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How Microsoft keeps reinventing itself

Member exclusive by



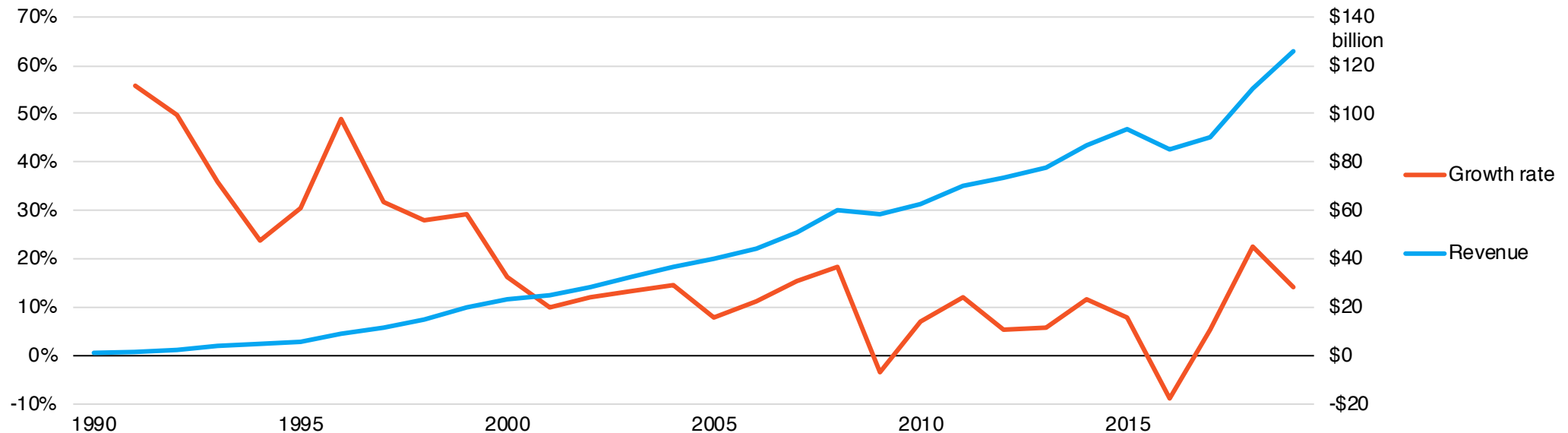
Dasia Moore

The oldest tech giant

At 45 years old, Microsoft seems to just be getting started. After struggling to keep its footing in a changing tech industry in the late 2000s and 2010s, the company is regaining momentum. In 2019, it reached a \$1 trillion market cap—an achievement only three other US companies can claim. More importantly, under CEO Satya Nadella, Microsoft has completely transformed its business model and established itself as a leader for a new era, surpassing its competitors in services revenue and emerging as a top competitor in cloud computing.

