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Microsoft Corporation, 2013

www.microsoft.com, MSFT

Headquartered in Redmond, Washington, Microsoft is the world's largest software company and had record revenues of \$73 billion in fiscal year 2012 that ended on June 30, 2012. Microsoft develops a variety of software and hardware products and services for customers around the world, including its Windows Office, Windows 8 operating system for personal computers (PCs), Windows Phone 7 operating systems for mobile phones, Windows Server operating systems, Windows Azure, Microsoft SQL, Visual Studio, Silverlight, and the popular Xbox gaming and entertainment console. Many PC makers such as Acer, Lenovo, Dell, Hewlett-Packard, and Toshiba pre-install Microsoft software on devices. The firm also offers consulting services, cloud-based services, and training certifications as well as online products such as Bing, MSN, adCenter, and Atlas. Microsoft has strategic alliances with Nokia, NIIT, and Dominion Enterprises. The company owns Skype and recently introduced a Windows Phone and a Windows tablet computer named "Surface."

Microsoft's third quarter of fiscal 2013 results reported April 2013 were outstanding, with its Business Division's revenues up 8 percent to \$6.32 billion, its Server and Tools' revenues of \$5.04 billion up 11 percent, its Windows' division revenues of \$5.07 billion up 23 percent, its Online Services segment revenues up 18 percent to \$832 million, and its Entertainment and Devices segment revenues up 56 percent to \$2.53 billion.

In August 2013, CEO Ballmer announced he would resign from Microsoft within 12 months, so the firm is scurrying to determine who will be a good replacement. The month prior, Microsoft revamped its organizational structure, dissolving its eight business lines up in favour of four new segments to focus on engineering and encourage collaboration across the company. Basically the company is now structured as a division-by-function type of structure. The divisions are expected to focus on operating systems, apps, cloud technology and devices. The move largely reversed the strategy and structure put in place by CEO Ballmer in 2005. Microsoft's stock price jumped in response the Ballmer announcing that he would resign soon.

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History

Founded by Bill Gates and Paul Allen in 1975, Microsoft was established to develop and sell BASIC Interpreters for the Altair 8800. The company rose to dominate the PC operating system market in the mid-1980s with their MS-DOS software, followed by the Microsoft Windows operating system, which was a graphical extension of MS-DOS. Microsoft went public in 1986, instantly creating three billionaires and 12,000 millionaires from Microsoft employees. In 1990, Microsoft introduced its software office suite, Microsoft Office that bundled MS Word and MS Excel together.

Microsoft acquired Skype Technologies for \$8.6 billion in 2011 in its largest-ever acquisition. Following the release of Windows Phone 7, Microsoft underwent a gradual rebranding of its product range throughout 2011 and 2012. Its logos, products, services, and websites adopted the principles and concepts of the Metro design language. Microsoft in early 2012 introduced Windows 8, an operating system designed to power both PCs and tablet computers. Then in May 2012, Microsoft introduced its own tablet computer, the Microsoft Surface. As the company continued to diversify away from operating systems, it paid \$1.2 billion to buy the social network firm Yammer and then launched its Windows Phone 8. To cope with the potential increase in demand for products and services, Microsoft is slowly but surely opening its own Microsoft Stores across the USA. Bill and Melinda Gates are today one of the richest couples on the planet, and one of the most giving couples in terms of philanthropic endeavors through the Bill and Melinda Gates Foundation.

