Seven management lessons from Microsoft

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The software giant Microsoft is a mere corporate stripling. Yet around its formidable success lies an equally indomitable mystique. It is phenomenally successful. Few are bold enough to analyse how and why Bill Gates’ and Paul Allen’s bright idea turned into the corporate titan of our times. Until now.

Since its inception, Microsoft has consistently been underestimated by its competitors. Giants like AOL/Time Warner, Palm and Sony have each had a run at Microsoft and failed. And companies like Nokia, Apple, Novell, Borland, WordPerfect, Lotus Development, Sun, IBM, Netscape, Oracle and SAP either disappeared or have lost market share in their battles with Microsoft.

In order to understand why Microsoft is so successful, there is no point in hiding behind accusations that it pursues monopolistic practices. To understand Microsoft’s success, we need to look elsewhere: at the new rules for the “experience” economy – where customers value products and services that can enhance the quality of their life experience – and at where the new “high ground” for business models in this experience economy is.

Let us start with the high ground, which defines the strategic position from which a company and its “value web” can capture the maximum share of value and customer spend from users for the least effort and resources. People are bombarded with information and new products every day and are motivated to simplify their lives through easy-to-use quality services, interfaces and content. The majority of customers do not care about technological infrastructure or the nature of the devices and software these services, information and content are offered on, just so long as they work and are user friendly.

So, what are the different routes to the high ground? As illustrated in Figure 1 overleaf, the high ground integrates digital infrastructure, products and services into experiences, delivered via appliances and interfaces, to communities of users. Every company that has attempted to claim this high ground has done so from their strengths in one or more of these areas. Each has underestimated the difficulty of making that integration work successfully.

For example, AOL has been quite successful in building online communities with tens of millions of users in North America and to a lesser extent Europe. It has tried with limited success to translate this franchise into a dominant position on the user interface and in the content business through the merger with Time Warner. Nokia, Symbian and Sony/Ericsson have come at the high ground from their positions of strength in making fashionable, user-friendly electronic appliances for communications, entertainment, gaming and personal productivity, attempting to create a dominant position through open mobile and broadband architectures, and building a value network around themselves to create the experiences users
want. These companies have recently bumped hard into the Microsoft swarm of products and services centred around the .NET open software framework and the PocketPC, Smartphone and X-Box.

So, what are the seven key lessons we can learn from Microsoft?

1. **Thrive on co-evolution and head for the nodal position in your value web**

   In the experience economy, every marketplace is a complicated web of interconnecting relationships where business models are defined by the totality of relationships between the various players. Business ecosystems are continuously evolving based on the changing relationships between organisations and business models, where competition is for the richest, most connected position within the ecosystem – the “nodal” position – where your company will have some strategic advantages and the ability to appropriate real value.

   The ability to turn your company “outside in” through partnering becomes essential as network technologies allow customers, employees and partners to mingle under the same electronic tent. Yahoo!, for example, partnered liberally with outside players, built connections so successful that other companies paid to establish links, and created the flexibility to constantly add new functions.

   Companies that truly bank on this sort of networking understand that outsourcing and joint ventures are long-term skills not just techniques.

   Microsoft has built the world’s largest business ecosystem, made up of six million developers, tens of thousands of companies generating trillions of dollars of revenue, together with Intel and the makers of personal computer hardware. By controlling the evolution of its software through application programming interfaces, Microsoft is able to protect its intellectual property while still enabling others to collaborate with it and develop according to relatively open standards. It now also gets instant feedback on software performance through automated error reports delivered over the web any time there has been a program error on any Windows XP application – so the customer feedback loop is now part of the ecosystem – as well as feedback from developers and makers of information appliances.

2. **Innovate at the right pace or die**

   Palm, creator of the world’s first truly successful PDA (personal digital assistant) product, is struggling. Three years ago electronic organisers running Palm’s operating system owned 75 per cent of the handheld computer market. Today, Palm’s share has dropped to 57 per cent. Microsoft’s initial move into the market, Windows CE, was considered technologically inferior. But after reworking and relaunching the product as Pocket PC two years ago, Microsoft now holds nearly a third of the market. Analysts project that it will control roughly a third by 2004. How did it happen?

   Palm violated a basic rule for surviving: innovate or die. Its initial success blinded it to the need to add new features. Palm’s early goal was to make a simple product at a cheap price. Yet as microchips, screens and batteries improved, it made sense to pack handheldds with new applications like those for playing music and video. Palm mostly sat still. Meanwhile, Pocket PC-based machines like Compaq’s Ipaq, were...
steadily improving, with faster processors and more memory – and getting cheaper.

3. Innovation creates value; good business models capture value
Competitive dynamics in the 21st century are not about technology but business design. What wins or loses the “co-opetitive” game is an organisation’s ability to create different levels of value through adaptive re-combinations of the components of a business model. The key is understanding how to identify and select new options for creating and capturing value using the new tools, business models and markets emerging in the connected economy.

