

Microsoft's bundling strategy: Amassing Market Share While Hobbling Government IT

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Forward

Microsoft has 85% market share¹ in public sector workplace collaboration and communication technology. In large part, Microsoft has amassed this dominant market position because: 1) conditions within government procurement systems favor incumbency over security, innovation and effectiveness; and 2) Microsoft takes very deliberate steps to limit competition and perpetuate its lock on the public sector market.

Microsoft has built and maintained this dominant position in the public sector market through a range of aggressive bundling, contracting and licensing tactics that collectively limit interoperability, prevent the adoption of best-of-breed solutions from alternative providers, and make it difficult to disentangle from Microsoft's technology ecosystem. While Microsoft's controversial practice² of restricting³ customers running applications on rival clouds has been well reported⁴, the implications of its bundling practices are less widely understood by customers, regulators and the public.

Rather than succumbing to inertia, government customers should take steps to foster more competition and diversity within their IT environments, particularly given the risk that reliance on a single vendor creates. Building more redundancy across multiple vendors builds a stronger, more innovative government IT system overall.

Introduction

This paper examines the merits and significant drawbacks of purchasing a “bundled” suite of applications from a single software maker versus a “best-of-breed” approach, mixing and matching individual software solutions and products based on the specific environment and user needs. For the purposes of this paper, we will detail the practices of Microsoft, one of the most prolific and successful bundlers in government IT.

Bundling Today

Proponents of bundling point to a number of factors to justify the approach. Chief among these are that organizations can implement the software more quickly, that technology bundles are marketed as offering a “better integration” with less need for testing, the ease of maintenance through a single entity, and assurances of customer service with “one-throat-to-choke.” And, not to be overlooked, there are also promises of cost savings.

In our experience, the decision to purchase a bundled IT offering is generally driven by ease-of-procurement and IT capacity considerations, rather than an organization's actual technology needs.

¹ Omdia: Monoculture and Market Share: The State of Communications and Collaboration Software in the US Government

² Thrott: Critics Say Windows Licensing is Anticompetitive

³ ZDNET: Customers aren't happy about Microsoft's restrictive cloud licensing policies

⁴ Bloomberg: Microsoft Customers Decay Cloud Contracts That Sideline Rivals

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However, after years of watching bundling proliferate in public sector IT contracts, we believe there are numerous underappreciated pitfalls that far outweigh its perceived benefits. In our experience, the decision to purchase a bundled IT offering is generally driven by ease-of-procurement and IT capacity considerations, rather than an organization's actual technology needs. In the end, we believe that a "best-of-breed" approach to IT procurement is far better at meeting the needs of government technology clients.

We can best illustrate Microsoft's approach to bundling with an example of a fictional new company that wants to purchase productivity software so their employees can email customers and create spreadsheets and documents. At even the most basic enterprise level, Microsoft bundles⁵ more than a dozen additional products and services with its flagship productivity software, including Microsoft Defender Antivirus, OneDrive, Teams, endpoint device management tools, identity and access management, and more. Bundling⁶ these tools together gives the company an entire stack of products and services it didn't originally want or need, which decreases the likelihood the company will shop around for comparable services and products if and when it does need them, and further intertwines its business with Microsoft. This type of activity is why competitors often complain⁷ about Microsoft's bundling and tying behavior and why regulators continue to listen.⁸ Also unique to Microsoft is a massive base of legacy on-premise customers that it works to shift to cloud-based infrastructure and services, which greatly amplifies the downstream effects of its bundles on innovation and competition.

According to recent research findings from Omdia⁹, Microsoft has an 85% market share in public sector collaboration and communication technology and tools. While Microsoft products and services are certainly adequate, it is worth considering how a single vendor achieved such a monopoly in a highly competitive marketplace. Aggressive bundling and licensing practices are certainly a large part of the answer.