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Vision and Mission

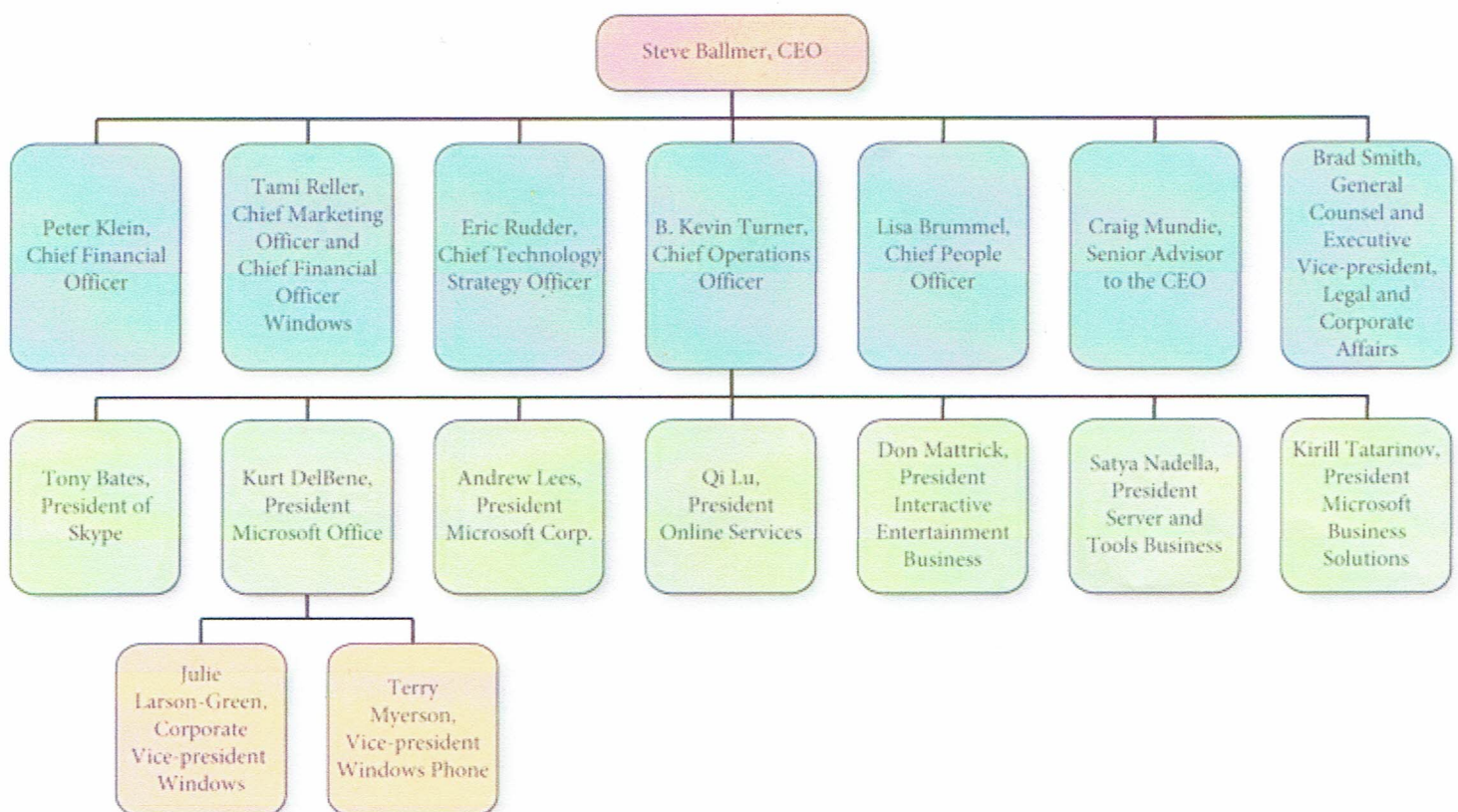
A statement at the corporate website says: "At Microsoft, our mission and values are to help people and businesses throughout the world realize their full potential."

Organizational Structure

Among the 17 executives listed in [Exhibit 1](#), there are three women in Microsoft's management hierarchy. Note in [Exhibit 1](#) that Microsoft uses a division-by-product organizational structure, with Steve Ballmer being chief executive officer (CEO) and Kevin Turner being chief operations officer (COO). Some analysts say that executive titles could be more effectively named. For example, President of Microsoft Corp. versus President of Microsoft Business is unclear to some observers. It is unclear from the structure where Microsoft Phone and Microsoft Tablet and Microsoft Stores reports. Such items would ideally be clear in executive titles. Perhaps a strategic business unit (SBU) structure would be more effective.

The Surface Tablet

EXHIBIT 1 Organizational Chart



Source: Based on company documents.

