

A MORTAL MICROSOFT

Competitors, customers find cracks in software empire



By Mike Ricciuti, Alorie Gilbert and Joe Wilcox
Staff Writers, CNET News.com
October 14, 2002, 4:00 AM PT

For the first time in years, Microsoft seems vulnerable.

The technology recession, strategic miscalculations and general wariness following the Justice Department's four-year antitrust case have resulted in a psychological shift against Microsoft throughout the industry. Rivals and customers are sensing opportunities to challenge the software empire after decades of presumed invincibility.

In this four-part special report, CNET News.com examines key technologies, competitors and internal mistakes that are exposing cracks in the Microsoft kingdom.

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As high-profile problems with its .Net campaign have shown, the software giant can be its own worst enemy in major initiatives.

A MORTAL MICROSOFT

Open source: Rebels at the gate

By Mike Ricciuti
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For years, Bill Gates and other top executives at Microsoft railed against the economic philosophy of open-source software with Orwellian fervor, denouncing its communal licensing as a "cancer" that stifled technological innovation.

Today, Microsoft claims to "love" the [open-source concept](#), by which software code is made public to encourage improvement and development by outside programmers. Gates himself says Microsoft will gladly disclose its crown jewels--the coveted code behind the Windows operating system--to select customers.

"We can be open source. We love the concept of shared source," said Bill Veghte, vice president of the Windows Server Group. "That's a super-important shift for us in terms of code access."

Did Microsoft suddenly find open-source [religion](#)? Hardly. It was dragged there kicking and screaming by its customers, who are increasingly drawn to open-source software like Linux, whose inner workings of code can be seen by anyone and modified.

While small in scope, Microsoft's adoption of some key open-source tenets is monumental in meaning. It is an acknowledgement that the company sees the technology as its [most serious competitor](#) in years and is taking steps to make sure its Windows franchise can survive the attack.

The open-source movement also represents a larger threat to Microsoft that transcends any particular technology or company: The high-tech industry has undergone a psychological shift that encourages challenges to Microsoft, which for many years had been technologically possible but practically unthinkable.

For a combination of reasons ranging from the troubled economy to mistakes in Microsoft business strategies, many large companies are wondering, for the first time in maybe a decade, why they pay so much for its products and how they can get by with less.

"This is going to force Microsoft to look at how they structure their software architecturally, and how they package and market their products, and I think that's good," said Michael Cherry, an analyst with [Directions on Microsoft](#).

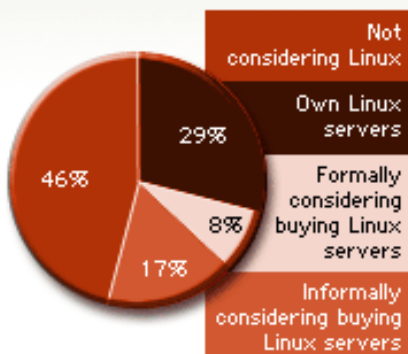
Microsoft has itself to blame at least in part for strengthening the hand of its rivals. A

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LINUX ON THE MIND

In a survey of 225 chief information officers conducted in August by Morgan Stanley, about half of the respondents said they either own or are considering buying Linux servers.



"WE CAN BE OPEN SOURCE. WE LOVE THE CONCEPT OF SHARED SOURCE."

--Bill Veghte, vice president, Microsoft Windows Server Group

"WE'RE LEARNING, IF YOU WILL, FROM THE LINUX WORLD."

--Steve Ballmer, chief executive, Microsoft

"THERE HAS YET TO BE ANY INNOVATION, NEW FEATURES, NEW CAPABILITIES OUT OF THE LINUX PLATFORM."

--Microsoft's Ballmer

"THE FUNNY THING ABOUT THIS LINUX THING IS IT MIGHT

controversial new software licensing [policy](#), which raises prices for some customers and asks them to pay in advance for future releases, has angered many Microsoft customers and driven them to seek cheaper alternatives such as Linux.

While no one expects the open-source trend to affect Microsoft's profits immediately--the company is still ringing up record sales and has roughly \$40 billion in cash--it is clear that the technology's popularity has forced the company to respond.

"Microsoft hasn't yet been hurt by Linux in any absolute sense, but open source gives customers alternatives," said Jonathan Eunice, an analyst with market researcher Illuminata. "It means Microsoft has to devote some of its resources to thinking about how to combat it. It makes Linux and open source a strategic problem, not a 2002 revenue-loss problem."

Microsoft customers say the software giant has already made significant changes, such as sharing source code with large customers and launching a "trustworthy computing" initiative to button-up troublesome security holes in its software.

"We're learning, if you will, from the Linux world," Microsoft Chief Executive Steve Ballmer told CNET News.com.

The company's next server version of Windows will ask clients to join online newsgroups for support and advice, following the community-based traditions of the open-source [philosophy](#).

"With open source, I can make systems work where closed-source software just won't," said Phillip Windley, chief information officer of the state of Utah and a longtime Microsoft customer. "I can't always afford to wait for a software vendor to come around to my way of thinking."

Too little, too late?

The question is, did Microsoft act too late? In just the past year, many companies have found that open-source software has gained a level of sophistication that makes it a viable alternative to Windows for server systems and Web site operations. [Amazon.com](#), [Verizon Communications](#) and Air New Zealand have all switched to Linux over the past 12 months to cut costs.

Initially, Linux was seen as a competitor to Windows only for server operating systems, used by roughly 27 percent of corporate servers and more than half of all Web servers, according to industry researcher IDC. Recent moves, however, have begun to [strengthen](#) Linux's appeal in desktop PCs when combined with open-source alternatives to Microsoft's Office, such as Sun Microsystem's StarOffice.

That's leading some longtime Microsoft customers to the next, once-unthinkable step: serious consideration of Linux and other open-source software as a replacement for Windows and Office on their desktop systems.