Government customers, seeking to accelerate the purchase process, will often opt for a bundle that is easy to deploy and defend internally versus tools that are best built for their environments. A confluence of factors explains this purchasing behavior:

- **There is a shortage of capable resources and a limit on IT's capacity.** Government IT departments spend the bulk of their time on updates, patches, and other fixes that are associated with existing solutions, rather than conducting strategic planning and use analysis. It is worth noting that Microsoft technology is among the most "patched" in the world. In fact, just last year the Cybersecurity and Infrastructure Security Agency [issued compulsory orders](#)¹⁰ across the federal government to "patch a series of known exploited vulnerabilities..." likely in part because agencies are behind on patching despite IT resources are already stretched to the limit on the task.

- **IT leaders are risk-averse and seek safety in numbers when making IT purchasing decisions.** It can be difficult for IT officers to justify the use of new software solutions when the incumbent solution or vendor is a known entity, even if it has meaningful limitations or drawbacks.
- **There is an ease to procurement if “standard” policies are used.** Hidden procurement biases favor incumbent providers, despite requirements for competition. In government settings, policies favor existing vendors that have gone through required vetting and procurement protocols, in many cases attaining unofficial “preferred vendor” status. This process creates significant advantages for the incumbent. This approach can be effective – especially for commoditized products and services – but not for technology purchases. Technology evolves too rapidly for that format to work.
- **There are few incentives for cost accountability.** In government settings—and even in some commercial ones—there is little to no incentive to spend less than your allocated budget and savings to the organization are not well-rewarded. In some cases, IT decision-makers are also separated from funding decisions, either through their lack of seniority in the agency or a lack of awareness of how their funding takes place. Recent research suggests that reducing IT workload and facilitating ease-of-procurement are priorities in the public sector, more so than cost or the needs of end-users.

A November 2021 survey of 250 government IT procurement officers in a report by Omdia¹¹ found:

“The top reason cited by respondents (57%) for selecting a communication and collaboration partner was reducing work for their IT departments, calling into question their responsibility to obtain the best value for employees and taxpayers. Some 44% chose a “streamlined procurement process” that was “easy to buy from” as the most important criteria. Price ranked dead last (39%).”

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¹¹ [Omdia: The Case for Vendor Diversity: The Need for Change in Government Technology and Procurement Practices](#)

Limitations of Bundling

However, despite the above justifications for bundling, the approach has meaningful drawbacks.

- **One-size-doesn't-fit-all.** A bundle implies that the vendor – in our examination, Microsoft – has the best understanding of the customers' needs for all tools and services in a particular category. But in reality, technology buyers have the best understanding of their own organizational needs and preferences, and therefore should have maximum flexibility when making purchasing decisions. A one-size-fits-all approach limits the ability to purchase best-in-class solutions tailored to specific needs.
- **Lack of Innovation.** Government IT departments that evolve around specific incumbent products, like Microsoft's offerings, do not incentivize innovation or a nimble approach to IT. In fact, government IT staff may become so ingrained with the existing solutions in use that they have limited motivation – or even ability – to switch to a more innovative product that better suits customer needs.

Security Risks of Bundling

Microsoft actively promotes enhanced cybersecurity with its bundled upgrades, but this does not provide the enhanced cybersecurity as advertised. Consider the following example: Microsoft presents additional cybersecurity as an argument for a customer to upgrade from a Microsoft Office 365 E3 plan to E5.¹² An E5 plan features not only an Office 365 Plan E5 but also a Windows desktop subscription, and Enterprise & Mobility Suite (“EMS”) and the following:

- Azure Active Directory Premium Plan 2
- Azure Information Protection Plan 2
- Microsoft Defender for Cloud Apps
- Azure Active Directory Identity Protection (as a feature of Azure Active Directory Premium Plan 2)
- Azure Advanced Threat Protection
- Azure AD Privileged Identity Management (as a feature of Azure Active Directory Premium Plan 2)

What is marketed as a cybersecurity upgrade becomes an entry point for a full suite of bundled products and services. But the irony of this approach is that the E5 deployment remains vulnerable to attackers, as we've seen in attack after attack, including the Exchange Server or SolarWinds attacks. Multiple government agencies using the same Microsoft technology, deployed in the same way, presents a huge attack surface. A successful attack on one agency becomes a successful proof of concept to attack another.