Microsoft year-on-year growth rate and annual revenue, 1990-2019

By fiscal year

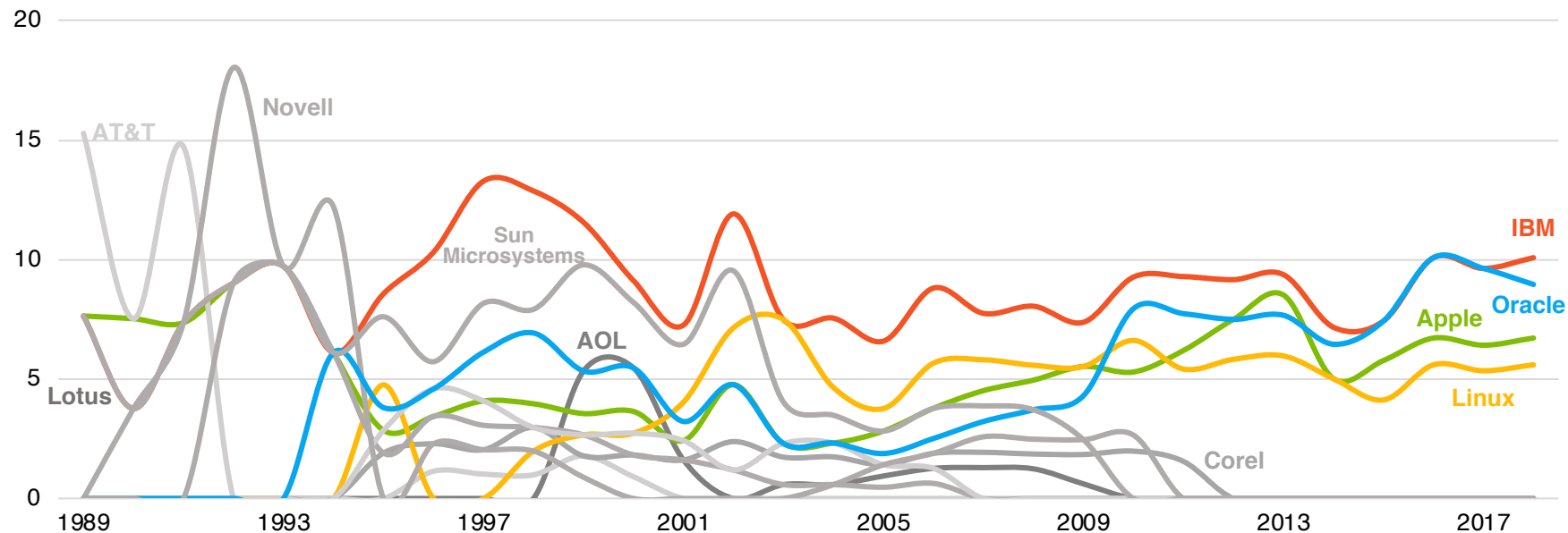


A history of outlasting the competition

Microsoft has faced formidable competition over the years. Founded in April 1975—exactly one year before Apple and two decades before Google and Amazon—Microsoft reached its peak growth and power in the 1990s. Though it has not won every battle since, it has often won the war, outlasting several of its early competitors. Of course, other competition remains: IBM, Oracle, Apple, Linux, and newer competitors Google, Amazon, and Adobe.

Of Microsoft's top competitors from 1989-99, only four remain relevant competition