Satish Mahajan, chief information officer of American Automobile Association, is evaluating Linux for his server systems and beginning to eye the open-source software for his desktops as well. "When

Special report It's a Linux World ▶

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"THE FUNNY THING ABOUT THIS LINUX THING IS IT MIGHT JUST END UP BEING THE PERFECT KIND OF THREAT FOR MICROSOFT."

--Rob Horwitz, analyst,
Directions on Microsoft

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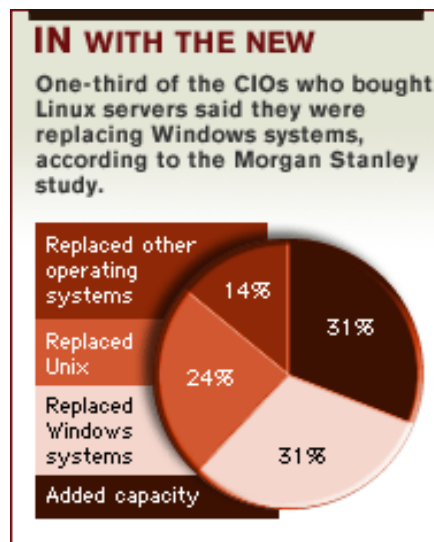
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I talk to my colleagues, I hear more and more willingness to move a portion of their businesses to Linux. I'm still weighing the pluses and minuses, but it has moved up on my scale," he said.

MICROSOFT ON ALL FRONTS

The software giant faces tough competitors in key markets where it hopes to expand:
[Scroll over graphic to view other markets.]

OPEN SOURCE

[Operating systems]

Microsoft product:
Windows
Competitor:
Linux, distributed by Red Hat, IBM, SuSE, others

[Web servers]

Microsoft product:
Internet Information Server
Competitor:
Apache, used by nearly two-thirds of all Web sites

[Application servers]

Microsoft products:
Windows 2000 Server, upcoming Windows .Net Server
Competitor:
Linux running Tom Cat, an open source Java application server that works with Apache

[Development tools]

Microsoft product:
Visual Studio.Net
Competitor:
Eclipse, an IBM-led open-source initiative to define a common way to link Java tools

[Desktop applications]

Microsoft product:
Microsoft Office
Competitors:
StarOffice, a low-cost desktop application suite from Sun Microsystems
OpenOffice, an open source implementation of the suite

ENTERPRISE

Microsoft:
The software giant's Great Plains and Navision acquisitions place Microsoft in the enterprise market.
Competitors:
SAP, PeopleSoft, Oracle, J.D. Edwards, Siebel Systems, others

MSN

Microsoft:
As the company increasingly turns to MSN as its flagship in the consumer market, competition also increases.
Competitors:
AOL, Yahoo

.NET

Microsoft:
.Net is Microsoft's far-reaching plan to revamp its entire software architecture via Web services and XML.
Competitors:
Java-based initiatives from: Sun Microsystems, IBM, Oracle, BEA Systems

Individual products from nearly every software maker and distributor, including Borland, Sybase, Plumtree, Ximian, Red Hat and others.

Mahajan and others say cost is only one reason for the decision to evaluate Linux. In Microsoft's modern world, its products are seen by a growing body of corporate technology managers and even some of the world's governments as inflexible, expensive and bloated. Large companies and public agencies--some of Microsoft's best [customers](#)--are [weighing](#) Linux and open source to simplify their operations and get off the [update-replace treadmill](#) long prevalent in the computer business.

Microsoft executives [acknowledge](#) the rising threat but, mindful of the popularity of Linux and open source among their customers, have tempered their comments.

"We need to take a balanced tone," said Microsoft's Veghte, the man assigned by CEO Steve Ballmer to come up with a competitive strategy toward Linux. "No matter how you look at it, Linux is a huge competitor and isn't going to go away."

Still, Ballmer--never known to mince words--is quick to point out where he sees Linux lacking. "The Linux client hardly runs any applications except a bunch of shareware stuff that's not very good," he said. "There has yet to be any innovation, new features, new capabilities out of the Linux platform.

"First they cloned Unix, and there are people working on cloning some of our stuff. But it's just a cloning OS. I don't think anyone should expect anything innovative coming out of that world," said Ballmer.

The most difficult part of this competition is one of simple economics: Linux and other open-source technologies are licensed for free. That's where Microsoft can't compete, a point Ballmer willingly concedes. As Ballmer said at a recent conference in London, "We cannot price at zero, so we need to justify our posture and pricing."

But Ballmer thinks price is only one reason why companies are considering Linux. "People are

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Ballmer: United, we'll stomp on Linux
<http://news.com.com/2100-1001-959165.html>

Sweeping changes at America Online
<http://news.com.com/2100-1023-957632.html>

going to look at Linux, whether our stuff costs \$5, \$50 or \$100. So we have to work that value proposition every day."

Numbers cause concern

In a recent [survey](#) of 225 chief information officers, 29 percent said they owned Linux servers and 8 percent are formally considering buying them. More troubling for Microsoft, 31 percent of those who recently purchased a new Linux server used it to replace a server running Windows.

Many technology managers cite the controversy over Microsoft's new licensing plan in their reasoning.

"We're looking at Linux as a less expensive alternative to Windows and Office," said Alan Flint, systems applications manager at Richmond Wholesale, a food distributor in Richmond, Calif. "I'm looking for more simplification in my environment because I'm displeased with Microsoft's licensing programs."

Mahajan said Microsoft's licensing plan is also driving him to take a closer look at Linux. "The cost of Microsoft's software continues to increase and change from the old days, where you could buy Windows 98 and keep it for three years. That's not an option anymore. You have to pay."

Utah's Windley agrees, saying the new plan "just makes people more leery" of Microsoft. "I've got a whole group of IT workers in this state who are tired of the licensing headaches with Microsoft. They want OpenOffice (an open-source version of Sun's StarOffice) just to do away with the headaches."

Flint sees another trend driving large companies away from Microsoft: the company's [practice](#) of issuing frequent upgrades and new versions of its products, often ahead of its customers' willingness to buy those products. "Microsoft wants to lock in their revenue by having customers tied to subscriptions. I think they are changing their licensing because there aren't many features that users are clamoring for."

