



The Long Arc Behind Bill Gates' Wealth, Part 2

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..... Did Bill Gates acquire most of his wealth by fair means or foul? Last issue's column examined the 1980s and early 1990s and largely saw fair actions. A few fell on the border. Today I ask about the mid-1990s and beyond.

What a period this was for Gates. The diffusion of the Internet required a redirection of numerous Microsoft activities. Gates had the skills to lead such an organizational renewal, and he did. Those actions were impressive.

The Internet also raised numerous challenges to Microsoft's market dominance. In protecting that dominance, Gates was accused of committing many fouls. These also were impressive, albeit in an infamous way.

The details make for a rich story behind a wealthy man.

Competitive meritocracy

A competitive meritocracy governs the high-tech markets. All firms have the right to compete to supply any user in any market. No firm has an exclusive right to supply a market or to avoid challengers in perpetuity. Any firm can enter with a new product if it believes it has something customers might want. Yet, most newcomers experience failure, which leads to wasted resources. To be sure, experimentation by firms in a competitive meritocracy can create quite a mess.

The mess, however, yields a dynamic benefit: Unfettered experimentation

leads to innovative entrants. Incumbents react, or, even better, anticipate the entrant and innovate before the entrants get very far. This leads to lower prices and better products. Users ultimately benefit.

Gates himself entered as an entrepreneur in the competitive meritocracy in PCs. He became a hero to many by taking IBM down a peg. By the mid 1990s, however, the shoe was on the other foot. His firm had become a leading incumbent.

As CEO of a large leading firm, Gates made it a part of his regular routine to scan the actions of entrepreneurs and new markets. The Internet and the World Wide Web began to attract considerable attention around 1994, and so Gates did his homework—in the spring of 1994 and again in the late fall.

This is where it gets interesting. Gates confidently dismissed the browser business as unlikely to be profitable, and he did not change his mind until the spring of 1995. By then, many developers had decided that Netscape, which had the leading browser, would make a good business partner.

Netscape's rise alarmed Gates for two reasons: First, Netscape's browser had a good chance of becoming pervasive. Second, Netscape built application programming interfaces (APIs) for other applications. That meant Netscape's browser could someday soon do the

same thing as Gates' operating-system business, which was extremely lucrative.

In the summer and fall of 1995, Gates pushed for a big Internet initiative. In December, Microsoft announced its Internet strategy.

This sequence of events illustrates what a competitive meritocracy can do. A successful software firm, Microsoft, had taken one direction until a start-up demonstrated the viability of another.

Alas, users did not experience unfettered experimentation for long. It was soon disrupted by Gates, who disliked where the experimentation might lead. That is where the fouls arose.

Contracting fouls

Gates sought to move Netscape's business partners exclusively to Microsoft APIs. One way to do that involved reducing the pervasiveness of Netscape's browser.

Gates pressed his staff to call every important firm delivering Internet services and building its pieces. Firms were offered deals to promote Microsoft's browser and simultaneously make it difficult for Netscape to distribute its browser. Virtually every one of these firms reached a deal with Microsoft in 1996 or '97.

Some assemblers, such as Dell, cooperated early and readily. Without any fanfare, Dell just stopped putting Net-

scape's browser on its systems, even when users asked for it (a fact pointed out in US Senate hearings, much to Michael Dell's embarrassment). Nontrivially, Dell had previously received favored status from Microsoft in preferential pricing and promotions for the operating system, and it continued to get that too.

Other firms, such as Compaq, took a painful route to cooperation. Compaq's management had heard from many users who wanted Netscape's browsers. As a reward for listening to its customers, Compaq received far rougher treatment from Microsoft than had Dell. In 1996, for example, Microsoft sent a letter to Compaq threatening to cut off its license for the operating system (in 30 days!) over an audit dispute that could and should have been settled by arbitration. It seemed obvious to everyone in the industry that Microsoft was reminding Compaq (and all watchers) that it was not a preferred business partner. Compaq capitulated on the audit dispute quickly, and a few months later on its browser policies as well.