¹² The features and functions of Microsoft's enterprise plans (prefix E) are equivalent to its government plans (prefix G) and are used interchangably

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In addition, Microsoft's 'patch Tuesday' has become a Sisyphean task for many agencies, with so many patches released simultaneously that other systems break while something else is repaired. And "[t]esting for patching side effects has never been Microsoft's strength."¹³ Hackers also know that major government agencies and departments won't be able to apply patches as soon as they are released. Hackers can reverse engineer the patch to identify the vulnerability it's meant to fix and then launch attacks against Microsoft's government (and corporate) customers, betting they have not been able to apply the update.¹⁴

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Microsoft's bundling means that organizations are paying for products they aren't using, including security solutions and add-ons that have not proven to be effective to the slate of recent nation-state attacks against U.S. infrastructure.

The True Cost of Services

The cost of buying a Microsoft bundle – even one including free options (at least for a while) – might not offer the pricing advantages government customers are expecting. In fact, the costs for Microsoft are frequently much higher than for other competitors. Let's look at a side-by-side comparison of generally comparable offerings from Microsoft and Google, which also offers services to government customers.

Microsoft Product	Microsoft Cost	Google Product	Google Cost
Microsoft 365 F3	\$8/user/month	Workspace Starter	\$6/user/month
Microsoft 365 E3	\$36/user/month	Workspace Standard	\$12/user/month
Microsoft 365 E5 ¹⁵	\$57/user/month	Workspace Plus ¹⁶	\$18/user/month

Figure 1: Comparison of Generally Comparable Offerings of Google and Microsoft

As you can see, the costs for Microsoft are much higher, as a number of government customers have discovered. The State of West Virginia projected it would save \$11.5 million by switching 22,000 state employees to Google Workspace from Microsoft O365.¹⁷ The General Services Administration estimated it would save \$15 million over five years by switching 17,000 employees and contractors to Google Apps from Microsoft.¹⁸ The State of Arizona also estimated it would save "millions of dollars" and "enhance security" by replacing Microsoft for Google for 36,000 employees and contractors.¹⁹ Indeed, even if the entry price point for an MSFT bundle seems attractive, the "lock-in" effect and the limitation of competition down the road allows the incumbent monopolist to slowly raise prices. Eventually, the suite costs far more than a more innovative series of best of breed point solutions.

¹³ Computerworld: Patch Tuesday: The rules of updating Windows (and Microsoft apps)

¹⁴ Mainstream Support for Microsoft Advanced Threat Analytics ended on 1/12/2021. Extended Support will continue until 1/2026.

¹⁵ Microsoft O365, copyright Microsoft 2021

¹⁶ Google Workspace, copyright Google 2021

¹⁷ Office of Gov. Jim Justice: State to save projected \$11.5 million with transition to Google Workspace

¹⁸ Google Cloud Blog: GSA has gone Google

¹⁹ Google Workspace: State of Arizona: Enhancing productivity and security with cloud collaboration

Benefits

There are benefits, of course, to procuring a bundle.

- **Integration.** Microsoft engineers and the Microsoft user community tend to use – almost exclusively – products from Microsoft. And it is only logical that Microsoft products integrate well with other Microsoft products – that is key to the company’s value proposition.
- **Pre-testing.** When Microsoft releases a new function or product, it has been tested for how it operates in conjunction with other Microsoft products, before it even is generally available. And while some issues still slip through, this aspect of “seamless integration” is a large part of the bundle.
- **Less costly.** Despite the perception that bundles always lower costs, this is not assured. Customers must negotiate a lower unit price for each product. But bundling does offer price competitiveness in some cases. For example, purchasing the suite of products of which Microsoft 365 consists – Office 365, Windows (desktop), and Enterprise Mobility + Security (“EMS”) can be negotiated to lower the cost. This is especially true if there is another security product that the Microsoft product is supplanting. (This is known as a “take out” in vendor parlance.) However, as the graph above demonstrates, Microsoft products, even bundled, frequently do not provide significant long-term savings over other vendors.

