

## Investment Research

### Microsoft (MSFT)

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#### Pricing and Position Strategy

Arguably, MSFT has the most attractive position in the market, because MSFT has built a dominant position within the enterprise segment of the market. Since the enterprise segment changes slower than the consumer segment, and since the enterprise basically serves the consumer, MSFT has the best opportunity to connect the market segments from a position of strength.

But for MSFT to really build the consumer segment of the market – and really capture lost market share and really negate the penetration of Google and Apple – MSFT must implement a clear, intuitive, application pricing strategy divided into a consumer segment and an enterprise segment. However, when defining the enterprise segment, MSFT would include the sophisticated user within the consumer segment.

Building one segment of the market can create significant value for another segment in the market. An intuitive approach to the market like this would create a very attractive pricing opportunity for MSFT.

First, the MSFT services, software and hardware offered to the market must seamlessly connect through the operating system. Too much software and services from MSFT don't connect well together. A seamless connection creates significant value in the market, because it enhances productivity within the market.

Over the last twenty years, MSFT has struggled in the market to create any real shareholder value with the MSN brand. At the end of the day, it's either the strategy – or the execution of the strategy. In this case, the MSFT pricing and position strategy has failed to recognize the value of the consumer segment in relation to the value created for the enterprise segment. Building the consumer segment (by definition) creates value for the enterprise segment of the market.

Recently, MSN started offering a free, scaled-down version of the MSFT Office. This dramatic shift in pricing strategy could create significant value in the

market for MSFT – especially if the organization implemented it across applications. In fact, the Office pricing strategy illustrates the thesis of this research.

Offer a free, scaled-down version of the MSFT application to the casual consumer, because it builds a market, which increases the value of the franchise. Build the market and then monetize an enhanced version of the MSFT application to the enterprise or the sophisticated user within the consumer segment.

This type of pricing strategy naturally reinforces both segments of the market. The objective is to build one segment of the market, create significant value for another segment of the market and then monetize the created value within the market.

MSFT needs to clarify the position of MSN, X-Box and Skype within the market. For too long, these assets have been underutilized in the market, especially considering the potential of the market.

First, Skype needs to clarify its position in the market. Where is the real value in Skype? Is it “really” trying to sell (to the consumer) Skype minutes as a revenue stream? Does Skype “really” compete with Verizon or AT&T? Why confuse the Skype position within the market? A confusing position within the market creates a natural impediment to consumption.

Offer a free, scaled down version of Skype to the casual consumer and then monetize a significantly enhanced version of Skype to the enterprise. If not already, security will become increasingly important to the enterprise as well as the consumer.

But MSFT must seamlessly connect its application base. Skype isn't even connected to MSN. And the MSN website is a natural distribution system for the consumer version of any MSFT application. Why does Skype require a separate login from the MSN website? MSFT must provide a seamless connection between the applications offered to the market.

Furthermore, trying to generate a significant revenue stream from selling Skype minutes to the consumer is a short-sighted, pricing strategy rationalized by a near-term, profit-center mentality. Price (by definition) creates an impediment to consumption. The objective is to build the market and THEN monetize the market.

X-Box has also been significantly underutilized in the market. It needs to carve out a more comprehensive position in the market. What is the position of the X-Box brand? Is it really just gaming? Or is it a form of human entertainment, which include the categories of gaming, video and music?

MSFT has a real opportunity to further develop the X-Box brand as a form of human entertainment. In fact, the preceding entertainment categories of gaming, video and music can all be effectively delivered through MSN, at least the consumer version.

For example, gaming can offer a free, scaled-down version of a game to the casual consumer. This will not only build a market for the game but also increase the franchise value of the game. At the same time, MSFT can offer a significantly enhanced version of the game to the sophisticated gamer, which will further develop the MSFT device (console) line of business.

At the end of the day, in terms of the video entertainment category, the consumer should be able to select any movie or any show at any time on any device. The market is clearly moving in this direction. Why doesn't MSFT allocate the necessary resources to accomplish this very important marketplace objective?

Over the last twenty years, MSFT has struggled to create any real shareholder value with the MSN brand in the market. At the end of the day, it's either the strategy – or the execution of the strategy. In this case, the MSN portal offers a stale user experience. Granted, MSN has changed the appearance of the web site over the years, but the offering has basically remained the same. In essence, MSFT has failed to develop the MSN business within the market.

To create real value in the market, MSN needs to offer a compelling reason to visit the website. Without a compelling reason, how can MSFT effectively monetize the website and create real value for not only the organization but also the shareholder?

Offer a free, scaled down version of any MSFT application to the consumer through MSN. This will build one segment of the market, and it will create significant value for another segment of the market. At the same time, monetize a significantly enhanced version of the MSFT application to either the enterprise or the sophisticated user within the consumer segment.

MSFT should clarify the position of MSN in the market. MSN serves the consumer segment. And MSN is a natural point of control for distributing the consumer version of any MSFT application.

Just think of video entertainment, MSFT could create significant value in the market if it offered a streaming video service better than Netflix, Hulu, or Amazon. The consumer should be able to select any movie or any show at any time on any device. The market is clearly moving in this direction. Why not allocate the necessary resources to accomplish this very important objective in the market?

Enthusiastic users would significantly increase the value of MSN in the market. This will build the consumer brand of MSN, and this will create a very attractive, pricing opportunity for the MSFT account. For example, the pricing of the MSFT account could vary according to the level of service provided in the entertainment categories of gaming, video and music. However, these services must be priced to accomplish the big-picture, marketplace objective of MSFT.

“Build one segment of the market, create significant value for another segment of the market and then monetize the created value within the market.”

Offer a free, scaled-down version of the MSFT application to the casual consumer, because it will build the consumer segment of the market. And by building the consumer segment, MSFT will create a very attractive opportunity to monetize an enhanced version of the application to either the enterprise or the sophisticated user within the consumer segment.

This approach to the market accentuates the strengths of MSFT. For additional thoughts on MSFT, please visit the website of Capital Executive LLC.

Sincerely,  
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Capital Executive LLC