Gates also pressed his employees to forge deals with Internet service providers and independent software vendors to make Internet Explorer the default browser, and to make Netscape's less visible. Most of those eventually cooperated.

Only AOL played hardball, which it could do because what it chose for its default settings could move "browser usage share" for a large set of online users. Accordingly, AOL received the best deal of all. Along with hundreds of millions of dollars, it got the key item that Steve Case had held out for—the right to have AOL's branded buttons on every desktop. Why was Microsoft in a position to trade position on the desktop? Stated simply, such was the power of Microsoft's contract restrictions on assemblers.

Gates pressed everywhere, even at Apple. The newly returned Steve Jobs cut a deal to make Internet Explorer the

default browser. Jobs preferred boos from his loyal buyers than the irritation of—and delays from—the provider of some of the Macintosh's valuable software applications. Witness, once again, Redmond's negotiating leverage.

This simultaneous manipulation of many parts of a distribution channel erected numerous roadblocks and basically made it a hassle for Netscape to distribute its browser to the typical mass-market user. No mass-market application software firm had ever put up with so much during its early life.

More to the point, the manipulation restricted user choice, and for reasons that had nothing to do with the products' merits and functionality. That is not how the competitive meritocracy is supposed to work. It departed from the ideal process because one heavy-handed CEO altered it to his advantage.

In brief, it was a foul.

Designing against the wave

It is usually not a foul to add functionality to a product without charging users for it. This is a favor to users. Microsoft did this favor by adding Internet functionality to a range of its products. These favors received notice and deserved praise, but were overshadowed by other design fouls.

Perhaps because it was so heavy handed, the most publicly discussed action was the bolting of Internet Explorer to the operating system. In fact, Microsoft committed no foul in adding this functionality—only in making it impossible for users or suppliers to remove Internet Explorer when they wanted to do so. This was an unnecessarily restrictive design and a transparently self-serving departure from prior practice.

Another example, perhaps less well known, illustrates the foul far better: what Gates did to Java. In brief, Sun Microsystems invented a computer language for networking, called Java, and wanted to do some experimentation with developers and users. Gates signed a contract with Sun, as if Microsoft

intended to make Windows compatible with Sun's preferred version of Java. However, not long after the ink was dry, Microsoft took actions designed to confuse users and developers about what was possible, slowing down everyone.

Later in court, there was a reductionist legal debate about whether Gates negotiated with Sun in bad faith. That is, did Gates misrepresent his firm's intentions to carry through on the contract? The answer seems to be plainly "yes" to a nonlawyer like me, given that Gates planned his actions in advance. The defense responded with a technically reductionist view that Microsoft's version of Java was an improvement and other versions of Java lacked sufficient functionality to dent the Windows monopoly. Hence, the alleged foul had to be inconsequential.

Both reductionist arguments miss the forest for the trees. Gates cared about Java's promise in the future to deliver services on the desktop, much as he worried about Netscape's browser. He did not want that bud to blossom.

More to the point, every established firm, ambitious entrepreneur, and venture capitalist in the country watched these events in disgust and got the message: If Gates didn't like where their experimentation might lead and he could do something about it, he would. Originality, technical potential, or user benefits did not matter.

In brief, that too was a foul.

Why act?

It was historically ironic that Gates subverted the principles behind the very system that had made him wealthy. By the norms of the competitive meritocracy, his actions were beyond disappointing. They were rather appalling.

Many appalling things in life are nonetheless legal, and Gates was never a fool about legal limits. Gates' lawyers did their homework, making sure each contract went to the boundary of appropriate contract law.

That did not get him out of the woods, however.

Antitrust law includes many arcane details, but at a broad level it is straightforward. Antitrust law makes it illegal for a dominant firm to use its negotiating leverage to gain an advantage when it competes for a new market. This is supposed to encourage a dominant firm to compete with new products and services rather than with negotiating leverage.

Here, Microsoft was at risk. Gates was using Microsoft's negotiating leverage with a variety of market participants to further its interests in Internet markets. Moreover, Microsoft was perfectly capable of innovating without using that leverage.

