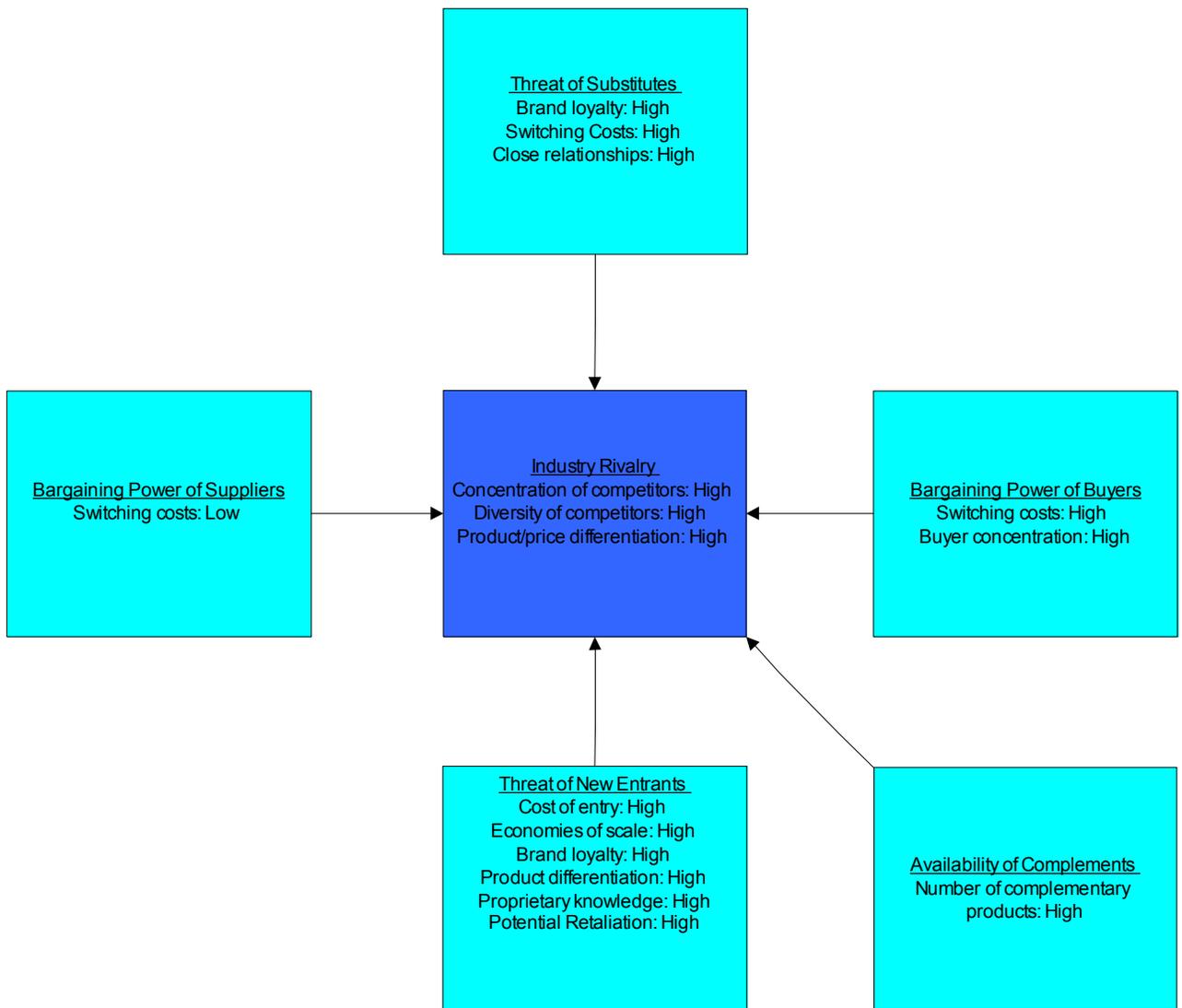
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Exhibit 1: Porter's Five Forces