Because information courses through every artery of business these days, companies need adaptive business processes to keep pace with ever-increasing customer demands. Where the Internet opens new opportunities – whether it’s a way for car designers to collaborate with their parts suppliers or a web marketplace for bidding on office supplies – businesses can’t be afraid to forge new processes around them. Innovating your business model demands reinvention of the organisation.

The most innovative models alter the structure of their industries, the way Dell Computer’s build-to-order PCs pushed the entire computer business to change its ways. Companies must view their process as a product too. Ensure that your current and new business ideas align with or can shape the trends in and around your industry and protect/enhance the value you are able to create through your business design. Business models based on complexity principles are, however, much more likely to generate money and above-average market capitalisation relative to revenues.

The company that Bill built
Microsoft Corporation was founded as a partnership in 1975 and incorporated in 1981. In June 2001 the company employed approximately 47,600 people full time, 33,000 in the US and 14,600 internationally. Today the company is the largest producer of software for personal computers in the world, with 2001 revenues of almost $25.3bn and net income of $7.35bn.

It has also diversified into other business sectors such as e-commerce, multimedia and broadband communications.

Microsoft develops, manufactures, licenses and supports a wide range of software products for a multitude of computing devices. Microsoft software includes scalable operating systems for servers, personal computers (PCs) and intelligent devices; server applications for client/server environments; knowledge worker productivity applications; and software development tools.

The company’s online efforts include the MSN network of Internet products and services, and alliances with companies involved with broadband access and various forms of digital interactivity. Microsoft also licenses consumer software programs; sells hardware devices; provides consulting services; trains and certifies system integrators and developers; and researches and develops advanced technologies for future software products. In July 2002 Microsoft was the world’s second-largest company by market capitalisation.

Microsoft’s strategic challenges
Since 1975 Microsoft’s business strategy has emphasised the development of a broad line of software products for information technology (IT) professionals, knowledge workers, developers and consumers, marketed through multiple distribution channels. While Microsoft’s management is optimistic about the company’s long-term prospects at the start of the new millennium, the following issues and uncertainties have affected recent strategy making.

Rapid change, uncertainty due to new and emerging technologies, and fierce competition characterise the software industry, which means that Microsoft’s market position is always at risk. Microsoft’s ability to maintain its current market share may depend on its ability to satisfy customer requirements, enhance existing products and introduce new products. This process grows more challenging as the pace of change continues to accelerate. Open-source software, new computing devices, new microprocessor architectures, the Internet and web-based computing models are among the challenges Microsoft must meet.
Microsoft has exploited increasing returns in its business model by continuing to earn increasing returns on its dominant position in operating systems, browsers and applications. It is now working on extending this to the palmtop and the mobile telephone.

4. Be an early adapter not an early adopter

If we ask who gets the value from innovation, it’s usually not the innovator. People download and re-engineer. In the high-technology business the biggest risk is of a new product failing in the early market. New products have to pass through what is known as a chasm in order to reach the point at which they can take off.

This phenomenon used to be limited to technology companies. Now, for all businesses in this fast-moving world, the ability to launch successful new services and experiences becomes critical. But new products often go through a chasm, where they often perish, before they find a beachhead where they can safely grow.

Once a company has gone through the chasm and found the beachhead, it can often experience the tornado of growth, where scalability and process become critical. Microsoft has been very successful at scanning for better ways of doing things and then pouncing when it sees a way to assist a company or technology across the chasm through its own intervention.

5. Community and commerce make content king

The first rule of information states that as the technologies for the codification of information advance, the amount of information available rises dramatically and the cost of much information approaches zero. Huge quantities of free or incredibly cheap data currently swamp our senses through a media Tower of Babel.

Because our current digital infrastructure and physical infrastructure lack the intelligence to make sense of all of this for us, we interpret much of this data as noise rather than useful information. We are the first generation to have the novel experience of searching for content using a search engine on the Internet, only to be overwhelmed with predominantly irrelevant information. In this content-saturated world, content-driven business models fuelled by advertising revenues have in-built limits, constrained by the amount of information and advertising people are able to pay attention to.

A whole new generation of content management, campaign generation, knowledge management, customer relationship management and “customer process”-driven software is now aiming to ensure that we only ask people for their attention when it is appropriate to their needs or wants at a particular time. This requires businesses to:

- redefine both their business designs and their business and management processes in order to evolve to a customer process-driven operation
- invest in intelligent digital infrastructure that can drive the customer-directed value chains and networks required to deliver the winning value propositions of the networked economy.

The latest versions of Microsoft’s products and its focus on services via the .NET framework mean that it will soon be at the forefront of new service creation and enablement in the experience economy. Community and commerce will then lie at the heart
of the user experience, making relevant content available just when, how and where the user needs it.