However, government lawyers did not just come out and accuse Gates of committing fouls. Rather, in 1996 and throughout 1997, government lawyers raised questions about whether Microsoft was abiding by a settlement that the firm and the government had reached in 1994 over antitrust issues in Microsoft's contracts with assemblers (a long story).

The issues differed in terms of details. As one case bled into another, however, the issues became confused and confounded. Rather than sort these out and negotiate a new settlement, Gates instructed his lawyers to respond aggressively (another long story). This defiance dared the government lawyers to fight back, which they did.

Allow me the benefit of hindsight to explain the new core issue with some reflective distance. Here is why the government lawyers cared so much: How much did users lose from shorter market experimentation? The answer depends on how much the fouls shortened competitive outcomes, and what would have happened in a longer series of events. Specifically, competition began petering out in 1997, when Microsoft's fouls drew developers away from Netscape's and Java's APIs to Microsoft's. Competition then collapsed in 1998, when developers abandoned Netscape's altogether.

I know sensible people who think competition would have continued indefinitely in the absence of the fouls. Just for illustration, consider the possibility of experimentation having continued for just a couple more years—while the Internet continued to diffuse to new users, or until the dot-com bubble burst, whichever you like.

The two fewer years of experimentation yielded two losses. First, users never experienced what would have been invented had developers lived longer with a cooperative business partner such as Netscape. Instead, everybody just gave up trying to experiment in ways that raised Redmond's ire. Remember, the late 1990s was an era of easy money and the biggest venture-capitalist-led entry boom in the history of computing, so there would have been quite a lot of experimentation—at least three more rounds of browser upgrades and complementary inventions in security, search, identity protection, and stuff I cannot imagine.

Second, users also did not experience what Microsoft would have done had it possessed a sense of competitive urgency. Because Gates' motives were defensive and reactive, Microsoft slowed several of its Internet initiatives once Netscape's coalition collapsed. For example, Internet Explorer went years without another upgrade. Developers also were stuck, and many complained, but they had nowhere else to go.

To be fair, this is much easier to say with hindsight than it was in 1998, when the losses were mostly prospective. It was especially difficult for government lawyers because Gates' lawyers boldly declared innocence. Both could not be right. A legal confrontation was inevitable.

The trial

The trial involved many eye-opening revelations and spectacles. The first occurred at Gates' deposition.

Depositions are normally perfunctory, boring legal events. This was anything but that. It went very badly for Gates.

Under the cold light of hard questions, the lead prosecutor, David Bois, reduced Gates to human proportions. It was almost shocking to see an executive who had unquestioned authority at his own company become defensive and vulnerable in a setting he did not fully control.

More to the point, Bois made Gates sound internally inconsistent. Gates denied his firm had market power, and he denied recalling e-mails that clearly showed that he fully comprehended his negotiating advantages with business partners. Bois made it appear that Gates lived in his own world, effectively deploying market power while denying its existence when convenient.

During the actual trial, it just got worse for Microsoft. Although the trial was complex and involved many sideshows, any spectacle made headlines. In particular, one subpoenaed memo and e-mail after another revealed the self-serving (as well as coarse!) language that characterized Microsoft's internal debates.

The adverse publicity led to tons of collateral damage to Gates' public image. News commentators wondered if the company's internal culture had any sense of restraint. Many prior business partners wondered whether their deals had been enacted in good faith. It further inspired the open-source movement (which already treated Gates as a bogey man). By association, it tinged many legitimate activities, reducing the value of years of brand building.

Making a long story short, the prosecution eventually achieved its principal legal goal. It persuaded the presiding judge, Penfield Jackson, that management had the intent and means to alter the competitive process in its favor, and that it did so. Indeed, Microsoft lost rather badly in Jackson's rulings.

Microsoft's legal defense team next aimed its efforts at reversing the judgment before an appellate court. Long story short again, under the circumstances Microsoft's lawyers did rather well, winning on some points and losing

others. They also got the court to place some limits on the range of punishment Microsoft could receive.