TITLE: Michael Porter's Five Forces - Enterprise Software Industry



**Exhibit 2: Competitive Positioning Worksheet**

*Sources of a Differentiation Advantage*

	<b>Microsoft</b>	<b>Oracle</b>	<b>Sun Microsystems</b>	<b>Apple</b>	<b>IBM</b>
<i>What needs do key attributes of the company's product/service satisfy that other products/services do not?</i>	End to End Solutions, Integrated Solutions	- They are experts in database products - There are 23 different customized solution packages.	- Java Technology (platform Independence) - Solaris OS - Their products can be used in association with SAP	- Mac OS - NEXTSTEP operating system - Rich media focus - internet /intranet platform, and component software	- All new software is open source (non-proprietary). - IBM Global Services incorporates their software, hardware, business knowledge into one unit.
<i>What demographic, psychological, sociological characteristics correlate with the motivation of the customer?</i>	- Unmatched Brand Name and Reputation	- Brand Name	- Brand name - Reputation as programming-savvy company with great training	- Brand name - Multimedia advance	- Global - Brand Name

What are the sources of any advantages of your competitors?

<b>Oracle</b>	R&D and innovation capabilities (Oracle offered the first commercial SQL relational database management system in the market; they also offered the first native XML support database system), the customer base of their database products, the brand name recognition of database products.
<b>Sun Microsystems</b>	Customers feel "safe" with a very technical company that is known for its programming and its education
<b>Apple Computer</b>	Apple's Macintosh desktop is renowned and also has partnerships, such as Sun and NeXT Software, to develop internet platform, multimedia, and component software.
<b>IBM</b>	Open source, strong alliances, and partnerships

### Exhibit 3: Microsoft Financial Highlights

In millions, except earnings per share

Year Ended June 30	1998	1999	2000	2001	2002
Revenue	\$ 15,262	\$ 19,747	\$ 22,956	\$ 25,296	\$ <b>28,365</b>
Operating income	6,585	10,010	11,006	11,720	<b>11,910</b>
Net income	4,490	7,785	9,421	7,346	<b>7,829</b>
Diluted earnings per share	0.84	1.42	1.70	1.32	<b>1.41</b>
Cash and short-term investments	13,927	17,236	23,798	31,600	<b>38,652</b>
Total assets	22,357	38,321	51,694	58,830	<b>67,646</b>
Stockholders' equity	16,627	28,438	41,368	47,289	<b>52,180</b>

Desktop and Enterprise Software and Services Revenue:

In millions

Year Ended June 30	2000	2001	2002
Desktop Applications	\$ 9,013	\$ 9,580	\$ <b>9,327</b>
Desktop Platforms	7,383	8,265	<b>9,276</b>
Desktop Software	16,396	17,845	<b>18,603</b>
Enterprise Software and Services	4,014	4,875	<b>5,183</b>
Total Desktop and Enterprise Software and Services	\$ 20,410	\$ 22,720	\$ <b>23,786</b>

Source: <http://www.microsoft.com/msft/default.msp>

### Exhibit 4: Microsoft Business Solutions Product Lines

Product Line	Functionality	Target Markets
eEnterprise	Financials, HR/Payroll, ERP	Upper midmarket
Dynamics	Financials, HR/Payroll, ERP	Lower midmarket
Solomon	Financials, HR/Payroll, ERP	Lower midmarket
Small Business Manager	Financials	Small companies
FRx	Reporting and budgeting	Upper and lower midmarket
Microsoft CRM	CRM	Small companies and lower midmarket
Axapta	Financials, HR, ERP, CRM	Upper midmarket
Attain/Financials	Financials, ERP, CRM	Lower midmarket
XAL	Financials, ERP	Lower midmarket

