

*BOB DEW*

**DISTRIBUTION LIST**

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*Brad's -*  
*FYI*  
*Brad 2* | *albyn*

*Jachimk / Richard -*

*what Jett completed before he left  
He did not know about your Donnelly efforts ...*

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**From:** Jeff Alder  
**Date:** September 4, 1991  
**Subject:** THIN-DOS DESIGN AND INTRODUCTION

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**BACKGROUND**

The number of naked PCs sold in the United States is 2.5 million per year. In order to attack the counterfeiting of MS-DOS and increase the penetration in the naked PC market, THIN-DOS will be introduced in early November. THIN-DOS will supplement rather than replace any of the existing MS-DOS products. The introduction of THIN-DOS should provide four substantial benefits.

**BENEFITS**

1. An increase in MS-DOS 5 revenue and profits.
2. A competitive defense against DR-DOS provided by 2-3 year license agreements.
3. Increased penetration of the naked PC market.
4. A substantial decrease in the profit incentive and opportunities for counterfeiters.

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### DISTRIBUTION

THIN-DOS will be for sale on new PCs in the United States. The target market is packaged product customers with volumes of over 1000 units/year, PCs sold without an operating system and PCs sold with counterfeit DOS. I estimate half of the existing package product customers will switch to THIN-DOS as well as 10% of the existing 2.5 million naked PC market. The projected total annual volume is 400,000 units. The increase in total revenue will be 4.5 million dollars. The increase in total gross margin will be 4.1 Million dollars, Based on:

1. 10 % penetration of the naked PC market
2. 50% cannibalization of the existing package product business
3. Royalty of \$27/unit for THIN-DOS
4. Package product price of \$55/unit
5. A product cost and price for THIN-DOS of \$5

THIN-DOS will be sold through a royalty licence and a per copy charge. The OEM will pay a royalty based on the number of PCs it ships. In addition, the OEM will pay a per copy charge for the THIN-DOS product. The OEMs will be monitored to insure they are not ordering more copies of THIN-DOS than PCs they are paying royalty on. Adjustment will be required for business inventories.

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### **PRODUCT DESIGN**

THIN-DOS will include full MS-DOS 5 functionality. It will be shipped shrink wrapped with the disks within the back cover of the manual. A corrugated sheet will be placed against the back cover of the manual before shrink wrapping to prevent damage to the disks from bending. THIN-DOS will not have a retail box and the OEM will be required to ship THIN-DOS within the box the PC is shipped. This design is to prevent gray market distribution.

The documentation will be the MS-PRESS concise guide text with a few modifications. The cover will be white with a red banner which reads, " For sale only with a ( place name of OEM here)" running diagonally in the top right hand corner. The OEM will be required to place the PC's name on a sticker which attaches to the shrink wrap over the designated area of the banner. For example, the cover would then read "For sale only with a (Dell PC)". A non-removable sticker will be specified in the licence agreement. The circular hologram will be placed on the cover of the manual. The rectangular hologram will be reduced and placed on the spine of the manual. It is important to include both holograms to be consistent with our anti-counterfeiting efforts. A hidden ink will be included on the cover as a second means of counterfeit detection.

The manual will include the following components

1. Cobb card
2. Coupon card( still under consideration)
3. User licence
4. Page with the 900 support number with directions to call the OEM first
5. The appropriate text of Getting Started
6. The MS-Press Concise Guide text

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**PRODUCT COST**

The royalty cost for the MS-press guide is still under negotiation. The component cost for THIN-DOS will be as follows:

Disk Set	\$1.70
5.25"     \$1.70	
3.5"     \$2.40	
Holograms	\$ .26
Corrugated Panel	\$ .05
Manual	\$1.30 ( Estimate, includes all cards)
Royalty	\$0.10 ( Estimate , assume flat fee amortized)
Labor Burden ( 4 x .11)	\$ .44
Total direct cost	\$3.85
Indirect multiplier	1.3
Total product cost( 5.25")	\$5.00
Total product cost ( 3.5")	\$5.91

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**PRODUCT PRICING**

The combined royalty and product price of THIN-DOS will be set low enough to encourage OEMs shipping naked systems or purchasing counterfeit DOS to switch. However, the price must be high enough to prevent existing royalty customers from switching. I suggest the following guidelines which attack the naked PC market and still prevent royalty customers from having an economic incentive to switch to THIN-DOS.

**THIN-DOS**

Royalty amount	\$27
Product cost	\$5
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Total THIN-DOS cost	\$32

**EXISTING ROYALTY**

Highest existing royalty amount	\$23
OEMs cost of producing DOS product	\$7
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Total existing royalty cost	\$30

Using these guidelines, existing royalty OEM will not have an incentive to switch to THIN-DOS. The street price for counterfeit DOS is about \$35; this pricing will allow Microsoft to compete with the counterfeiters. The introduction of THIN-DOS in conjunction with our increased anti-counterfeiting efforts should substantial reduce the sales of counterfeit DOS.

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### **GRAY MARKETING PREVENTION**

It is very important to control the gray marketing of THIN-DOS since the cost of the package is \$5 and the perceived value is over \$50. There are seven characteristics of THIN-DOS designed to prevent gray marketing.

1. The packaging will be ugly to discourage stand alone retail sale.
2. THIN-DOS will be shipped without a retail box.
3. The cover of the manual will have a red banner with the text "FOR SALES ONLY WITH A ( )".
4. The PC manufacturer will be required to place a non-removable sticker with the name of the PC on the shrink wrap over the appropriate area.
5. The OEM will be required to ship THIN-DOS within the PC box.
6. Audit provisions will be delineate in our contract with the OEM which allow the OEM as well as the OEM's customers to be audited at our request.
7. Since we will do the manual production and disk duplication, we have much tighter control and monitoring of the number of units of THIN-DOS an OEM ships.

### **AUDIT PROVISIONS**

There will be provisions in the contract to allow for spot audits of OEMs and their distributors. In our contracts with OEMs, we will specify that the OEM must contract with their distributors and dealers to allow Microsoft driven audits. These spot audits should explore the following conditions:

1. The OEM is not shipping more THIN-DOS than PCs.
2. THIN-DOS is only distributed within the PC box.
3. THIN-DOS is not being sold stand alone.
4. The OEM is placing the appropriate nonremovable sticker in the correct location as agreed to in the contract.

Microsoft will need to act swiftly when OEMs and distributors are in violation of these conditions. The damages associated with gray marketing of THIN-DOS are much greater than for packaged product MS-DOS. The details of the audit contract provisions and audit implementation need to be resolved.

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