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I N T E R O F F I C E M E M O R A N D U M

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TO: See Below

Subject: LETTER TO THE BOARD OF DIRECTORS

The following is a letter which I sent to the Board of Directors yesterday.

I. RATIONALIZING THE COMPANY

Digital is in several businesses, each with a different financial model and a different way of selling, and each with an overlapping set of products. By breaking the Company into six separate businesses and six separate models, we plan to demonstrate how, every day of every year, we will have a set of products for each business, and a financial model which will demonstrate profitability.

Without carefully defining each business and the business model that goes with it, every manager makes and changes plans to fit the model in their head, which is often inconsistent and frequently does not add up. The generation of products by Engineering has been particularly frustrating because every engineering group has in their head a different model which they try to fulfill. Because the models have not been mathematically defined, we have not had the complete product sets or the profitability.

We have now broken the Company into six businesses, each of which has its own model but is normally dependent on the products and the business model of the earlier Business Units.

A. Catalogue Operations

The first Business Unit is the catalogue operation. Here we take a commodity products with the simple goal of being the most competitive, with the lowest price and the most complete, straightforward product generation selling operation. The model is very simple. Every penny spent on product, advertising, marketing and logistics, or overhead, is dollars

taken away from each unit's profit. The model is very lean, but is very easy to understand.

B. Packaged Systems

The next two Business Units are Frank McCabe's Global Information Systems, sometimes called Mainframe business, and Charlie Christ's Business Unit which is departmental and small business computing.

Both are dependent on products that come from the catalogue operation for the systems they sell, and they add to it the equipment and hardware to offer packaged systems. They offer a limited set of products and software, but with these they can guarantee solutions that work. Because they concentrate on a narrow set of problems and because they plan to sell large quantities of these solutions, they should be very efficient, and have relatively little cost with high profitability.

Both the catalogue operation and the packaged systems groups contract with Engineering--whether it be within their own group or Central Engineering, or maybe outside the Company--to develop products. They will review all contracts once a month to ensure they are on schedule and accomplishing what was ordered.

C. Industry Systems

The fourth group is Industry Systems under Bill Johnson. There are a large number of teams, each of which specialize in an industry. They offer standard packaged solutions, or customized solutions, for their particular industry.

They too will have contracts with Engineering, and sometimes with their own engineering group, to generate those products needed to complete the offering to their industries. Because each has a business model which is supposed to deliver good profit to the Corporation they have to evaluate all costs, their pricing, and all the details of their model, to ensure they make a profit and grow to a reasonable market share.

In those industries on which we concentrate, we do very well. In those industries where we have not had dedicated groups we do very poorly.

D. Systems Integration

The Systems Integration group takes the products and services from all the previous groups and, usually with a large amount of consulting, generates special solutions for the customer. Sometimes, these are multi-year contracts with many millions of dollars; sometimes, they are small contracts that include only consulting. Their business model makes money on the

value they add to the Business Units previously mentioned.

E. Third Party Selling

There is a lot of confusion within Digital on third party selling. Some people look at companies that sell through third parties, and some of them do very well. They then come to the conclusion that if you sell through third parties you make a lot of money. This, of course, is only true if you do not spend money on marketing and direct selling, in addition to third party selling.

Recasting our business plans and our products into six Business Units, each with a sound business plan and financial model, will take some time. We will not have it all done by Thursday, but we will give you an outline of what we are going to do and how far we have gotten.

II. THE SOFTWARE PROBLEM

In the late 1970s and early 1980s, we committed almost all our Corporate resources to one computer and one operating system, which was VAX and VMS. We did all our applications, networking, databases and clustering on VAX/VMS. This took a lot of work and discipline because VAX and VMS both grew in complexity and size, and changed every time we came out with a new VAX. One thing an operating system such as VMS does is make every version of a computer look like what the customer wants to see.

This worked well and we did very well. However, five or so years ago, we decided to develop UNIX software with as equal an enthusiasm and vigor as we did with VAX/VMS. The problem was much too complex. There were many versions of UNIX. We vigorously support ULTRIX and OSF, and less vigorously System V and a few others. This meant we could not do everything on VAX/VMS for every form of UNIX we wanted to support and every computer type with all the internal variations.

It became even more complicated when we began supporting all the Intel computers with several operating systems. We also joined the ACE initiative, which means we have added two versions of UNIX on the MIPS chips: each new version of the MIPS chip is quite different and makes a whole new operating system.

Now we are committed to ALPHA which will run its own version of VMS and its own version of UNIX.

If we were to make a chart of all the computer types to which we have committed, and a list of things our customers would like to use on our systems, and if we then made a list of all the various operating systems and variations of operating systems and all the things supposed to go with each one of these variations,

such as complete database applications, networking software, clustering and a lot more, we can see how we cannot financially do anywhere near the number of things we have implied we would commit to. Besides, there is no way we could explain it to our sales people and our customers.

Our Packaged Systems groups are proposing a complete new approach to software and systems. Today we have new tools for solving problems. First, we have ubiquitous networks that drive anything everywhere. Secondly, computers, disks and memory are very fast, big and cheap.

In using these tools, the goal is to make systems so any application can run on the platform, and the operating system on which it is presently working which will work together with everything else on the network.

More and more, large companies are saying they want to completely drop mainframe computing and do everything with inexpensive desktop computing. I do not think they really mean they want to do it with the informality and lack of discipline and control of PCs and workstations. What they do mean is they want to break the job into many pieces, each of which can be done with a simple computer that costs approximately that of a PC or workstation.

They will want all the discipline and reliability they have today. They will want fault tolerant or fast recovery after failure. They will want redundant power supplies and battery backup, and redundancy in their networking. They will want every product that will offer them more reliability and security.

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(DICTATED ON 6/22/92)

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