Mentions per 1,000 words in Microsoft's corporate filings, 1989-2018

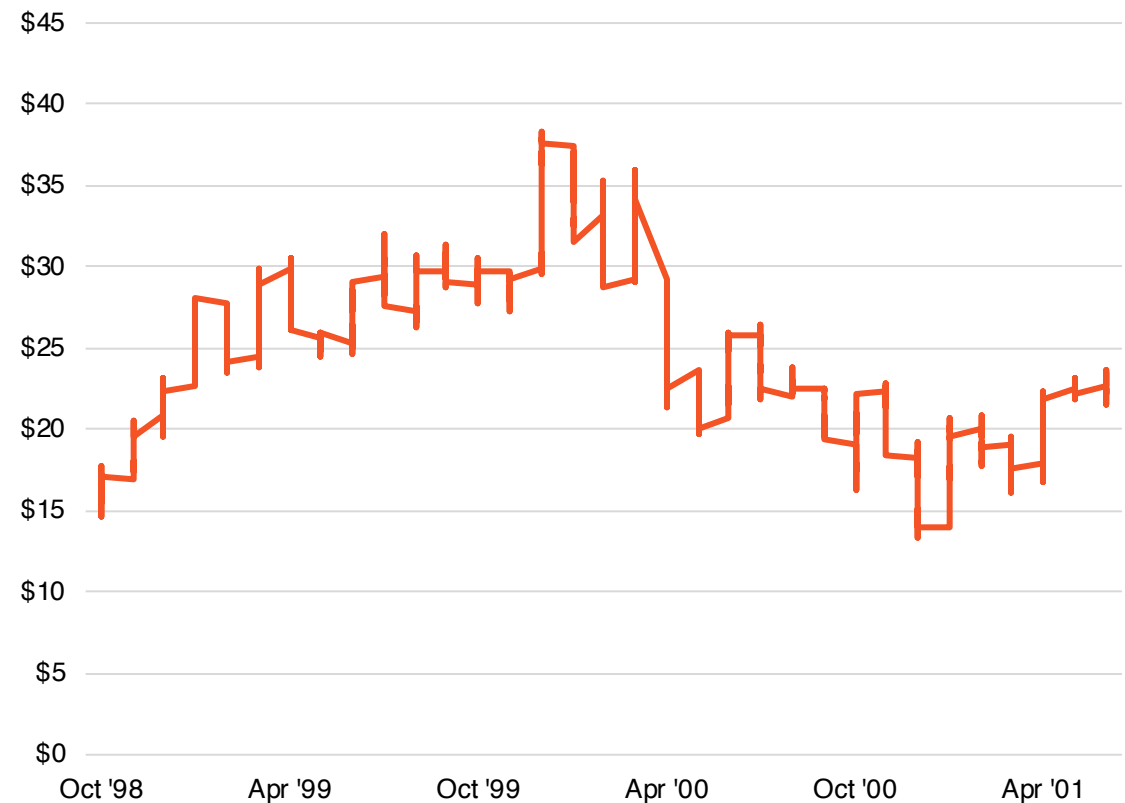


Microsoft or bust

In 1997, Microsoft was so far ahead of the competition that it felt generous enough to invest \$150 million to save its longtime rival, Apple, from bankruptcy. Its Office software products and Windows operating system were the global defaults, and the company had ambitions to make its Internet Explorer browser just as ubiquitous. But when Microsoft succeeded at squeezing competitor Netscape out of the market in 1998, the US government responded by suing Microsoft for violating antitrust law. Microsoft lost the case three years later, and though it never had to split into two businesses as was originally ordered, its outright domination of tech was broken, and a new wave of competitors rushed into the operating system and business software markets.

Adjusted daily closing prices during Microsoft's anti-trust trial

From Oct 1998, when trial testimony began, to Jun 2001, when the case was decided.