Cherry of Directions on Microsoft said these comments are echoed throughout the industry as technology buyers are much more price-conscious than they were in the 1980s and 1990s. "Linux is becoming more of a threat because customers used to be a lot less sensitive. Whether it was money or whether each version of Windows had enough compelling features, they were willing to upgrade even if it cost them more hardware," he said.

"Now they look at something like Windows XP and say, 'OK, it's more stable, but I have to buy new machines. I don't think Microsoft has ever made a version of its products that used less resources than the previous version.' Or, 'Windows 2000 Server looks really good, but all I need is a Web site, and I can take this old 486 and I can put Red Hat Linux and Apache on it and have a Web server up in no time at all,'" Cherry said.

Support from big guns

Moreover, technology buyers said Linux is getting better in quality and range, largely because of help from Microsoft's rivals. "Once folks like IBM and Sun started providing support for Linux, (they) made Linux better by plugging some holes and providing better support," Mahajan said.

That, coincidentally, is exactly how Microsoft got its foot in the door with Windows back in the 1980s. "Microsoft used the divide-and-conquer marketing tactic. They didn't go to IT managers-- they went to business departments. And suddenly, the IS manager looked around and said, 'Man, we're running a lot of Microsoft stuff.' So I think that's going to happen with Linux," Cherry said.

Nevertheless, despite the significant challenge posed by Linux and open source, Microsoft

hardly has its back against the wall. Linux may have become a bona fide competitor in the server market, but Microsoft still rules on the desktop.

Industry veterans, including many Microsoft customers, note that it is extremely difficult--and expensive--to unseat the incumbent technology in large companies. One of the largest costs is retraining users.

"It would be very hard to convince the mainstream user in Utah state government that Linux is the right desktop choice for them. Most of the reason for that is not functionality--it's training," said Windley, who supports 22,000 desktops throughout Utah. As a CIO contemplating making such a huge change, he noted, "you have to be willing to fall on your sword, because you very well may expire doing it."

In addition, those companies that did agree to Microsoft's new licensing program have paid to use the company's products for up to three years in advance, making it unlikely that they will switch to a competitor.

But the mere existence of Linux will most likely benefit Microsoft's customers in the long term. In fact, many longtime analysts said that, with the slump in the technology business and the weakening of some key rivals, Microsoft needs Linux.

"The funny thing about this Linux thing is it might just end up being the perfect kind of threat for Microsoft," said Rob Horwitz, another analyst with Directions on Microsoft. "It's something that ain't gonna kill Microsoft, but it is something that will help it focus on who the enemy is and what they have to do."

Key to that battle plan is making its products more secure and reliable, customers say, as well as changing licensing policies to be less complicated. Otherwise, Microsoft will find itself the victim of a time-honored trend in the computing business: obsolescence.

"Linux is the end game in 'good enough' computing," Illuminata's Eunice said. "It's great stuff, it comes at little or no cost, and it's good enough to do the job. Just as Windows gave Unix makers fits in years past--and the Unix makers gave minicomputer guys fits, and minicomputer guys gave the mainframe makers fits--open source is giving Microsoft and Windows fits." ■

A MORTAL MICROSOFT

Enterprise: Clash of the titans

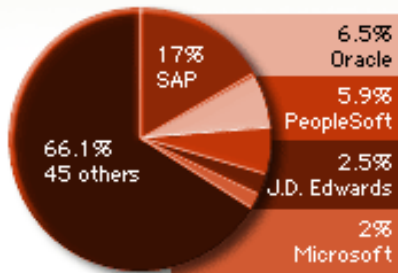
By Alorie Gilbert
Staff Writer, CNET News.com
October 15, 2002, 4:00 a.m. PT

Two unlikely destinations far from Microsoft's Seattle-area headquarters are becoming increasingly important to its future: Fargo, N.D., and Vedbaek, Denmark.

Those are the respective locations of Great Plains Software and Navision, which Microsoft acquired in one of its most important initiatives in years. The two companies, which make accounting and other software, form the core of Microsoft's long-planned move into enterprise applications--complex programs designed to help companies do such things as close books, process orders, manage inventory, and track customers, suppliers and employees.

MICROSOFT LEAPFROGS INTO ERP

By virtue of its purchase of Great Plains Software and Navision, Microsoft has moved into the top five among makers of software for enterprise resource planning.



Source: IDC, based on 2001 worldwide sales

That is a daunting prospect even for the world's largest software company, thrusting it into unfamiliar terrain dominated by such industry giants as Oracle, SAP, Siebel Systems and PeopleSoft.

"(Microsoft's) intention is to lead and dominate the midmarket for business applications, not just for accounting but by selling anything an enterprise would need to run their business," said Paul Hamerman, an analyst at technology research company Giga Information Group.

Microsoft, however, can hardly be characterized as an underdog. Controlling more than 90 percent of the desktop operating system and business application markets, the company has unparalleled influence on the entire high-tech industry and has repeatedly shown that it can take new markets away from long-established competitors.

The company sees its thrust into enterprise business applications as the linchpin of a broader [strategy](#). As sales of its mainstay Office business software begin to wane, Microsoft is hoping to tap into the multibillion-dollar potential of the enterprise software market and the twin technologies that have become hot corporate trends in recent years--enterprise resource planning and customer relationship management, better known in the business as ERP and CRM.

"Both the consumer and business markets for desktop applications are saturated," said Matt Rosoff, an analyst at [Directions on Microsoft](#). "It's getting harder and harder to get people to upgrade to the next version of Office. So, one way for Microsoft to grow is to get into markets where it hasn't been competing, such as enterprise applications."

Microsoft Chief Executive Steve Ballmer told CNET News.com that the software maker is

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"IT'S GETTING HARDER AND HARDER TO GET PEOPLE TO UPGRADE TO THE NEXT VERSION OF OFFICE."

