

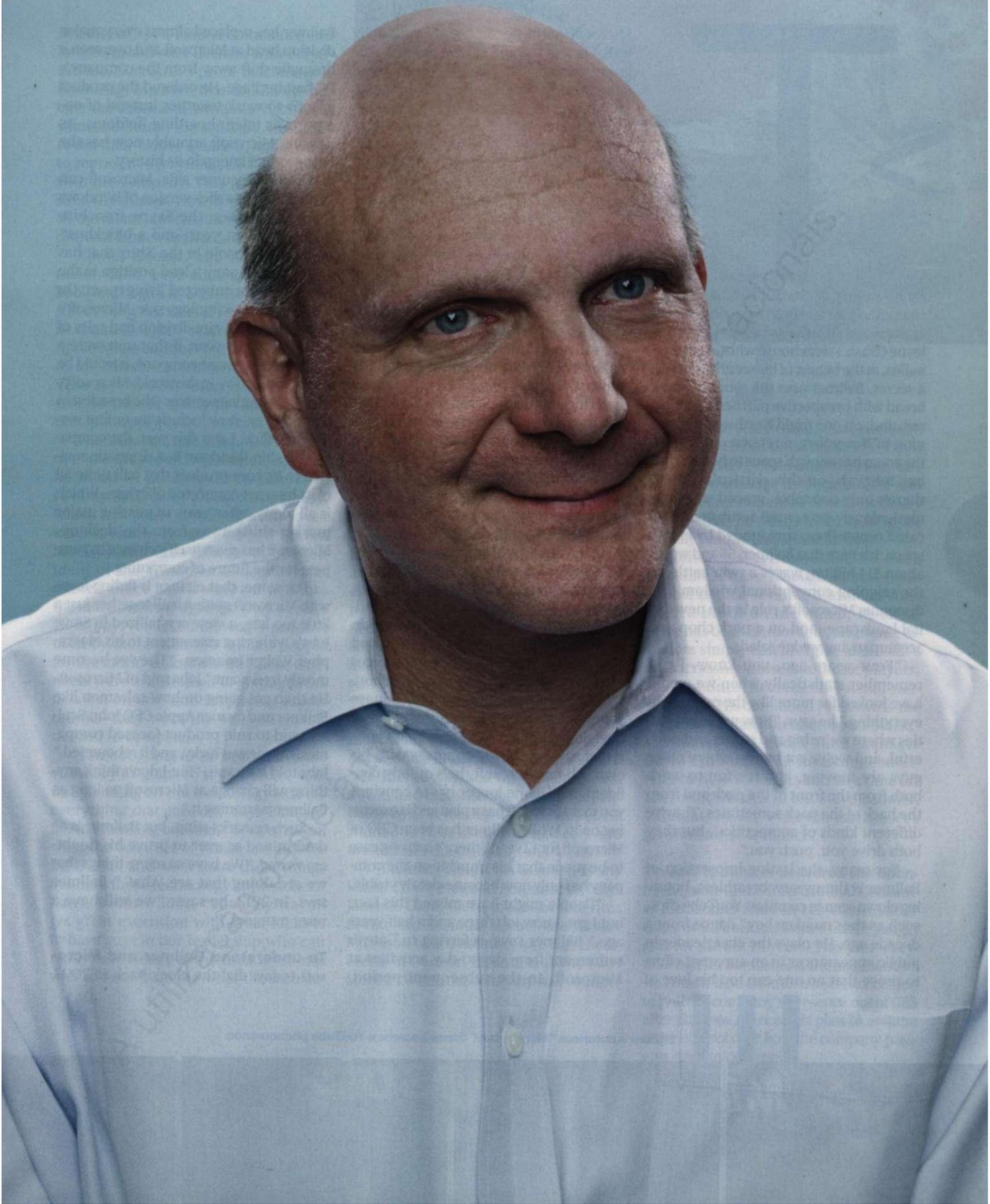
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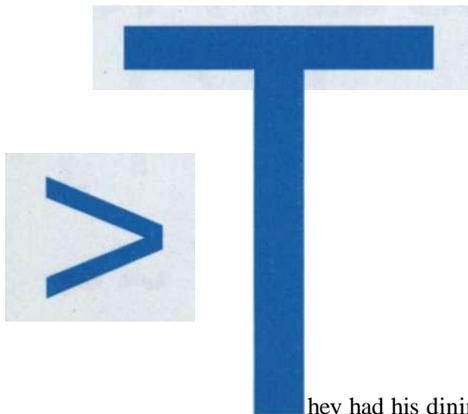
~ ~

> Microsoft
has cooler tech,
more energy,
higher profit,
more relevance?