Yet, by losing just a little, Gates lost in a big way. The appellate court did not conclude that Microsoft's actions fell outside the domain of antitrust law. It *did* find that Microsoft had market power and had misused it.

I am not shy about saying that I believe this trial's outcome was good for the long-term health of high-tech markets in the United States. Had Gates won the trial, other powerful executives would have been tempted to adopt Gates' strategic playbook for limiting the experimentation of others. I believe society is better off without such self-serving limitations.

As for whether the trial undid the fouls in this particular market, however, I must highlight ambiguity. Although Microsoft did not escape punishment altogether, it did avoid severe punishment. That happened through a sequence of highly unlikely events.

It turned out that Judge Jackson had acquired Judge Ito disease—he gave long, frank interviews to reporters during the trial. Though the interviews made for entertaining reading (Jackson thought Gates needed a comeuppance), they were published prior to the appeals court's final judgment. The appellate court severely reprimanded Jackson for breaching protocol (another great read), sending the open legal questions, including the determination of the eventual punishment, back to another judge.

That was quite fortunate for Gates. Any other judge would be better for Microsoft's prospects.

Another factor then played a role. The new Bush administration had no appetite to fight this case further, but initially could not act on those predilections without inviting very bad publicity. However, after the horror of 9/11 provided motivation and/or cover, the new lead prosecutor negotiated a settlement with minimal bite, and, after some tussle, got the new judge to approve it.

The new judgment did one thing well: It made it far more difficult for Microsoft to claim legality for questionable tactics and defer a trial for a long time, something Gates had effectively done in the past. Now all complaints were heard quickly by a court or a court-appointed committee.

Unfortunately, since the market had already moved on, there was not much to adjudicate.

Fast-forward to the present

Gates' career could not be the same after the trial. He had become singularly associated with the questionable behavior at the center of the firm's legal problems.

Gates gave up his CEO position and moved to a newly created position, Chief Software Architect. Steve Ballmer became CEO. The reasons were never fully explained in public, but I would guess that—after the finger-pointing stopped—even Gates' friends in Microsoft thought this was a way for the firm to move forward, at least on a symbolic level.

Thereafter, Gates continued to engage in firm decision making, and I have sometimes wondered how Ballmer could take the executive reins with Gates potentially contributing as he always had. The situation must have placed strains on their friendship and working relationship.

The case left the news after 2001—except for periodic stories involving Ballmer settling every private antitrust case Microsoft faced. The private suits in the US cost over \$4 billion, a small fraction of Microsoft's cash on hand. As of this writing, Microsoft is still negotiating with the European Union, so the final bill is not in.

Ballmer has changed some practices, although it is unclear whether the court's oversight or the rise of open-source tools motivated the changes. For example, in the summer of 2007, Microsoft announced the "Windows Principles," which is Microsoft's written promise to behave in a predictable way

toward developers. This is a good policy, albeit late in coming.

Make no mistake: The old Microsoft would not have adopted this policy. For example, Google experimented with a search bar in the standard desktop installation. I believe the old Microsoft would have taken action against Google with the release of Vista, but, after some prodding, the new Microsoft stuck with principled actions. I salute Redmond for it. Users benefited from the experiment. I hope to see more principled action in the future.

While all this was happening, Gates set aside a large fraction of his wealth for charity, aiming the organization primarily at ending worldwide disease. In a surprising gesture, Warren Buffett pledged to move a big chunk of wealth into the same organization, making it the wealthiest nonreligious nonprofit organization on the globe.

This fast-forwards us to the present moment: Gates wants to devote more time and energy to this organization. These choices will send Gates' life in a new and unambiguously positive direction.

What if?

There is one enormous irony in the long arc of Gates' managerial career. His temperament, savvy, and intellectual breadth are qualities that would have made him an extraordinary serial entrepreneur, founding one organization after another. Yet, the road he traveled was quite different: continual employment at a single firm for over 30 years.

That ultimately led to new types of challenges in a corporate setting and the singular tragedy of Gates' career. He tried to retain the unqualified self-serving approach that had worked so well for him as an entrepreneur, even when the actions of a dominant firm required a different touch.

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