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Microsoft Woos Toyota, Duels Amazon in \$10 Billion Cloud Bet
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By Dina Bass

Oct. 28 (Bloomberg) -- Five years after unveiling a plan to shift into cloud computing, Microsoft Corp. may finally be making headway.

Microsoft's then-Chief Technology Officer Ray Ozzie penned a memo in October 2005, saying the company was at risk if it didn't reinvent itself as a provider of software and computing services over the Web.

Heeding the warning, Microsoft has signed up customers including Toyota Motor Corp., 3M Co. and Lockheed Martin Corp. for its cloud product. By March, 90 percent of the company's engineers will be working on cloud-related products, says Chief Executive Officer Steve Ballmer. And the server unit may generate \$10 billion in annual revenue from cloud services in a decade, says Microsoft President Bob Muglia.

"We will see those numbers and more," Muglia said in an interview.

Developers will learn more about the cloud strategy at a conference today at the company's headquarters in Redmond, Washington, where Microsoft will highlight tools that make it easier to move applications to the cloud. In a report due after the market closes today, Microsoft will say net income rose 34 percent last quarter to \$4.8 billion, or 55 cents a share, as sales gained 22 percent, according to analysts' predictions.

Further progress in cloud computing will hinge on whether Microsoft can narrow Amazon.com Inc.'s lead. Microsoft in November released its flagship cloud product, Azure, which stores and runs customers' programs in its own server farms.

Lagging Behind Amazon

That came three years after market leader Amazon introduced a suite of cloud services that let companies rent, rather than buy, servers, the powerful machines that run networks and handle complex computing tasks.

Still, Microsoft ranks high in surveys asking chief information officers which cloud vendors they plan to use, said Sarah Friar, a software analyst at Goldman Sachs Group Inc.

"What Microsoft is doing well from a cloud perspective is they are enterprise class and understand what it means to both sell to large enterprise but also meet all their requirements," said Friar, who is based in San Francisco.

The approach won over Toyota City, Japan-based Toyota. The automaker is using Azure to track the 2,000 calls daily that come into the Lexus roadside and crash assistance service. The program took days to implement, compared with weeks for an internal database, said Glen Matejka, a Toyota manager.

3M, whose products range from Post-It notes to flu tests, uses Azure to host a new program, called Visual Attention Service, that lets website designers test which parts of a site catch the human eye.

3M Cuts Costs

3M, based in St. Paul, Minnesota, halved costs by entrusting the program to Microsoft's machines instead of its own, said Jim Graham, technical lead for the program.

Cloud computing can make it affordable for companies to tackle projects that previously would have required purchasing and maintaining tens of thousands of servers.

"Look at the so-called quants on Wall Street," said Microsoft General Manager Bill Hilf. "They say 'I want to ask a question but it's going to take me 20,000 servers to answer.'"

Each time that happens, banks don't want to build a new server farm. They want to just access those machines as needed.

Getting customers on board wasn't easy. During Microsoft's mid-year reviews, a series of meetings in hotel ballrooms near Microsoft's campus early this year, executives got a sobering message from sales staff, Muglia said. Customers weren't convinced Microsoft took its cloud push seriously, Muglia said.

Bet Hedging No More

"When we talked about choice, what they heard was we were hedging our bets," he said.

Microsoft sales chief Kevin Turner decided that the pitch needed to change. Rather than discussing various options, Microsoft's sales force has altered its pitch to "lead with the cloud" and now focuses customer meetings on cloud technologies, Muglia said.

Microsoft's biggest challenge in cloud computing may come from Seattle-based Amazon. The online commerce provider generates about \$500 million in sales from cloud services, more than five times Microsoft's cloud-related revenue, according to Friar.

Amazon Chief Executive Officer Jeff Bezos has said Amazon Web Services, which includes the company's cloud services, will eventually be as large as his company's electronic-commerce business, which makes up 97 percent of the company's sales.

Neither Amazon nor Microsoft discloses cloud-related revenue.

Mid-Sized Businesses

Among small and medium-sized businesses, 77 percent surveyed by Goldman Sachs said they used Amazon, compared with 10 percent for Microsoft and 17 percent apiece for Google Inc. and Salesforce.com Inc. Larger businesses reported 12 percent use for Microsoft, compared with 18 percent for Salesforce and 11 percent for Google. Amazon wasn't included in that survey.

Amazon isn't encountering a lot of competition when it bids for customers, said Adam Selipsky, an Amazon vice president.

"We're really not being told by customers or prospects about material adoption of broad cloud offerings that are currently out there from other vendors," he said.

International Business Machines Corp. started offering cloud programs in March that let businesses develop and store programs in IBM data centers.

VMware Inc., a software maker, has an edge over Microsoft in so-called private clouds, which store programs in a company's own servers, Friar said. Google and Salesforce have some high-end features Azure

lacks, according to David Smith, an analyst at Gartner Inc. in Stamford, Connecticut.

Margin Pressure

Selling software as a service may also squeeze Microsoft's profit margins because it entails additional costs of operating data centers to run customer programs, Friar says.

Still, the company should be able to generate more revenue from cloud products than for its regular software, Muglia said.

Cloud products, which are sold as a subscription, may help Microsoft get more customers on multiyear agreements. Those make revenue flow more predictably and lessen reliance on the vagaries of product cycles and computer upgrades, Smith said.

Microsoft may not lag behind rivals long, Goldman Sachs research suggests. When the firm's analysts asked companies about the future, 29 percent listed Microsoft in their cloud purchasing plans. IBM came in second, with 25 percent, Salesforce racked up 24 percent and Google garnered 20 percent.

Amazon trailed, with 8 percent.

Muglia likens the advent of cloud computing to the shift away from mainframes toward personal computers and servers. He says he doesn't want to see Microsoft consigned to a role as leader in a has-been technology, citing IBM.

"The threat is that we become like IBM is on the mainframe," Muglia said. "People still use mainframes an awful lot but it's not where the future lies. I just have no interest in running the Microsoft mainframe business."

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