Sales of Microsoft's Surface tablet are not good; analysts expect the company to sell between 500,000 and 600,000 Surface tablets in their second quarter of fiscal 2013, much lower than the company's original estimate of 1 to 2 million. Introducing a tablet is a good idea for three reasons: (1) Microsoft has the cash to invest heavily in research and development (R&D) for its own tablet; (2) the tablet market has been booming; and (3) the PC market is declining. But the problem perhaps is that Microsoft priced the Surface too high at \$499 and up, roughly the same

Microsoft could compete on price, not luxury, when up against Apple products. Microsoft could undercut Apple's price, and even if it loses money on Surface, the initial loss could be worth it if it revitalizes sales of other company products. The success of Windows 8 largely hinges on widespread adoption of the Surface tablet. The whole point of Windows 8 was to launch Microsoft into the world of tablet computing, and with weak sales of its tablet, Microsoft's transition away from the faltering PC market may be a difficult one. Microsoft should perhaps consider McDonald's successful strategy of offering and heavily marketing inexpensive products (for example, the Dollar Menu) and by promoting low-grade items.

Segments

Microsoft has five reportable business segments as listed in [Exhibit 2](#). Note that Microsoft Business is the largest segment in both revenues and operating income, whereas both the Windows and Windows Line (called Windows Division from here on), and Server and Tools segment, contribute greatly to the company's financial position. A sixth segment, titled Corporate Level Activity, includes all financial dealings not allocated to specific segments. The division includes costs related to marketing, product support services, legal, finance, and other business activities. Some analysts contend that the company's segments could be more effectively named to reveal their nature.

The Windows Division receives approximately 75 percent of its revenue from the Windows operating system, with the bulk of this revenue coming from equipment manufacturers such as Dell, Sony, Toshiba, and others pre-installing Windows on their machines for customers. The division in addition to providing Windows also provides related software, online services, and PC hardware products. This division could be vulnerable if worldwide PC sales continue to slump, as they did in 2012 with a 3.2-percent decline. Windows 8, launched in October 2012, provides better communication with cloud services and enables tablets and phones to run with near PC power. The whole world is becoming less dependent on traditional PCs, which historically has been Microsoft's bread and butter and is a key reason why the firm is looking to diversify.

EXHIBIT 2 Microsoft's Revenues by Segment (in millions)

	2012	2011	2010
Windows Division			
Revenues	\$18,373	\$19,033	\$19,491
Operating Income	11,460	12,211	12,895
Server and Tools			
Revenues	18,686	16,680	15,109
Operating Income	7,431	6,290	5,381
Online Services			
Revenues	2,867	2,607	2,294

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	2012	2011	2010
Operating Income	(8,121)	(2,657)	(2,408)

Microsoft Business

Revenues	23,991	22,514	19,256
Operating Income	15,719	14,657	11,849

Entertainment and Devices

Revenues	9,593	8,915	6,079
Operating Income	364	1,257	517
Corporate Level Activity	(5,090)	(4,597)	(4,136)

Source: Based on 2012 *Annual Report*, p. 21–25.

Microsoft's Server and Tools Division is Microsoft's third most profitable division, producing name brand products such as Windows Server, Microsoft SQL, Windows Azure, Visual Studio, Enterprise Services, and others. Enterprise Services include product support and consulting services and account for 20 percent of the division's revenues. The division also offers developer tools, training, and certifications. Around 55 percent of Server and Tools revenues are derived from multiyear licensing agreements, with the remaining 25 percent coming from transactional volume licensing programs. In 2012, revenues increased by 12 percent in the division mainly attributed to growth in the SQL and Windows servers, although Enterprise Services grew 18 percent over the same period from an increase in both product support and consulting services. Overall operating income still increased 17 percent.

The company's Online Services Division designs products that aid customers in simplifying tasks and making more informed decisions online. Products include Bing and MSN, which generate sales through advertising. In fiscal year 2012, advertising revenues grew 13 percent in this segment to \$2.6 billion. Online advertising revenues grew 13 percent over the fiscal year to \$2.6 billion; however, operating losses totaled \$8 billion resulting from \$6 billion in goodwill impairment from fourth quarter of fiscal year 2012, resulting from the 2007 acquisition of aQuantive. Expectations of future sales growth and profitability are significantly lower for aQuantive than anticipated.