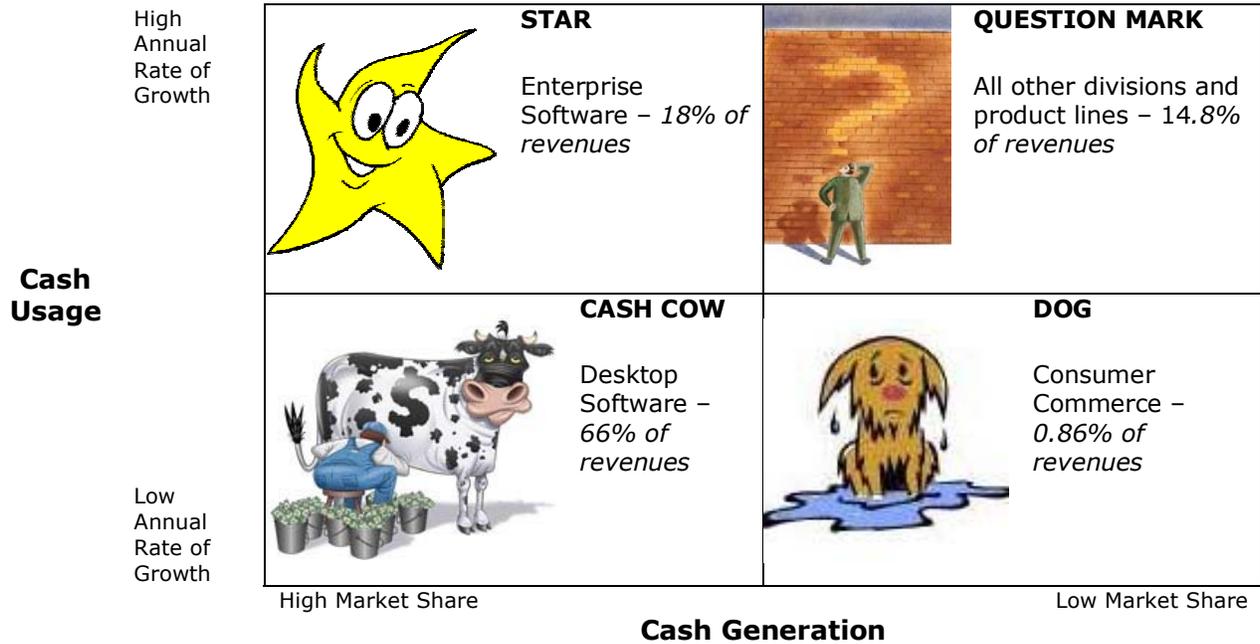
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Source:

[http://www.microsoft.com/BusinessSolutions/document.aspx?content=/businesssolutions/content/giga\\_analysis.xml](http://www.microsoft.com/BusinessSolutions/document.aspx?content=/businesssolutions/content/giga_analysis.xml)

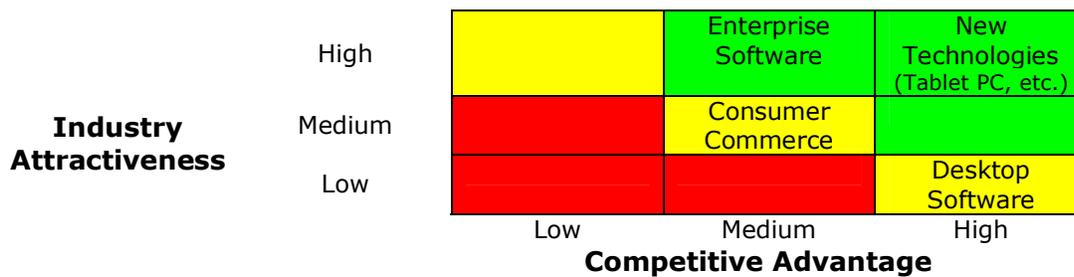


**Exhibit 5: BCG Matrix**



- Microsoft’s **cash cow** is its desktop software, which includes Windows OS and MS Office. While it is producing the vast majority of cash, its annual growth is slowing, and Microsoft is beginning to look for other product lines and divisions. In order to milk this cash cow, Microsoft introduces constant updates and adaptations to the products in this area.
- Microsoft’s **dog** is its consumer commerce division, which includes Xbox, MSN, and Web TV. Microsoft has significant competitors with regard to these products and is not faring well.
- Microsoft has a significant number of **question marks** (often cynically called “Microsoft’s crapshoot”), such as the new Tablet PC, which can be grown into stars and used to hedge other areas.
- Microsoft’s **star** is its enterprise software division (Business Solutions). This division competes in a fast-growing industry and is generating substantial cash for Microsoft.

**Exhibit 6: GE/McKinsey Matrix**



Key: Build | Hold | Harvest