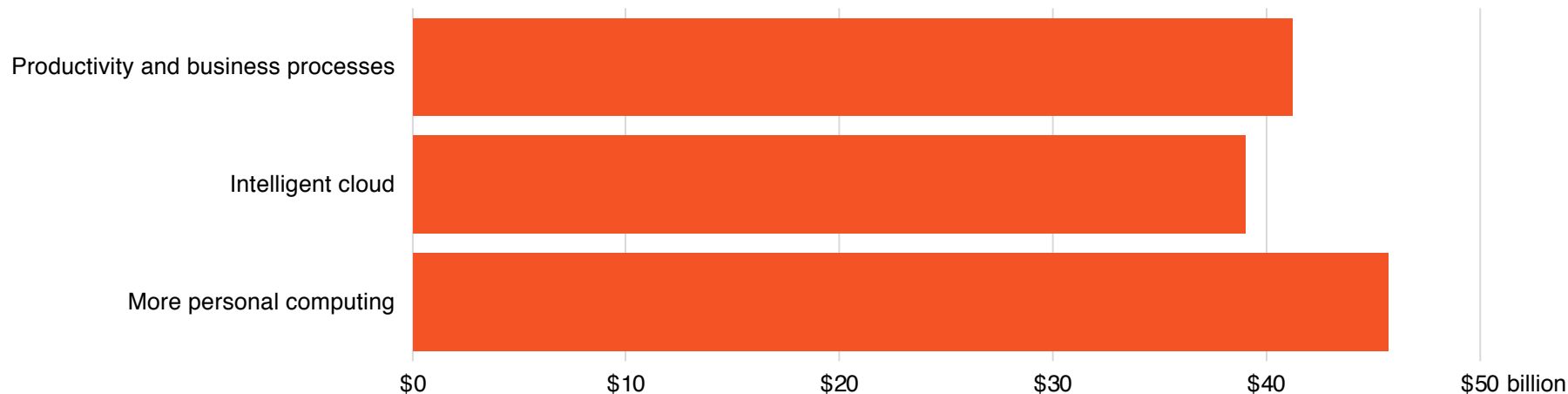


The new Microsoft

In the face of regulator scrutiny, new tech giants, and a changing tech industry, Microsoft has had to reinvent itself. Traditionally, the company relied heavily on software licensing: As recently as 2013, licensing accounted for over 80% of revenue. But licensing isn't as profitable a business as it once was. Software competitors like Google and Apple have emerged, and technological advancements have made one-time licensing of software outdated. Today, Microsoft makes its money from a combination of personal and business software-as-a-service (SaaS) and public cloud infrastructure and services. Most of these services generate revenue through recurring subscriptions as well as traditional one-time license purchases.

Microsoft revenue by segment, 2019

Each business line includes a combination of one-time licensing, subscription, and other revenue sources.



Shuffling CEOs, shifting strategies

Over its 45 years, Microsoft has had three CEOs. Founder Bill Gates handed the reins over to Steve Ballmer in 2000, at the height of Microsoft's antitrust battles and at the end of its peak decade. Satya Nadella became CEO when Ballmer stepped down. He had previously led Microsoft's cloud services business.



Bill Gates

CEO 1975-2000

Gates founded Microsoft at 19 years old. Within four years, sales had surpassed \$1 million. Gates oversaw the creation of Microsoft's two early powerhouses: Windows OS and Microsoft Office.



Satya Nadella

CEO 2014-present

Nadella began at Microsoft in 1992 as a marketing manager. By 2009, he had become president of the server and tools division. Nadella's role in server and tools would prove useful in his efforts at revitalizing Microsoft. He had led development of Microsoft Azure cloud services, which would become one of the company's biggest revenue drivers. Nadella is often credited with transforming Microsoft culture from one of chasing competitors to embracing collaboration.



Steve Ballmer

CEO 2000-2014

Ballmer's tenure is often seen as a low point, given failed hardware launches and slumping growth. But Ballmer laid the foundation for cloud and SaaS businesses. Microsoft also entered gaming during his tenure with its Xbox console.

But Microsoft's leaders haven't always gotten it right

In its efforts at transformation, Microsoft has made a few missteps. Windows phones and MP3 players—the company's attempt at competing with Apple on consumer hardware—were flops. More generally, Microsoft's slow transition from a licensing model to subscription-based SaaS cost it significantly, and the company lost its head-start on newer tech giants like Google, Amazon, and Alibaba that adopted SaaS more quickly.

2.5%

The share of the market Windows Phone OS held in 2015, two years before Microsoft gave up on smartphones

40:1

About the rate at which Apple's iPod revenue outpaced Microsoft's Zune MP3 player revenue during the holiday season of 2008