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*By Ashlee Vance
Photograph
by Jeff Minton





They had his dining room waiting. Steve Ballmer, Microsoft's chief executive and one of the richest men in the world, often eats privately at a Bellevue (Wash.) steakhouse whose name remains, at the behest of his security guards, a secret. Ballmer uses the room to break bread with prospective partners, employees, and, on one frigid Northwestern evening in November, a reporter. Although the room has enough space to host a small bar mitzvah, on this particular night, there's only one table, graced with four meticulously presented settings and located center-floor, surrounded by empty space. It's here that Ballmer, 55 and worth about \$14 billion, wages a twin battle on the reigning conventional wisdom that discounts Microsoft's role in the new digital landscape-and on a pork chop and accompanying wedge salad.

"Four years ago, you know, I can remember statistically when we would have looked far more like the overdog in everything," he says. "Now we've got battles where we're big and strong and powerful, and we've got battles where other guys are moving, and it's fun to work both from the front of the pack and from the back of the pack sometimes. They're different kinds of competition, but they both drive you, push you."

For many, the lasting impression of Ballmer is the sweaty, breathless, booming clown seen in countless YouTube clips, such as the "monkey boy" dance from a decade ago. He plays the cheerleader in public appearances in an apparent effort to prove that no one can top his love of

Microsoft-and he succeeds cringingly well. Six feet tall and stocky, Ballmer has an enthusiasm that makes him seem even larger. You get the sense he could beat you up. And yet the man in his private dining room, dipping bits of iceberg lettuce into a ramekin of blue cheese dressing, is an altogether different character. He asks about your family and moves deftly between sports, politics, and business. He listens to your replies. He never swears. At times he pushes his chair back and puts his elbows on his knees; other times he leans deep into the table. In an industry dominated by eccentric introverts, Ballmer is out of place in that he's pretty normal.

"The fact of the matter is that the new guy will never quite look exactly like the visionary founder no matter how hard they try," Ballmer says, when asked about the criticism that he lacks Bill Gates's visionary profile. He asks the waiter to hold the sweet cream from his berries because, he volunteers, he has a weigh-in with his trainer at 5:30 in the morning. "I know what I want for Microsoft," he says. "Whatever anybody wants to say or do, I've said for myself, I want to do more."

If there's anything unsettling about Ballmer, it's his powers of fact retention. Maybe the third iced tea is kicking in, but at one point, Ballmer recites in descending order the exact market capitalization figures of all technology companies valued at more than \$20 billion. Then he slices down to \$10 billion. And then \$5 billion. "Now, do you want to include Chinese companies?" he asks. He poses strategy questions about companies, hears your retort, then instantly counters with his own. About Microsoft, he's quietly confident-as if he no longer has to convince you that Microsoft has a plan and is executing on it. While Ballmer has been CEO of Microsoft for 12 years, there's a strong case to be made that his imprint on the company has only now become clearly visible.

"People might have missed this fact, but I got a new job three and a half years ago," Ballmer says, referring to Gates's retirement from day-to-day activities at Microsoft. In the subsequent period,

Ballmer has replaced almost every major division head at Microsoft and overseen a dramatic shift away from the company's PC-first heritage. He ordered the product groups to work together instead of operating as talent-hoarding fiefdoms. As a result, Microsoft arguably now has the best product lineup in its history.

On the consumer side, Microsoft can finally point to a slick version of Windows for smartphones; the Skype franchise it acquired last year; and a blockbuster gaming console in the Xbox that has given the company a lead position in the battle for the connected living room. On the corporate technology side, Microsoft's data-center software division had sales of \$17.1 billion last year; if that unit were a standalone software company, it would be one of the top five in the world. Microsoft's cloud computing services-the broadest in the industry-now include an online version of Office. Later this year, the company will ship Windows 8, a dramatic revision to its core product that will unite all of its Internet-connected offerings. Which is all to say, after years of missing major market shifts away from the desktop, Microsoft has given itself a chance to compete for the future of computing.