--Matt Rosoff, analyst,
Directions on Microsoft

"THE BIGGEST PART OF THE COMPUTER MARKET IS NOT THE ENTERPRISE OR THE CONSUMER MARKET. IT'S THE SMALL AND MEDIUM-SIZE BUSINESSES."

--Steve Ballmer,
chief executive, Microsoft

"MANY SMALL BUSINESSES HAVE NOT GRASPED THE VALUE OF CRM SOFTWARE."

concentrating on what he sees as a hugely lucrative market serving small- and medium-sized businesses. "The biggest part of the computer market is not the enterprise or the consumer market. It's the small and medium-size businesses," he said.

Ballmer also downplayed competition with established business application makers. "There will be some overlap between us and SAP, Siebel and others...But that overlap isn't 90 percent of their revenue or 90 percent of our revenue. It's a small percentage of our revenue in both CRM and ERP," Ballmer said.

Key to Microsoft's strategy is a time-tested weapon it employs in hostile territory: undercutting prices. When the company wanted to make its SQL Server database management software a market leader on Windows, Microsoft slashed prices in competition with database giant Oracle. To gain a foothold in the local networking business dominated by Novell, the company heavily discounted its LAN Manager software. And to displace WordPerfect as the ruler of word-processing software, Microsoft created Office as a value pack of business applications.

The practice continues with enterprise software, particularly in customer relationship management. Microsoft CRM, or MSCRM, will debut this year at prices between \$20,000 and \$30,000 for complete packages, including setup and integration. Competitive products routinely sell for at least \$100,000 and can often cost millions of dollars when integration and consulting fees are included, giving Microsoft a huge edge with small to medium-size customers.

In some respects, Microsoft is taking a page from Oracle's playbook. Both companies used their roots in IT infrastructure, such as databases and development tools, to branch out into applications that run atop such products. Selling applications in turn fuels new sales of infrastructure products.

That means every time Microsoft makes an enterprise application sale, it sells more copies of products like Windows operating systems and the SQL Server database--used by all of Microsoft's enterprise applications--along with development tools like Visual Studio.Net. As an added incentive, Microsoft is offering steep discounts to customers that buy business applications and infrastructure software.

"Microsoft is hoping that its business solutions unit will not only spur sales of new products, it will help them sell...more copies of Windows and encourages the sell-through of Exchange (e-mail server software) and Office," said Rosoff. "They have a tremendous amount of money to invest in this business. They can't be ignored."

If Microsoft at times seems obsessed with enterprise applications, the numbers show why. The market has been a lucrative one, generating double-digit growth for leading software companies until the recession dampened demand. In the late '90s, businesses rushed to install new enterprise applications as a way to avoid [Y2K problems](#). Companies invested in still more applications to join the dot-com boom.

Microsoft may have missed those waves, but it has no intention of being left out in the next one. The company predicts that the market will pick up again in two to four years, giving it just enough time to integrate the companies it has acquired, assemble various products and accelerate its sales efforts.

Special report

Microsoft plays for keeps ▶

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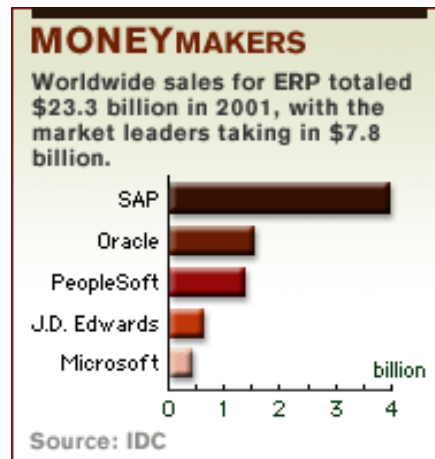
November 15, 2001

**NOT GRASPED
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--Joe Outlaw,
technology analyst, Gartner

**"MICROSOFT HAS
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--Elaine Coorens, president,
Coorens Communications



Microsoft executives also hope a thriving enterprise applications business unit can help offset any [slowdown](#) in the desktop applications market. Office sales are down slightly for the year, and there's little room for growth aside from selling upgrades to existing customers--a troubling indicator for a product that contributes more than one-third of Microsoft's revenue.

That's where Great Plains and Navision come in. Great Plains, which Microsoft [bought](#) for \$1.1 billion, had around \$300 million in revenue last year; Navision, [acquired](#) in July for \$1.45 billion, gives Microsoft an instant market in Europe with \$181 million in sales last year. Together, the two companies constitute Microsoft Business Solutions, one of seven lines of business Microsoft Chief Executive Steve Ballmer named as core areas of focus and investment for the company.

The fledgling unit, with several hundred million dollars in annual revenue, makes up a wee portion of Microsoft's \$28.37 billion in sales and is dwarfed by SAP, the 800-pound gorilla in the market, with \$7.24 billion in revenue last year. But Microsoft has far-reaching plans for rapid expansion.

"To accelerate demand and get customers to switch to Microsoft applications, it will take a next-generation value proposition, and that's about three years out," said Lynne Stockstad, general manager of Microsoft Business Solutions.

It may be even longer if Microsoft hopes to create a franchise that approaches anything like the wild success of Office and its popular desktop applications, such as Word, Excel and PowerPoint. Where such desktop software is designed for personal use, enterprise applications have the task of improving large-scale and complicated business operations.

In addition to six product lines it gained in its acquisitions, Microsoft plans to introduce [five new sets](#) of applications in the next 12 months. One of these sets, [MSCRM](#), is designed to help companies streamline their sales and marketing, making Microsoft a player in the customer relationship management market ruled by Siebel Systems. A second set is meant to help service companies organize projects and delegate work, and yet another aims to help retailers track inventory and gather sales information.

MICROSOFT ON ALL FRONTS

The software giant faces tough competitors in key markets where it hopes to expand:
[Scroll over graphic to view other markets.]