22%

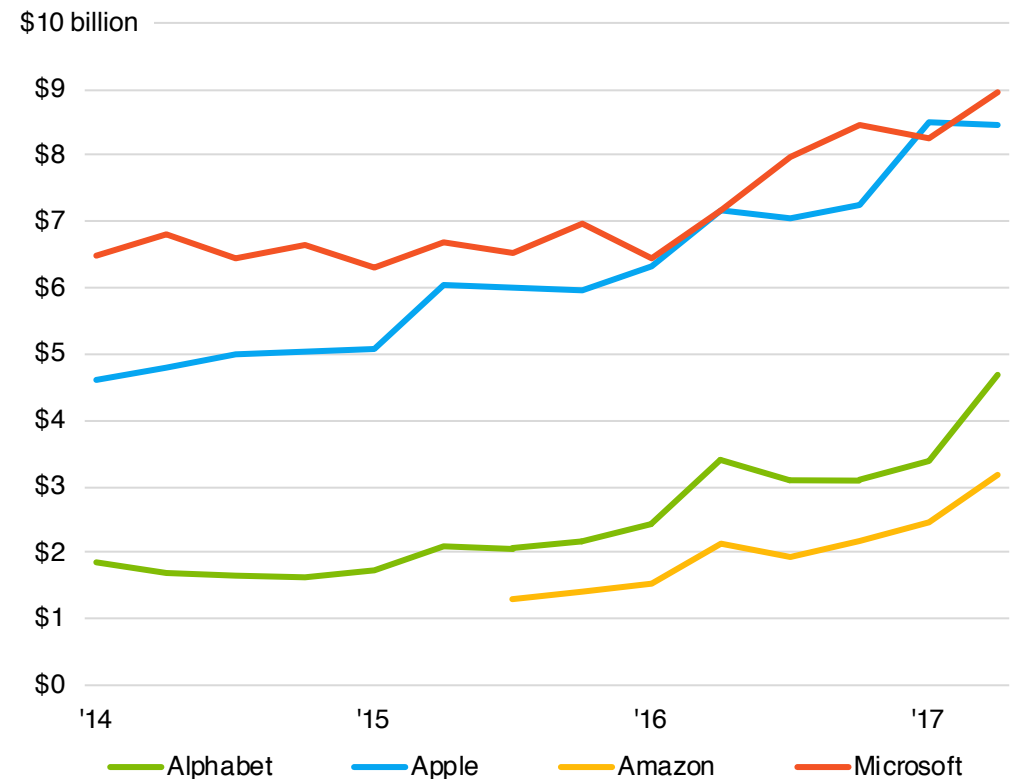
The decline in Microsoft revenue for license sales to computer and device-makers from the first quarter of 2014 to Q1 2015

SaaS: The shift that saved Microsoft

The first step in creating the new Microsoft was to transition to software-as-a-service. Microsoft has long been in the business of enterprise software, but it took a while to transition from licensing to a more agile, advanced software-as-a-service model. As consumers, we might see this transition as shift from Microsoft Office to Office 365. But on the business side, the SaaS transition is far more significant. In a licensing model, a client pays one time to have a version of software downloaded locally on their hardware. In an SaaS model, clients pay recurring subscription fees for software that Microsoft continually updates and often stores on its own servers.