For some, that chance is fading fast-with Microsoft getting it all together just a little too late, a view crystallized in Steve Jobs's withering assessment to his biographer Walter Isaacson. "They've become mostly irrelevant," Jobs said of Microsoft. He then got going on how salesmen like Ballmer and former Apple CEO John Sculley tend to ruin product-focused companies. "Apple was lucky, and it rebounded," Jobs, told Isaacson. "But I don't think anything will change at Microsoft as long as Ballmer is running it."

Such remarks sting, but Ballmer is as determined as ever to prove his doubters wrong. "We have so many things that we are doing that are 'Aha!'" Ballmer says. In 2012, he says, "we will have a reset moment."

To understand Ballmer and Microsoft today, dial the clock back to 2007.



Because of its PC market dominance and long-term software licenses with corporations, Microsoft's profit machine was humming, but even that couldn't paper over the debacle of Windows Vista. Consumers detested the software, businesses did their best to ignore it, and it came to represent everything that was wrong with the company. This failure carried over to Ballmer. How could a guy with all the talent and resources he had at his disposal launch such a dud?

Apple, Google, and Amazon.com, meanwhile, were clicking, and Facebook had begun its ascent. Microsoft was still dishing out woeful responses to the iPod and Google's search engine when Apple released the iPhone. The company appeared lost. Ballmer characterizes Vista as, "Not our finest hour. It didn't give us a lot of agility in our ability to remap, reapply, refocus resources."

The Vista episode prompted Ballmer to make drastic changes. The next year, he hired Qi Lu away from Yahoo! to revamp Microsoft's search business, which has paid off in Bing's improved market share. He also tapped Steven Sinofsky, an Office veteran, to be president of the Windows division. Other trusted Office hands were pushed into the mobile software group. They weren't all happy; it sucked leaving a product used by more than 750 million people for the murky unknown. But these engineers were accustomed to getting products out on time and surpassing expectations—they were the ones Microsoft needed to compete.

"I'm not going to pretend I'm some visionary or going to try and have central planning on the technology side for everything that goes on," says Ballmer. So, the thinking became, "Let's agree on what the basic set of things are that we believe in, and we'll share those things or share those technology approaches." Later, Ballmer adds, "The only way to get great execution with great ideas is to have guys in our leadership who can really take things to the next level—not wait to hear from me what the instruc-



Ballmer, with Ryan Seacrest, at his final CES keynote

tion is but take things to the next level. I had to find my role relative to the product side, which I hadn't had to find really as much while Bill was still here."

In October 2011, Tony Bates arrived at Microsoft after the company's \$8.5 billion acquisition of Skype and got a glimpse of the fresh energy. Bates, who spent years at Cisco Systems and then served as chief executive officer at Skype, was pleased to find camaraderie among his fellow division presidents. Shortly after Microsoft and Skype did their deal, Ballmer and Bates boarded a private jet and flew to Tallinn in Estonia, where much of Skype's engineering work takes place. On a Saturday, Ballmer went for a run in the morning and then showed up at the Skype office in jeans and a Skype T-shirt. "He literally kicked off his shoes, sat down, and met with about 400 people," Bates says. "It was not a rah-rah thing. He wanted to hear from the engineers and understand the company on that level."

"[Ballmer] has grown as much as any leader I have ever been exposed to," says James I. Cash. Cash, professor emeritus at Harvard Business School, is a former Microsoft board member and current director of General Electric and Wal-Mart Stores. "When the company was younger

and smaller, Steve could, quite honestly, overwhelm most of the issues he faced with his energy and smarts. Now he's learned to manage through people and made a commitment to interdisciplinary work. I think he will come off looking like a really unique and special leader."

Ballmer's critics scoff at such assessments. Even though Microsoft has almost tripled revenue and more than tripled profit on his watch, its share price has been immovable, and some investors simply can't forgive Microsoft's embarrassing misses in music players, smartphones, search, and social networking. "His continued presence is the biggest overhang on Microsoft's stock," said outspoken hedge fund manager David Einhorn at an investors conference in New York last year. "It's time for Microsoft's board to tell Steve Ballmer, 'All right, we see what you can do, let's give So-and-So a chance.'"

On Jan. 9, Ballmer delivered the opening keynote at the International Consumer Electronics Show in Las Vegas. Either Gates or Ballmer has kicked off the gadget gala for the last 12 years. This year's keynote had no bombshells; the biggest news was that it'll be Ballmer's last. He decided to pull the company's presence out of CES after this one, part of his plan to assume more control over how the company presents itself to consumers.