6. **Use network effects to create and harness embedded intelligence**

The value of a network is potentially greater than the square of the number of nodes in the network. Because the nodes in an industrial network communicate seldom or at all with each other, the value of the network remains low as the connections between the nodes are both silent and unintelligent. In the knowledge economy, however, the connections between the nodes are capable of being made intelligent using a wide variety of technologies, enabling value-adding communication, scheduling and co-ordination to occur. When this happens in a linear fashion up and down a value chain, significant cost reductions and revenue enhancement are possible.

In collaborative value networks, such as are springing up in travel, telecommunications, retailing, manufacturing and distribution, and financial services, much greater economic returns are possible due to the increasing returns that such networks can deliver to customers and participants. This also causes the value of the network to rise dramatically in proportion to:

- the level of intelligence installed between the nodes of the network
- value of the functionality such intelligence offers users

In the experience economy the economics of increasing returns play a critical role in determining the winners and losers in every industry. One of the most attractive features of network effects that emerge from digital infrastructures is that we can use them without having to think too much or at all. Microsoft is actively aiming to build intelligence into every device through the .NET framework and to enhance the bandwidth available to such devices through broadband networks with .NET, Microsoft is betting that it will command a leading role in delivering the advanced platform and software services that will make different digital devices work together and connect seamlessly. Some say that Microsoft's concept for .NET is like a funnel: easy to get into but hard to get out of. Most .NET applications will allow programmers to write software in different languages. But the .NET code-writing tool runs only on .NET. Similarly, .NET services can be accessed on any device but it will be hard for users to switch to competing XML offerings and still take their data with them.

Microsoft executives justify such lock-ins by arguing that the company has to make money somehow given the otherwise open nature of the .NET platform. Microsoft intends to charge users a monthly fee for a .NET My Services account. It also plans to charge developers for .NET My Services tools and also charge every web site that uses My Services data.

Microsoft is laying its framework for the future with a projected investment of approximately $5bn in research and development in fiscal 2002. At the centre of the company’s R&D efforts is Microsoft .NET, a project that Microsoft believes is as significant in the development of computing as the graphical user interface and the introduction of the Internet.

.NET is Microsoft’s platform for a new computing model built around XML web services. Just as the web revolutionised how users interact with content, XML is revolutionising how applications communicate with data and how computers and devices communicate – by providing a universal data format that lets information be easily shared, adapted or transformed. .NET will create new opportunities for Microsoft and for thousands of developers and industry partners by enabling constellations of PCs, servers, smart devices and Internet-based services to collaborate seamlessly.

.NET services are oriented around people rather than around specific devices, applications, services or networks. They also protect personal information by allowing the user to control who can have access to their information and providing a new level of ease of use and personalisation. For example, an airline can link its online reservations system to that of car rental partners so that travellers can book a car at the same time that they book a flight – even from their mobile telephone or other handheld digital device.

Responding to change

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such as Teledesic. While Sun, HP, IBM and others, with Java, Unix and other technologies, have been able to see this vision, they have not had the business models or the market positions to embed their technology platforms into enough devices to create ubiquitous network effects like Microsoft.

7. Adapt and learn real-time

New waves of technology create complexity that needs to be mastered to build and deploy new value-adding capabilities. Market opportunities must be envisioned and seized – incremental movement will be too slow. Organisational intelligence generates foresight and insight into opportunities. Many asset-based positions will be arbitrated away by global capital markets. Knowledge assets need to be created and deployed for value across the world. Products must be developed in close partnerships with all constituents. Real-time information is critical to efficiently manage across all partnerships and geographies. The transformation of business and management processes is often a prerequisite to develop the characteristics required to compete effectively in the experience economy.

Microsoft cultivates a culture where employees are encouraged to question everything. Though this can be harsh at times on those who are not able to assertively defend their positions, this meritocracy encourages everyone to look carefully at their assumptions and to embrace new ideas if they work better than current approaches. In a business where innovation is critical, the ability to recognise new patterns in the environment and then rapidly to build and change mental models to reflect what is going on “out there” and anticipate future developments is a crucial survival skill.

Many of the old competitive strategy rules still apply in determining whether a business can create real value for its stakeholders. Market share, quality of management, segmentation for lifetime customer value, competing on distinctive capabilities and building barriers to entry still apply to making an economic return. But in an increasingly networked world of evolving ecosystems and value webs, concepts such as nodal positions, network effects, the impact of dominant standards and community building must be understood by managers should they wish to create significant value for their organisations and shareholders.

Microsoft understands and integrates these concepts as part of its broader strategy development and has been able to build and consolidate an extremely strong base for success in the future networked economy. Of course, it is unclear whether Microsoft knows exactly how this future world will emerge. But whatever the range of possible futures, it has built a portfolio of options.

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