The company's Microsoft Business Division produced 32 percent of total companywide revenues and 72 percent of operating income in fiscal year 2012. The segment derives revenues from software and online servers that help to increase personal team and organizational productivity. Microsoft's most notable product, its Microsoft Office System, makes up more than 90 percent of this division's revenues. However, future reliance on this segment is somewhat tenuous because Google and other competitors are now offering Web-based products that work much the same as Microsoft Office products work.

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Smartphone Growth

Smartphone shipments have risen dramatically since 2005 from 50 million phones shipped worldwide to more than 650 million phones shipped in 2012. Shipments by 2016 are expected to be more than 1,200 million phones. Most of the growth is expected to come from emerging markets, with China leading the way. In 2012, China surpassed the USA as the world's largest smartphone market, yet there are millions of untapped customers remaining in China. India, Brazil, and other emerging markets offer millions of customers. Aside from traditional phone providers, companies such as Apple, Dell, and others are all continually offering new products and features to differentiate their handsets. Google and Microsoft are teaming up with existing phone producers to provide new and better operating systems for their respective phones.

Nokia Migrates to Windows 8

Nokia unveiled in late 2012 their latest Lumia 920 and 820 model smartphones, Nokia's first set of smartphones to run off the new Windows 8 operating system. A main advantage gained for Nokia using Windows 8 resides in the compatibility of file-sharing capabilities because both the 920 and 820 devices will sync with PCs and tablets with Windows 8. Nokia hopes the switch to Windows 8 will differentiate its products and aid in improving sales which declined 37 percent from the second quarter 2011 to the second quarter 2012.

Cloud Computing

Cloud computing, supplying computing services via the Internet without having to use hardware or platform support, continues to grow in its use and offerings. Many businesses employ the technology to save on costs because they can lease data storage and computing capacity from web-based providers. Advantages for businesses using cloud technology include reduced capital investments in equipment and software, while allowing for payments only for the capacity needed. Traditionally, firms would buy their own in-house capacity and have to forecast future needs, often resulting in purchasing more capacity than was needed. Google is the lead company using cloud technology to support many of their offerings. However, there is still some concern among businesses that cloud computing offers less security, and increased dependability on a third-party vendor such as Google to continually provide the service at an appropriate network speed is questionable. Nevertheless, cloud services are expected to yield revenues of \$100 billion in 2016, up from \$40 billion in 2011.

The Future

Microsoft is developing technologies that increasingly enable touch screen and voice to be more readily understood by PCs, tablets, and phones. Microsoft CEO Ballmer envisions that technology will soon act on people's behalf rather than at their command, so he has directed Microsoft R&D staff to develop cloud services that enhance the experience for both businesses and individuals. Microsoft plans to better align the communication between PCs, tablets, phones, and servers by developing improved operating systems with Windows 8 delivering preliminary results in this arena.

High-definition TVs and tablets of today are expected to soon lose market share to gadgets that can read human emotions and to eye gaze technology that will allow for automatic scrolling and opening of apps. Even "skin stretch feedback" on devices will take into account people's emotions. Tom Wilson, CEO of emotions3D, for example recently remarked that such devices will "interpret moods and give consumers a more helpful and rewarding experience." Some analysts predict that the audio quality alone on smartphones will increase 16 times from 2013 to 2018. Also, as the tablet's video gaming experience increases and becomes closer to the experience on an Xbox, PlayStation or Nintendo's market share for traditional gaming consoles may decline. More useable devices for people on the go are being developed in part to reduce accidents while driving and using mobile devices.

Microsoft in early 2013 introduced its new Office 365 product, a subscription service for \$99.99 or \$9.99 per month pay-as-you-go option. Office 365 constantly updates itself every time you open a program. The product works great

Microsoft and virtually all companies' computers, tablets, smartphones, and more.

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Microsoft's \$2 billion investment to finance part of Dell computer's buyout in early 2013 is an attempt by the firm to support the ailing PC industry—which saw shipments fall 14 percent in the first quarter of 2013 alone. Millions of consumers globally are skipping over PCs altogether and going straight to mobile devices.

Technology is changing so rapidly everyday, and new rival firms arising globally in the industry, that Microsoft needs a clear strategic plan going forward.

Develop a new strategic plan for the upcoming new CEO of Microsoft.