Quarterly services revenue for Big Tech

For quarters reported by Microsoft, Amazon, Apple, and Alphabet

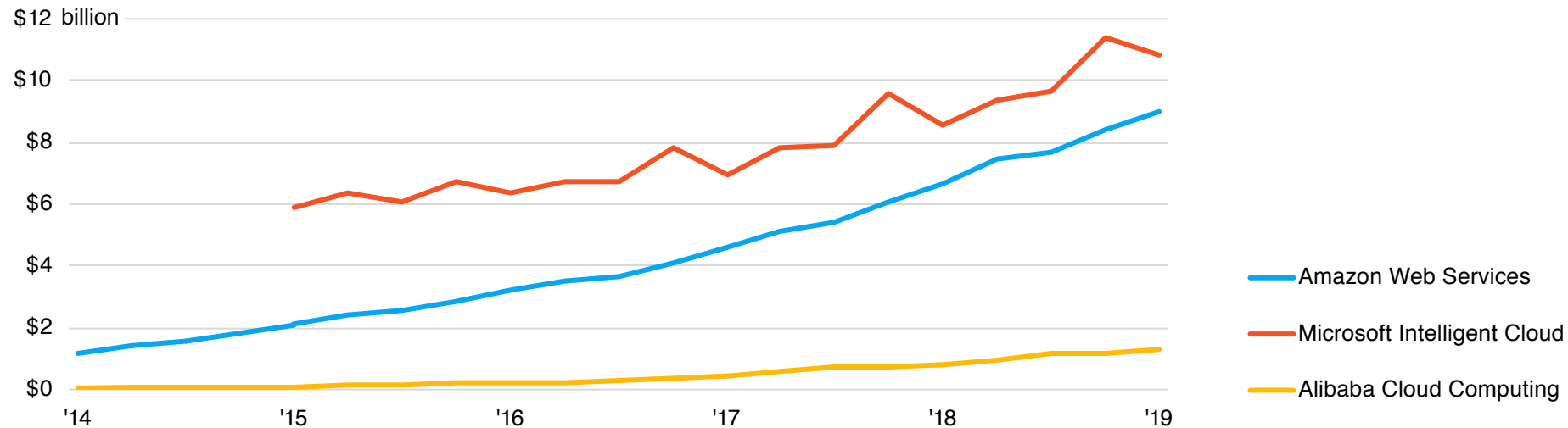


Leading in cloud computing

The shift to SaaS is closely tied with Amazon's entrance into cloud computing services, which accounts for about a third of Microsoft's revenue. Microsoft operates at three levels of cloud services: infrastructure-as-a-service (IaaS), platform-as-a-service (PaaS), and cloud-based SaaS. Five large tech firms dominate IaaS in particular: Amazon, Microsoft, Alibaba, Google, and IBM. Together, they account for more than three-quarters of the IaaS market. Of these, Microsoft claims the second-largest market share (after Amazon) and the highest cloud revenue. Microsoft made headlines in October when it won a \$10 billion US defense contract over cloud giant Amazon Web Services.

Quarterly cloud revenue for the top three public cloud providers

For quarters reported by Microsoft, Amazon, and Alibaba



Microsoft's recipe for cloud success

In Quartz's field guide to Microsoft's comeback, reporter Dave Gershgorin identifies three strategies that helped Microsoft earn an edge in the cloud business:

1. **Hitching a ride on its customers' growth.** A pay-for-what-you-use model means that as Microsoft's clients grow—and thus use more computing power—Microsoft's cloud revenue grows, too. This strategy has been especially helpful in the case of clients who use cloud to power their rapidly-growing ecommerce sites, including Jet, Iberia Express, and Pandora.
2. **Taking advantage of “flexible” data centers.** A data center is a host of incredibly fast, incredibly high-storage connected computers. Even after it meets its customers' computing and storage needs, Microsoft has plenty of data center power left over. So the company runs its own programs on the cloud, too. This means Microsoft cloud infrastructure benefits the company twice: Once as a external product, and second as an internal tool that allows other Microsoft products to grow.
3. **Being first to the “hybrid cloud.”** Microsoft was the first company to give clients the option of integrating their private, on-premise servers with Microsoft's public cloud servers. As Forrester analyst James Staten told Quartz, this is important because while 95% of companies surveyed are interested in moving to the cloud, almost none of them want to rely solely on cloud storage.

A diversifying business model

Another feature of the modern Microsoft is that it is less dependent on any one business. Whereas licensing made up more than 80% of revenue in 2013, Microsoft's revenue sources today range from workplace software to gaming. In addition to cloud services and Office 365 software, the company brings in revenue from its Surface tablets (its most successful hardware yet), LinkedIn, Xbox gaming consoles and platforms, and more.

19 million

Weekly active users for Microsoft Teams, a workplace messaging platform the company says is more popular than Slack

517 million

Global unit sales of Xbox One gaming consoles in 2019. Xbox gaming accounts for less than 10% of Microsoft's total revenue

