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From billg Sun Aug 6 21:34:05 1989
To: steveb
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I have been thinking about this in a pure MS context to understand what is important for us and then see how the IBM relationship helps with that.

ny worth \$7B. Thats doubling the current valuation. We would have to more than double our profits. Let say systems has to bear the same proportion of that burden in the future as it does now and that as a group (server, mouse, lang, and toolkits) do their share (small) with server making up for the fact that mouse, lang and tollkits cant bear their part. That leaves the Os part (dos, win, os/2) with a huge burden. Basicly last year (I may get the numbers wrong) it was around \$180M worldwide PROFIT. Assuming 12m machines thats \$15 PROFIT per machine or giving IBM 1/3 of the market (a little high) \$22.5 per non IBM machine. We have to drive that number up to around \$45. Taking a 3 year time frame I think windows has a lot to do with it -I can see us lowering the price differential for "high end windows" (a nickname I have for what os/2 has to be perceived as over time) because we want to get it bootstrapped to the point where it wont cost a lot more than windows does. This means the price we can charge for windows will drive a lot of our future. Now how can we get this doubling per system thing to take place.

First, we have to make sure windows isnt easy to clone for both technical and legal reasons. Who is smart that thinks about this - patents and such. I can do it at some point and I think we will be able to achieve it. DOS being fairly cloned has had a dramatic impact on our pricing for DOS. I wonder if we would have it around 30-40% higher if it wasnt cloned. I bet we would!

Second, we have to make windows really good - not in the ways we have assig to os/2 but in ease of use approaches and software environment richness approaches. We will need smart people to adavance the product - smaller, faster for the kernel but smarter for all the interface pieces. Apple isnt dont what they should in this area and we can. I am not saying to tilt back towards windows or even to keep particular people but rather to keep what we have and focus it on refinement of speed/size and interface stuff. We may need to do some more software evangelization in certain catergories.

WE have to make windows like DOS is today - basicly new applications all are done for it and people assume it.

Financially if we havent tied our hands we need to be able to double the oem price or go after a VERY agressive retail strategy. The things we cant afford are:

- 1. Not being able to improve the product freely. In other words getting into the mess that Os/2 is in. Windows is still not as nice as the mac and it would be easy to be a lot better. Win 3 goes a long ways but we cant get IBMEd on this one.
2. A cheap royalty to IBM that means if other oems refuse to per system license we end up getting very little.

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3. Transferring a lot of money to IBM.
4. Not positioning windows aggressively.

If we hold windows back we wont double our oem revenues. I know os/2 is important and we need it to get UNIX apps ported and to fight the high tech and server battles. But windows is DOS for twice the price and we need it to be pervasive.

I am afraid of a structure with IBM where we are in partnership for the following reasons:

- a) server businesses arent enough of a gold mine to be a huge part of our goal. With IBMs cost structure I would like you to explain to me how a server business can even break even.
- b) I am hard core about not putting DOS/win into the financial partnership. If only IBM users buy their package or that % then a low roaylty is ok but how do we avoid IBM holding us back on windows. Maybe I am paranoid.
- c) Lan business is too fast moving to let them write all the code
- d) Once os.2 takes over I see our profit per machine actually dropping and never increasing again. This last point I meant to spend more time on. Os/2 will dominate eventually and it should allow us at some point to double again (is that asking too much? maybe) or at least grow per unit more than the UNIX machines cut into the desktop market so we grow with the market.

One question I have steve is:

Shouldnt we let the slow pace of negotiation continue? I think that is in our best interest.

Shouldnt we force them to explain how to make money in the server business since they are the ones who put so much into it?

IBM never knew our plan and if they did they shouldnt like it - our old plan (DOS) which is the current financial success of the company- sell cheap to IBM and make money from everyone else. I prefer an OS.2 deal like that a lot more than a joint venture. OF course it makes us sensitive to 2 phenomena I worry a lot about: a) cross selling and b) IBM increases market share. A is the worst since increases in royalties will force some oems to rely on A. I dont know how to solve that. If you feel we have to "joint venture" with IBM I think we give up growth opportunity.

Somewhat this discussion is the most important one for the companies busines future and I guess I should think about it more. In any case there are some thoughts. You can call them greedy. Its funny but I always thought other people in the company would end up pushing me to think more about thi financial upside stuff but it never happens. I was supposed to get to be a product guy with people pushing me to charge enough but when it comes to oses I feel more guilty than anyone that we dont have the clear plan to make 2x as much in oses. Os profit is our past present and future so lets you and I figure out how to double it without IBM problems. No easy job!

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