Microsoft grew up doing massive launches every three to five years for its blockbuster products. Now its rhythms have started to change. There's still the Windows 8 extravaganza

TOP: ROBERT SORBO/MICROSOFT





The start screen of Windows 8

expected in a few months, but there are constant updates to Bing, Windows Phone, and Xbox—all delivered via the Internet. "They talk about fast twitch and slow twitch muscles, and I forget, long-distance runners have one and sprinters have the other," Ballmer says. "Well, in some senses all product teams kind of need a bit of a fast twitch and a bit of a slow twitch, because there are bigger innovations that take longer and there are other things that you can do in shorter periods of time."

Microsoft is churning out a dizzying array of products. In addition to the voice- and gesture-controlled Kinect add-on for the Xbox, and the game console itself, Microsoft pushes Windows 7 on all manner of desktops, smartphones of various shapes and sizes, superthin laptops for travelers, and a handful of tablets. It's the Xbox and smartphone displays that get the attention these days, though, because they're running Metro, Microsoft's new interface.

The software presents people with large, colorful squares and rectangles that display applications and information, such as calendar appointments and your Xbox avatar. Most of the tiles have an interactive quality, so that your contacts tile, for example, will update itself with new photos posted by friends on Facebook. Metro attracted Nokia, Samsung, and HTC as major smartphone partners and has earned praise from reviewers accustomed to deriding Microsoft as an also-ran. David Pogue, the *New York Times* gadget reviewer and a huge Apple fan, described Windows Phone as "gorgeous, classy, satisfying, fast, and coherent" in a review last year. "Never in a million years would you guess that it came from the same company that cooked up the bloated spaghetti that is Windows and Office."

With Windows 8, Microsoft will add Metro to PCs and tablets, establishing a common appearance and experience across every device running Microsoft's software. That's a huge cultural shift for Microsoft. In the past, the Windows team set the agenda. This time the Windows

clan will borrow from work pioneered by the mobile group. "The Windows team has always been very insular and could have opted to do something different," says Charlie Kindel, who left Microsoft in August after 21 years as an executive at the company. "I see this as a positive sign that Microsoft can have more of that connective tissue."

Along with the unified interface, Microsoft's products now share all sorts of bits and pieces. Through its voice recognition technology, you can bark out "David Bowie" to your Xbox, and the Bing search engine will go hunting for songs, television shows, and movies related to the rock star. One more bark- "Play"—and the tunes begin cranking out of your home theater. Want to change the song? Yell out again or flick your finger across an Xbox remote control app on your Windows Phone. And, through the Kinect technology, Microsoft expects to lead the way in software that recognizes hand waves and the like on PCs, phones, and even in cars.

At present, Microsoft has 14 retail stores and plans to open up to 75 more over the next three years, usually placing them as close as possible to Apple outlets. "Well, the traffic is going to be there, and we've got to beat them anyway," Ballmer says with a shrug. Meanwhile, Microsoft has been giving the Best Buys, Wal-Mart's, and other third parties an education in the New Microsoft at a 20,000-square-foot facility a few miles from its Redmond headquarters called the Retail Experience Center, or REC.

In the front part of the REC, Microsoft has created a mock living room and home office outfitted with various gadgets. On one wall, a handful of screens display versions of an e-commerce site for Contoso, a fictional store chain created by Microsoft. In this idealized world, Microsoft shows its retail partners how it envisions people using its technology and uses the Contoso website to demonstrate how its products can be displayed well online.

Just past the fake living room is something more impressive: a full-scale fake store that looks a lot like a Best Buy. Visitors walk by a "parking lot" that's been painted onto the wall, go up the wheelchair accessible ramp and through the automatic doors. There they find one section of the store dedicated to Xbox games, another to Windows phones, a third to Microsoft's mice and keyboards, and yet more themed around

Office and Windows. It's an all-Microsoft extravaganza that must resemble some of Ballmer's fondest dreams.

Every year, Microsoft conducts about 400 tours of this facility for chain store executives. The company creates demonstration disks the retailers should put in PCs, advises what categories—professional, entertainment, work—they should be arranged in, and presents discreet anti-theft devices that tuck behind the computers so as not to obstruct the consumer's view.