OPEN SOURCE	ENTERPRISE
<p>[Operating systems] Microsoft product: Windows Competitor: Linux, distributed by Red Hat, IBM, SuSE, others</p> <p>[Web servers] Microsoft product: Internet Information Server Competitor: Apache, used by nearly two-thirds of all Web sites</p> <p>[Application servers] Microsoft products: Windows 2000 Server, upcoming Windows .Net Server Competitor: Linux running Tom Cat, an open source Java application server that works with Apache</p> <p>[Development tools] Microsoft product: Visual Studio.Net Competitor: Eclipse, an IBM-led open-source initiative to define a common way to link Java tools</p> <p>[Desktop applications] Microsoft product: Microsoft Office Competitors: StarOffice, a low-cost desktop application suite from Sun Microsystems OpenOffice, an open source implementation of the suite</p>	<p>Microsoft: The software giant's Great Plains and Navision acquisitions place Microsoft in the enterprise market. Competitors: SAP, PeopleSoft, Oracle, J.D. Edwards, Siebel Systems, others</p> <hr/> <p style="text-align: center;">MSN</p> <p>Microsoft: As the company increasingly turns to MSN as its flagship in the consumer market, competition also increases. Competitors: AOL, Yahoo</p> <hr/> <p style="text-align: center;">.NET</p> <p>Microsoft: .Net is Microsoft's far-reaching plan to revamp its entire software architecture via Web services and XML. Competitors: Java-based initiatives from: Sun Microsystems, IBM, Oracle, BEA Systems</p> <hr/> <p>Individual products from nearly every software maker and distributor, including Borland, Sybase, Plumtree, Ximian, Red Hat and others.</p>

But Microsoft faces serious competition in these areas, not the least of them a fierce group of [rivals](#) including SAP, Siebel, Oracle, J.D. Edwards and PeopleSoft. Moreover, Microsoft needs to convince its all-important application resellers--a loosely organized collection of companies that sell billions of dollars worth of software--that it offers them a better way to make money than these competitors.

"Microsoft has to convince systems integrators that it is a deal all the way around--marketing, sales, technology," said Rob Horwitz, an analyst with Directions on Microsoft.

Small companies, small prices

Microsoft hopes to succeed where SAP and others have stumbled, selling business applications en masse to small companies. For instance, MSCRM will have a starting price of \$395 per user and is targeted at companies of between 50 and 500 employees.

At that price, it's more likely to run into companies like Best Software, FrontRange Solutions and Salesforce.com rather than SAP or Siebel. Siebel's top-of-the-line applications typically require several million dollars to license and install, as well as a staff of IT experts to maintain.

But Microsoft defines its target market broadly, at companies with revenue between \$1 million and \$1 billion a year. Around the middle of that range, it will encounter larger competitors that are struggling in the weak economy and are setting their sights lower on smaller businesses.

Then, the [competition](#) between Microsoft and the likes of SAP, Oracle and PeopleSoft will reach "biblical proportions," said Ram Gupta, executive vice president of products and technology at PeopleSoft.

As a strategic advantage, Microsoft touts its network of 4,500 sales partners that specialize in delivering software to small businesses. Software companies like PeopleSoft and Oracle employ a large, expensive direct sales force often populated with representatives who have a taste for big commissions. These companies also rely on expensive consultants called systems integrators to install their products.

Though a strength, Microsoft's network of sales partners also pose another challenge for the company. Only a fraction of the worldwide network of Microsoft resellers are actually up to speed on Microsoft Business Solutions applications, and some traditional Microsoft resellers are tentative about such applications.

A different ball of wax

Michael Cocanower, president of ITSynergy, a Microsoft reseller in Phoenix, illustrates this point well. His company specializes in setting up databases, custom software and computer networks for companies with up to 250 personal computers

"To sell someone an accounting system, that's a whole different ball of wax," Cocanower said. "We don't have expertise in accounting, and accounting is not an area of business I'm really excited to get into. It's such an important part of a company. If you screw it up, you can really cause problems."

Some resellers complain that Microsoft and its Business Solutions division still behave like different companies, and the lack of coordination discourages them from getting involved with Great Plains, Navision and the Business Solutions unit. "We have a great relationship with Microsoft--they pass off sales leads, for instance. That reputation gets us nowhere with Great Plains," Cocanower said.

Microsoft is also undertaking the massive task of rewriting the applications it has acquired with

Great Plains and Navision so that all the products use the same code base. That task, which involves rewriting several million lines of software using Visual Basic and C++ programming languages, will take an estimated three years and the combined effort of 1,500 software developers, said Jeff Edwards, an executive with Microsoft's Business Solutions unit.

Once complete, the integration will make it easier for Microsoft to maintain and further develop the products. It will also enhance interoperability between the different applications.

As far as new Business Solutions applications are concerned, Microsoft is already taking heat for Small Business Manager, an off-the-shelf accounting package it introduced nearly a year ago that is designed to compete against Intuit's QuickBooks. Some resellers say the product doesn't stand up well.

One of many obstacles

"If you do a comparison for what people need, the cost of QuickBooks is more favorable," said Elaine Coorens, president of Coorens Communications, a Microsoft certified partner in Chicago. "It's also easier to use, and you can get more out of it."

Stockstad said Microsoft Business Solutions is introducing a new version of the product soon that should make it more competitive, but analysts say this is just one of many battles the company will face. Microsoft's new customer management software, for example, may pose far more serious obstacles.

"Many small businesses have not grasped the value of CRM software," said Joe Outlaw, a technology analyst at Gartner. "Very small companies already tend to view themselves as customer-focused. If they don't know their customers, they're not in business."

Microsoft says the value of all its Business Solutions applications is intertwined with the delivery of its .Net products, the next-generation version of its operating systems, database and development tools designed to make companies more efficient by harnessing the Internet.

Nevertheless, as often happens with grand plans, the release of .Net products has taken longer than promised. "Microsoft has been pushing this concept for a long time. But there is not a lot out there product-wise," Coorens said.

With the release of its CRM suite and a new application called Microsoft Business Network, scheduled to ship in the first quarter of next year, the company says .Net will begin to become a reality. Both products are being designed to take business transactions typically handled by phone, fax and paper--such as purchase orders, receipts and inventory checks--and move them online.