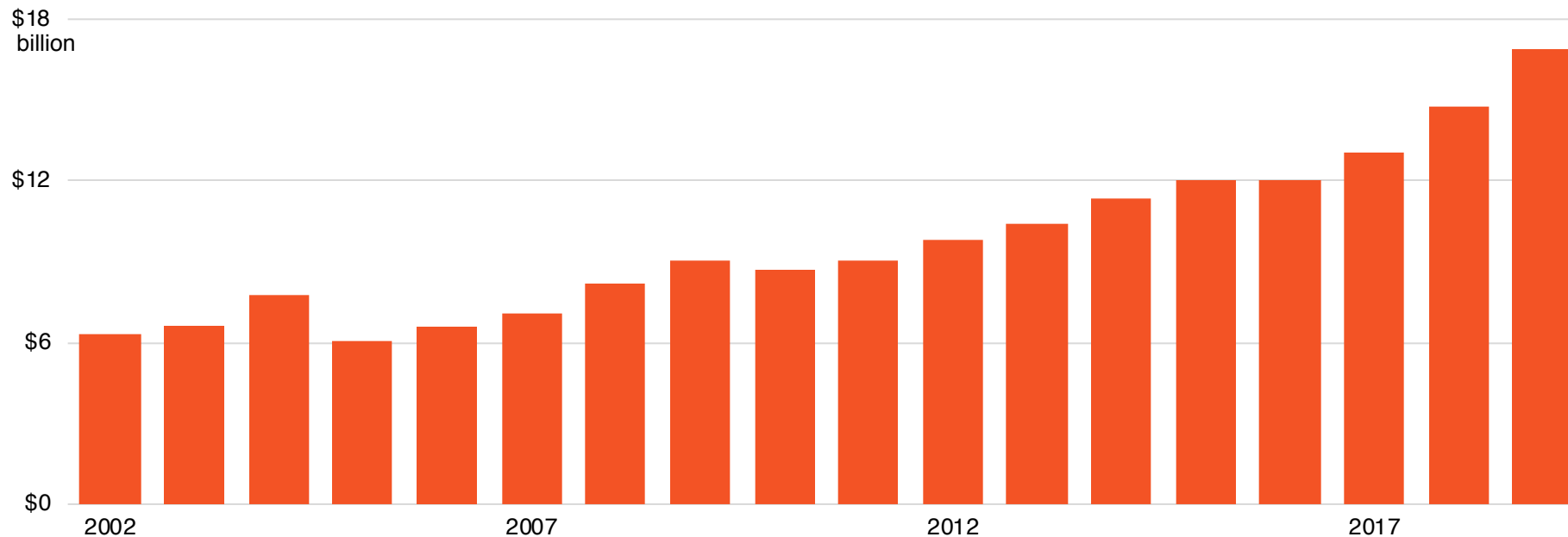
\$26.2 billion

What Microsoft paid to acquire LinkedIn in 2016. Forecaster eMarketer estimates LinkedIn will have 68.8 million users by 2023

What's next for Microsoft?

Microsoft knows it can't afford to be a latecomer to another technological shift like SaaS—or miss out entirely, as it did with smartphones. Last year, the company spent \$16.8 billion in research and development, largely in Artificial intelligence (AI) and Internet of Things (IoT). Microsoft's AI development plan is two-fold: It builds algorithms to sell to other developers, and it integrates AI features into its Windows, Office, and cloud platforms. Microsoft's Azure IoT suite lets cloud clients connect smart devices to perform some tasks, like inventory and maintenance, remotely.

Research and development expenditures, 2002-2019



Want to know more? Read Quartz coverage of Microsoft.

- [Microsoft wants anyone to be a developer, whether they code or not](#) – For more on how Microsoft envisions its role in the future of tech.
- [Microsoft is now worth over \\$1 trillion, a stunning run since Satya Nadella's ascent](#) – If you're interested in how the company has grown under Nadella.
- [Microsoft is repositioning Bing as a company search engine](#) – For a detailed look at the transformation of one Microsoft product.
- [Microsoft and Amazon are at the center of an ACLU lawsuit on facial recognition](#) – If you're curious about what clouds are on the horizon for Microsoft.

You'll also enjoy our member-exclusive field guide, [The new Microsoft](#).

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