The REC also shows off Microsoft's smorgasbord of marketing props. It has displays that range from a high-end, disco-themed dance stage to flaunt its Kinect games to a giant-size Windows phone that can go on a wall. The retailers can flip through a catalog of customizable window displays, in-store displays, and signage. Stores can also order up Microsoft salespeople—a group of specially trained folks who will dress up like Best Buy or Wal-Mart employees and teach the retailer's actual employees how to hawk Microsoft products.

"In the past, we definitely took a very hands-off approach in terms of saying, 'Look, we built the operating system, but Sony makes the PC, and you sell the PC,'" says Chris Capossela, a former aide to Gates and the newly appointed chief marketing officer at Microsoft. "We were, frankly, far more indirect with our approach to the consumer."

About eight months ago, Ballmer combined the retail, wireless carrier, and hardware manufacturer teams into a single group under Capossela's charge. And now Capossela says his "mission in life is to create this unbroken demand chain" where people have a consistent view of Microsoft's products from the ads they see on TV to what they experience on the Web and in stores. "The key isn't what people are saying," Ballmer

Microsoft's full-scale mockup of a Best Buy-like store





Opening day last year at Microsoft's Seattle store

says. "The key really winds up being what do they think about the product. Would they look at a product that we deliver? If people understand what we have now, they will give us a shot."

The fullest expression of Ballmer's ambition is Microsoft's cloud computing strategy. About 40 million people subscribe to the \$60-per-year Xbox live service that delivers games and television shows. There's also the Zune service for music and movies, which runs across Xboxes, PCs, and phones. This year, Microsoft moved its Office software to the cloud, and it has tens of thousands of paying customers on its business software service called Azure. Through its consumer service SkyDrive, people can store files online and automatically have the photos and videos they take with their Windows phones saved in the cloud and then access them from their PC or Xbox.

In some of these areas Microsoft moved fast, and in others it was late. Either way, Silicon Valley has decided Microsoft is a PC company that is unable to play in the cloud. The prevailing wisdom of cloud people says Web services offered on a rental model pose a huge challenge to Microsoft, with its long-held practice of selling multiyear software licenses. The cloud model gives customers more freedom and lower prices.

"When you talk to other entrepreneurs and tell them you're using Microsoft's cloud services, they look at you like you have leprosy," says Jeremy Howard, chief scientist at Kaggle, a San Francisco startup that runs data analytics contests. Howard, however, maintains that Silicon Valley's startup class has let biases get in the way of reality. Kaggle began its business on Amazon's data-center rental service but has since moved to Azure, which has proved easier to use and better at handling the massive calculations Kaggle performs. "I love it," Howard says. Microsoft has brought Kaggle into a program in which it gives startups free access to its software and developer tools. "We didn't even reach out to them," Howard says. "They came to us, and do their best to make sure you don't have to pay a dime."

Microsoft continues to dole out the free software for about three years in the hope that the startups will stick with its products. It's part of a larger effort to woo young companies and flip their impressions of Microsoft. Greg Papadopoulos, a venture capitalist and former chief technology officer at Sun Microsystems, says people can get caught up in the sexy devices and services produced by the likes of Apple and Facebook and lose sight of the bigger picture: The vast majority of the \$3 trillion spent per year on information technology comes from businesses. They

have just begun a journey to modernize their operations and embrace cloud services. Papadopoulos considers it a two-horse race between Microsoft and Oracle to win the lion's share of this transition.

To date, Oracle has done little more than announce it will get into the cloud business. CEO Larry Ellison was against cloud computing—"nonsense," he called it at a Silicon Valley industry event in 2009—before he was for it. Microsoft, meanwhile, has mobilized millions of software developers by giving them tools to rewrite their software as cloud services. When it comes to building a true cloud platform for mainstream businesses to glom onto, "Microsoft is kind of the only play here," Papadopoulos says. Only Google has a comparable vision that encompasses both consumers and corporations.

One of Microsoft's strongest cloud plays is Skype. Each day, Skype delivers 750,000 new downloads of its software and handles more than 531 million minutes of calls. In terms of where huge numbers of people spend huge amounts of time, Skype finds itself in the same conversation as Facebook. "Skype is just an asset to die for, and there aren't many of those," says Papadopoulos. "Skype could go down as one of those really transformative acquisitions."