".Net is about being able to connect," Stockstad said. "And connectedness means more automation between businesses and their customers, partners and employees."

That may sound good, but will small businesses with bare-bones technology staffs be convinced?

"It's a challenging market, the small to mid-size business market," said Rosoff of Directions on Microsoft. "It's fragmented for a reason. It's hard to reach these people." ■

A MORTAL MICROSOFT

Services: A risky bet on MSN

By [Joe Wilcox](#)

Staff Writer, CNET News.com
October 16, 2002, 4:00 a.m. PT

Only a year ago, Microsoft and the rest of the high-tech industry were anticipating huge consumer demand for Web services ranging from shopping to communication. Then reality set in.

Originally code-named HailStorm, Microsoft's plan for delivering consumer Web services immediately ran into resistance because of [security concerns](#) and [confusion](#). Microsoft made matters worse by publicly christening the program as .Net My Services, a name often [mistaken](#) for its broader .Net technology architecture.

Now, the company is building its consumer Web services around its MSN Internet access service--a move that poses yet another set of risks, given that the online property has been a money-losing operation for years. The decision will fall under intense scrutiny this month when Microsoft breaks out MSN revenue from other consumer products for the first time in the company's quarterly financial report.

"That puts a spotlight on MSN. Wall Street looks and sees that, again and again, all this thing does is lose money," said Rob Horwitz, an analyst with [Directions on Microsoft](#). "It's time to figure out how to make this puppy profitable."

The gamble has ramifications well beyond MSN. The move represents an important change in strategy for Microsoft, which had originally sought to provide the [infrastructure](#) needed for e-commerce sites and other consumer businesses to run Web services. Through HailStorm, for instance, Microsoft had planned to offer Web hosting and access to a rich database of customer spending habits.

But Microsoft realized it has relatively little experience as a [hosted services provider](#), so it plans instead to refocus on what it does best: Sell software. "Nobody at Microsoft was able to clearly explain and plot out a timeline where the company would start making money from its services. Microsoft is a product company," Horwitz said.

The product, in this case, is MSN. By offering these new Web services almost exclusively through this venue, the software giant is taking a step backward in its Web services plans and betting that MSN subscribers will pay to use those services, even though the company has not figured out how to make the online network profitable so far.

To some industry veterans, Microsoft's plan basically is trying to make a right out of two wrongs. But Paul-Jon McNealy, an analyst at Gartner, said the company is taking the right steps by adding potentially lucrative services to MSN. "If you look at how you build incremental revenue streams, you start with advertising and look at pieces people are interested in early on. That's music and games in the narrow- and broadband stuff, and movies down the road," he said.

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"WE HAVE THIS SORT OF DOUBLE-EDGED SWORD."

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"IF YOU LOOK AT THE AMOUNT OF TIME PEOPLE SPEND ON THE INTERNET, AOL IS HUGE."

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MICROSOFT ON ALL FRONTS

The software giant faces tough competitors in key markets where it hopes to expand:

[Scroll over graphic to view other markets.]

OPEN SOURCE	ENTERPRISE
<p>[Operating systems] Microsoft product: Windows Competitor: Linux, distributed by Red Hat, IBM, SuSE, others</p>	<p>Microsoft: The software giant's Great Plains and Navision acquisitions place Microsoft in the enterprise market. Competitors: SAP, PeopleSoft, Oracle, J.D. Edwards, Siebel Systems, others</p>
<p>[Web servers] Microsoft product: Internet Information Server Competitor: Apache, used by nearly two-thirds of all Web sites</p>	<p>MSN</p> <p>Microsoft: As the company increasingly turns to MSN as its flagship in the consumer market, competition also increases. Competitors: AOL, Yahoo</p>
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<p>[Desktop applications] Microsoft product: Microsoft Office Competitors: StarOffice, a low-cost desktop application suite from Sun Microsystems OpenOffice, an open source implementation of the suite</p>	

In many ways, the strategy is classic Microsoft: Use existing software to leverage other products, just as the company has done for decades with its Windows operating system. The difference, of course, is that the market share for the MSN Internet service has nowhere near the overwhelming dominance of Windows; in fact, the network trails its main competitor, America Online, by millions of subscribers. Moreover, Microsoft faces growing competition from consumer-focused companies like AOL Time Warner and Yahoo that are [offering services](#) of their own.

Still, Microsoft has committed itself to the Web services crusade in its search for new business as growth in the PC market--and therefore Windows--continues to level off. And after the disappointing results of its earlier consumer service initiatives, the MSN plan seems to make as much sense as anything else.

"Overall, we're seeing the entire industry making a shift, where more companies are offering less for free and focusing more on the bottom line," MSN product manager Lisa Gurry said. "(We're) also focusing more on profitability than we have in the past."

A tale of two MSNs

Microsoft's plan will split MSN in two. For years, Microsoft offered those using the free MSN.com

portal and those paying for the MSN Internet access service essentially the same content and Web services. Starting with the [release](#) of MSN 8, expected as early as October, Microsoft will separate what is offered through the Internet access service from the portal's options.

Rather than an a la carte menu of disparate paid services through MSN.com as earlier conceived, Microsoft will offer more focused services only to paying MSN 8 subscribers. Because those customers have already shown they are willing to pay for MSN's Internet access, Microsoft is targeting them as the most likely consumers of other online services. MSN 8 includes software from existing Microsoft products, such as Money or Picture It, that tie into additional Web services available for fees.

"The MSN.com portal will continue to deliver great content and services such as Hotmail and MSN Messenger," Gurry said. "But our focus on new technology innovations and services will be delivered primarily through our MSN 8 subscription service or future subscription services."

Microsoft is banking on some of those new technologies, such as [spam filtering](#), to woo customers from America Online, Yahoo and even MSN.com to MSN 8. "The parental controls are a nice hook," McNealy noted.

Executives say the strategy will allow Microsoft to consolidate its Web services into more easily managed chunks. MSN 8 will offer three prices based on whether consumers bring their own access, use a standard dial-up account or have a fast broadband connection. The company could offer still more pricing options by [adding services](#) tailored to particular types of customers, such as students and home businesses.