Best-of-Breed Services

With a best of breed approach, IT departments look at the various tools and services users need, and then choose the best offering for each. For instance, instead of simply checking a box for the full Microsoft suite, an agency may choose Zoom for video conferencing, Google Workspace for productivity tools, Box for cloud storage and Crowdstrike for security tools and services.

Often there is a level of flexibility with best-of-breed solutions, which can translate into long-term savings as the each component is both needed (not just bundled) and each provider needs to compete to win the contract for its services. Government agencies can build an IT service offering that is customized for its user community, and can even be tweaked for certain individuals or groups of individuals.



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While this may sound like more work for already stretched government IT departments, it actually frees the department to provide more benefit directly to users:

1. A bundled offering rarely – if ever – provides the very best solution or tool across each and every product category.

- a) It is true that adopting new solutions can require time consuming upfront integration, testing, implementation, and education. However, once government agencies have adopted, stabilized, and trained users on new software, they can realize long-term cost savings. Agencies are able to operate with fewer features and functionalities, while attaining a level of flexibility that comes with a best-of-breed approach.
- b) Adopting a best-of-breed approach enables migration to cloud-built solutions, which require lower maintenance than incumbent “patch-and-update” based solutions. IT support personnel currently spend up to 82% of work time²⁰ maintaining incumbent solutions. Information Technology demands innovation. It demands responsiveness. And it demands high availability. If IT support personnel are spending most of their time outside these pursuits to simply maintain incumbent solutions, users will be less efficient at their jobs or will bring their own “shadow IT” solutions to work.

2. Bundling leads to entrenchment which leads to increased costs.²¹

What Microsoft – and most IT vendors – want to do is become ‘a large fish in a small pond.’ That is, reduce the overall cost of IT operations for a customer, while becoming a bigger part of the spend. For example, consider a scenario in which the yearly support fees for all software supporting a particular application are \$100,000, and Microsoft comprises 30% of that spend. Microsoft’s goal is to reduce that overall cost to \$90,000 (a great top-line number for an IT department to give to management), but to become \$50,000+ of that new total. That’s entrenchment, and it is exactly what legacy technology vendors are trying to do in U.S. government procurement. Entrenchment fosters complacency and can lead to the incumbent contract being renewed even if that solution no longer fits the bill. The end result is that the government agency not only ends up with a barely adequate product, but also the legacy vendor then has leverage to increase the price. [Case in point: Microsoft is increasing the cost of Microsoft 365 in March 2022.](#)²²

²⁰ [Deloitte Insights - CIO Insider: Reinventing tech finance: The evolution from IT budgets to technology investments](#)

²¹ A “take out” is the term utilized by software vendors to illustrate that their own product has replaced another software vendor’s product.

²² [Microsoft Blog: New pricing for Microsoft 365](#)

Deciding

How should a government organization decide whether to bundle or choose a best-of-breed approach? In his [LinkedIn](#)²³ blog post, author Chand Sooran posed some interesting questions to help organizations make that determination.

- What will it cost to implement?
- How much training will it require?
- What are the ongoing costs of the software?
- How much will it cost to integrate with other systems?
- What complexity does it impose on the in-house IT department?
- How much will it cost to upgrade the system, including with security patches?

Once these questions are answered, Mr. Sooran tells us that “This must be weighed against the Total Benefits of Ownership.”

The comparison must be made for both the short term and the long term. As was pointed out, there will be some short-term pain in changing to a best of breed approach, but we believe these drawbacks are often acceptable, small and short-lived. The alternative is locking into a single vendor for everything and likely living with escalating costs, solutions that aren’t a custom fit to a particular government agency, and endemic security risks.

Conclusion

Government agencies – working with their IT departments – have the opportunity to break a monoculture that heavily favors incumbents and bundled services of legacy technology. Instead, they can create a system that fosters competition, security and redundancy with regard to multiple vendors. In some cases, the incumbents or a bundled package may win on the merits. But in others, newer and more innovative solutions may provide better services and better prices. And in the end, government agencies, users and U.S. taxpayers will all benefit.

²³ [LinkedIn: Why Is a Best-of-Breed Vendor the Right Software Solution Today?](#)



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