To underscore Microsoft's commitment to the cloud, Ballmer



delivered an "all in the cloud" speech two years ago at the University of Washington. It put the company's employees on notice. "If we're saying something externally, then people believe you mean it internally," Ballmer says. "The speech was a little bit of an aha! moment and"-repetition is as ever the man's go-to rhetorical device-"there will be an aha! external moment: These guys don't fear the cloud. They embrace it."

At a Microsoft store in the Bellevue Square mall, Ballmer darts from one display area to another, extolling the virtues of the merchandise. He knows the specifications of each item-price, screen technology, touchpad sensitivity-and has opinions on everything, including the music playlists displayed on the computers. Lady Gaga, he likes. "Gnarls Barkley, I hate," he says. He points excitedly to a screen fused to the store's wall. "Oh, ho! Live TV!" Microsoft just inked deals with several cable companies to deliver their programming through the Xbox.

Making his way around, Ballmer shakes the occasional hand and, in exchange for some mild ribbing, even allows a photo with an iPhone-toting customer. This is precisely the executive his peers admire. "He's the most honest, self-critical, self-aware person I have ever met," says Reed Hastings, the CEO of Netflix and a Microsoft board member. "I think he embodies a key quality of a great leader, which is he cares more about the company than

himself. He's willing to be open and drive improvement instead of being defensive."

Over the past 10 years, Microsoft's annual revenue has surged from \$25 billion to \$70 billion, while its net income has increased 215 percent to \$23 billion. Much of these gains have come from the Windows and Office franchises Ballmer inherited. That said, he's moved Microsoft from a virtual nonentity in data centers to a dominant player, building a business that brought in \$6.6 billion in profit last year. The Xbox also came to life under Ballmer and anchors the company's \$8.9 billion entertainment and devices division. Measured by total annual profit growth, Ballmer's performance (16.4 percent) surpasses those of such legendary CEOs as GE's Jack Welch (11.2 percent) and IBM's Louis V. Gerstner Jr. (2 percent).

Those impressive financials, though, do little to assuage investors who have witnessed the paralysis of Microsoft's share price over the last decade. The great fear is that the cash cows of Windows and Office will give out without anything comparable to replace them. Meanwhile, Microsoft sits on a cash stockpile of \$57 billion. "They seem completely immune to the fact that they are what I would consider hoarding cash," says Kim Caughey, an analyst at Pittsburgh-based Fort Pitt Capital Group, which owns Microsoft shares. "I don't see the shareholders being paid a whole lot of attention to."

Microsoft's shabby track record at anticipating technology trends adds to the angst. The company spent \$9 bil-

lion on research and development last year-more than any other tech company by far-yet remains in a costly game of catch-up. Ballmer tends to argue away product failings by saying the company does not chase after fads. Microsoft invests for the long term, and history has shown that it tends to win out in the end. "Perception is discontinuous," he says. "You are what you are, whatever it is. And then there's an aha! moment when people say you're something else."

Apple's enjoying its moment, and so is Google, which Ballmer says now plays the role of monopoly power. "I've been there, done that, understand that it may not be true, but it's actually a discontinuous positive moment. And then you get a moment where something doesn't go right. It will happen there." Ballmer also remains stubborn when discussing areas such as smartphones where Microsoft has obviously fallen behind rivals. "It wasn't because they knew about something we didn't know about," he says, noting that Microsoft has made phone software for about a decade. He points to a story in Isaacson's biography of Jobs that details how Apple picked low-power ARM chips instead of Intel's power-hungry chips for its mobile devices. As a result, Apple produced sleeker products that had longer battery lives. "One decision, and they would have been on a completely different path," he says. That may be true, but the point is that Apple made the right decision-and kept making them.

History smiles on Jobs because Apple almost went under and came back stronger than before. Ballmer, you could say, never had the advantage of bouncing back from near-obliteration-he's spent much of his time as CEO trying to expand beyond Gates's vision. He's not stuck in the past, he says, but learning new tricks. He's running an early version of Windows 8 on a tablet and living an old digital dream. "I've gone paperless," he boasts. "Zero! I get pissed when people have paper in meetings now."

During a reflective moment, Ballmer says that if he had it to do all over again, he would dedicate more time to watching over the development process of products rather than just issuing a vision to his employees. "I'd say probably Bill and I were spending a lot more of our energy on where to go," he says. "And we should balance our energy better on how to make sure we're going to get where we want to go." ©

Ballmer and Gates in the mid-1980s



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