Portal without a cause?

Shifting emphasis to paid subscribers might make sense for services, but Microsoft must also address how to continue capitalizing on the popularity of MSN.com and not just cannibalize its business to grow MSN 8's rolls. Microsoft claims that 300 million people use the Web portal each month compared with 8.7 million MSN Internet subscribers.

Part of MSN.com's growth comes from its placement as the preset home page for the majority of computers sold to consumers. The portal also gets traffic directed from other Microsoft products, such as Money, Office, Windows XP and Internet Explorer, which automatically send surfers to MSN Search for unrecognized domain names.

"Our surveys show year after year that almost 50 percent of consumers don't change their home page," said Jupiter Research analyst David Card. "If (MSN) didn't have the default home page, I'm sure their traffic would go down a bit, but they're a serious contender. They deliver a collection of services that people have found useful."

As traffic rises, however, so do the costs of operation--something Microsoft has grappled to contain. And advertising revenue, the main source of income for Web portals, has not been able to keep up with these operational expenses as companies have tightened their ad budgets to survive the tech recession.

"We have this sort of double-edged sword," MSN Chief Executive Yusuf Mehdi said at a recent meeting with financial analysts. "As we get more Hotmail users, the cost to run that service has risen. And if the online ad market doesn't keep pace, you are not able to make that profitable."

Microsoft has attempted to reduce costs through technical changes and the addition of [premium paid services](#), such as more storage capacity for Hotmail. The software giant may also expand other portal services, such as the .Net Alerts service delivered through MSN Messenger and Windows Messenger.

Pointing to dollar signs

Recent figures show that Microsoft may be making some headway. Despite the weak ad market, the company reported that MSN revenue jumped 20 percent in fiscal 2002, which ended June 30, from the year before. The company's \$595 million ad revenue was up \$38 million from fiscal 2001.

Mehdi contrasted his group's performance against that of Yahoo, which saw dramatic declines in ad revenue last year. "Yahoo dropped just shy of \$200 million in the last fiscal year, according to their numbers," he said at the financial meeting. "And we grew roughly \$40 million in that year."

The combined MSN services and Yahoo are nearly equal in the amount of time their users are online, each commanding about 9 percent of the total hours spent on the Net in the United States. They hold significant leads over the next ranking companies, Electronic Arts and eBay, which generally have about 2 percent or 3 percent, according to Jupiter.

The AOL question

But Yahoo represents only part of what MSN is up against. Another part--challenging AOL's paid subscriptions--is far more important to its consumer services strategy.

"If you look at the amount of time people spend on the Internet, AOL is huge," Jupiter's Card said. "It's like 25, 26, 27 percent...which is monstrous. Its market share dominance is phenomenal."

Based on Microsoft estimates, AOL takes in about 30 percent of U.S. consumer Internet revenue versus about 5 percent for MSN. AOL also has more [paying subscribers](#) for its Internet access service, 35 million versus MSN's 8.7 million.

Yet even in that underdog status, Microsoft sees a potential for huge windfalls. By fiscal 2005, the company estimates that the consumer online services will present a \$48.7 billion opportunity, fueled by advertising, digital marketing and Internet access revenues. Just increasing Internet revenue share to 10 percent would yield MSN nearly \$5 billion in yearly sales, by Mehdi's estimates.

In addition, industry analysts believe that MSN is in a stronger position [than its rivals](#) to capitalize on the shift toward revenue from transactions rather than portal advertising and Internet access. That is partly because Microsoft benefits from a rapidly coalescing technology strategy that looks beyond advertising and Net subscriptions to new areas of business.

For example, analysts say, Microsoft is advancing its broadband service faster than its competitors and locking in transaction-based entertainment to deliver over those fatter pipes. Among those services are PressPlay for music, Intertainer for movies on demand and Xbox Live for games--all services tightly tied to MSN.com, MSN 8 or other Microsoft software, such as Windows Media Player 9 Series.

"Microsoft's a step ahead of both AOL and Yahoo on this one, even though AOL Time Warner has more content," Gartner's McNealy said. "Right now AOL is No. 1. Whether they remain No. 1 in two years remains to be seen." ■

A MORTAL MICROSOFT

Strategy: Microsoft vs. Microsoft

By Mike Ricciuti
Staff Writer, CNET News.com
October 17, 2002, 4:00 a.m. PT

Microsoft's marketing machine has always worked like clockwork: New versions of the company's software would roll out, and customers would faithfully update their products to get enticing new features.

With .Net, its far-reaching technology initiative that is reshaping product lines, the company is counting on nothing less. In fact, the success of technology architecture is crucial for Microsoft to keep revenue rolling in from its operating systems, server software and desktop products.

The [technical vision](#) for .Net has been widely praised, and the first tangible piece of the program--the [Visual Studio.Net](#) development tools--is a quantum leap ahead of earlier versions by all accounts. But so far, with a few exceptions, customer adoption of the .Net concept has been sluggish.

"The bigger issue with [.Net](#) is selling it and explaining it," said Rob Horwitz, an analyst with [Directions on Microsoft](#).

To be fair, all technology makers are struggling to sell products due to the current economic slowdown. But for Microsoft, which is trying to launch .Net--an entire revamping of its key products--the timing is especially bad.

In some ways, Microsoft may be its own worst enemy. For all the company's resources and business prowess, a combination of [marketing confusion](#), [licensing demands](#) and software compatibility problems may have triggered a backlash among customers, in turn slowing adoption of .Net.

Microsoft Chief Executive Steve Ballmer said the company may have erred with its licensing strategy. And he says Microsoft was too aggressive with its .Net labeling. "Turns out we shipped some products that didn't have .Net as we know it...and that confused things," he told CNET News.com.

But Ballmer argues that customers are adopting .Net--at least the .Net development tools--nonetheless. "The truth is, we probably made (licensing) a little harder to understand than we could have. But that has not mattered. We have a lot of customers doing projects now, enterprise customers, with .Net," he said.

The stakes are high with .Net because its overarching strategy will color all of Microsoft's current and future initiatives. Once again, the company is [betting](#) that customers will happily pay for more technology even if they haven't fully digested the last generation of Windows--a perilous assumption at a time when businesses are re-evaluating every penny of spending to survive the industry recession.

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.NET IN A NUTSHELL:

1. Web services: The key element of .Net. Web services built using XML (Extensible Markup Language) are small building block-like pieces of code that connect to each other and allow Web sites, internal computing systems and businesses to talk to each other. All of Microsoft's software is being retooled to understand and generate Web services. Though analysts say the Web services concept is catching on, Microsoft has had setbacks. A consumer-oriented Web services plan, called .Net My Services, is being retooled into a single server application for use within corporations and to be offered over the Internet by Web portals. Questions involving privacy and other issues prompted Microsoft to send the plan [back](#) to the drawing board.

2. Programming model: Called the .Net Framework, it expands the existing Win32 model to include Web services development and supports XML and SOAP (Simple Object Access Protocol). The new programming model, along with the company's Visual Studio.Net tools bundle, is intended to entice developers using Visual Basic and other Microsoft tools to build Web services applications on Microsoft's software.

3. Client software: Includes Windows XP for PCs, Windows XP

"We buy Microsoft products, and we have this sort of love-hate relationship with them like everyone else, I suppose," said Phillip Windley, chief information officer for the State of Utah. "Last year, they forced us to conduct an audit, which was very painful. And it turns out that the bottom line was that we have overbought. They didn't offer to refund any of those overbought licenses. But if we had underbought, they certainly would have required us to pay more money, I trust."

Windley and other customers say they aren't in any hurry to upgrade to new .Net products because the company's tactics to wring every penny of revenue from licensing deals have left a bad aftertaste. Under its controversial new licensing program, called Software Assurance, Microsoft requires customers to pay now for software they will receive later--thereby guaranteeing revenue and insulating itself from any delayed buying decisions by customers.

MICROSOFT ON ALL FRONTS	
The software giant faces tough competitors in key markets where it hopes to expand: [Scroll over graphic to view other markets.]	
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Essentially, the plan compels customers to switch to an annuity-based model, where they annually pay up front for upgrades under a two- or three-year contract. This effectively raised volume-licensing fees from 33 percent to 107 percent, according to market research firm Gartner.

The plan looks bulletproof on paper, but it's missing one crucial element: customer demand. Many cash-strapped companies are no longer automatically upgrading their products as they have in the past, prompting Microsoft to take extraordinary measures aimed at locking in sales.

To make .Net fly, "Microsoft needs to convince customers to upgrade. This is a challenge," said Horwitz.

Many Microsoft customers have [grumbled](#) about the licensing plan, but many have also signed up for it. In fact, Microsoft saw a boost in sales of its software last quarter, mostly due to companies scrambling to get their systems onto the most current version of Windows and, thus, remain eligible for discounted software upgrades in the future.

In the short term, that puts money into Microsoft's coffers. In the long term, that carrot-and-stick approach may not always work. It puts Microsoft on a treadmill to deliver new technology in a timely

Embedded for set-top boxes and other thin-client computers, and the Windows CE .Net operating system for PDAs (personal digital assistants). All support the .Net Framework programming model.

4. .Net Enterprise Servers:
 Revamped versions of Microsoft's SQL Server, Exchange Server and other server software tuned to .Net are in the pipeline and will begin shipping late this year. First up: Windows .Net Server, a new version of the company's server operating system and the foundation for many future products from the company. Then Microsoft plans to turn its attention toward linking companies so that .Net systems can span organizations. New security software code-named [TrustBridge](#) is expected to debut in the first half of next year, along with real-time communications software, code-named Greenwich. Additional development tools are also [slated](#) to debut.

--Mike Ricciuti

"TURNS OUT WE SHIPPED SOME PRODUCTS THAT DIDN'T HAVE .NET AS WE KNOW IT...AND THAT CONFUSED THINGS."

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"WE BUY MICROSOFT PRODUCTS AND WE

manner, or customers may not sign up for the plan again.

"The timing between releases of products like Windows 2000 Server or Windows.Net Server is like three years or more," said Horwitz. "What if a company misses that window? What's Microsoft's answer to (customers) when they ask, 'Tell me exactly how my money was well spent'?"

"This is a ticking-clock challenge that they have really not had before," he said.

Another issue that may keep buyers from grabbing up the latest version of Microsoft's software is compatibility problems in moving older applications to the new .Net products.

While .Net represents "many areas of significant improvement and innovation over the previous generation of Microsoft technologies," according to a recent Gartner report, migrating old applications can be a challenge.

Gartner says "a surprisingly large amount of change" may be required to move older applications to .Net. At best, 40 percent of existing code written using Microsoft's Visual Basic 6 programming tools can be migrated to VB.Net, the new version of Visual Basic, without "substantial redesign and re-coding," the firm warns.

One telling detail from Gartner's report: Some of Microsoft's own [strategic products](#), such as SharePoint Portal Server, have not been migrated to .Net, and won't be native .Net applications for at least three years.

Microsoft does offer many tools to linking older applications into the .Net world, and many companies will want to move to .Net just for the boost in performance and stability, analysts said.

And finally, old bugaboo still haunts Microsoft: Making its Windows server software as secure and reliable as Unix and other large system software. That issue may go away with Windows .Net Server, said analysts. And Microsoft's Trustworthy Computing initiative is designed to quell security and reliability concerns.

But first, the company has to convince customers to buy .Net Server and other products, and it has to overcome longstanding resistance to using Windows on the most critical business systems.

"Microsoft is trying to convince everyone that their (server) software is ready for prime time," said Windley. "Maybe someday, but I think today there are significant security and reliability hurdles that they have yet to overcome. (Windows) XP is a huge step in the right direction, but it's still nowhere near as bulletproof as Unix." ■

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