As Goes Microsoft, So Goes The Computer Industry

by Thomas W. Hazlett and George Bittlingmayer

Sen. Ron Wyden (D., Ore.) is credited with the observation that competition is much too important to be left to the market. The Clinton administration seems to agree, as evidenced by its recent massive antitrust lawsuit against Microsoft. But has anyone bothered consulting the market to find out whether it agrees with the politicians?

As a matter of fact, we have. In the Microsoft antitrust case, Mr. Wyden's maxim is testable. Thanks to a nearly decade-long interest in the question of Microsoft's market power by both the Federal Trade Commission and the Department of Justice, we have a historical trail of enforcement actions against the maker of MS-DOS and Windows. By examining how the stock prices of various computer companies react to such events, we may actually observe an unbiased forecast—provided by investors playing for their own financial success—of the likely impact of antitrust actions against Microsoft in promoting economic efficiency.

It is obvious that any sort of antitrust action taken against Microsoft will hurt its shareholders. Thus Microsoft stock-price reactions flag those antitrust actions investors take to be serious threats to Microsoft.

Vested Interest

Whether these actions are likely to improve efficiency in computer markets we may glean from the stock-price reactions of other computer companies. They have a vested interest in seeing Microsoft behave more competitively. Such an outcome would lower the cost of software while expanding the size of the market for companies producing complementary products such as chips and peripherals. Moreover, it would clear the path for rival software firms to compete successfully with Microsoft. These companies are now supposedly constrained by Microsoft's exclusionary tactics. Alan C. Ashton, president of WordPerfect, told The Wall Street Journal in 1992: "Microsoft's sway over operating systems and applications puts everyone else in the industry at a disadvantage. They are a threat to everybody in the industry."

To gauge how investors reacted to announcements of federal antitrust action against Microsoft, we identified all articles breaking news on this subject in The Journal from 1991 through 1997 (54 in all). During this period the FTC investigated Microsoft for monopoly abuses, but deadlocked on seeking prosecution of the company in 1993, whereupon the Department of Justice quickly intervened with a new investigation of its own. That process created a 1994 consent decree concerning Microsoft's marketing—which Judge Stanley Sporkin in 1995 tossed out as insufficiently strict. Later that year, the US Court of Appeals for the District of Columbia Circuit overruled Judge Sporkin and reinstated the consent decree. In October 1997, the Justice Department alleged that Microsoft had violated the decree, a claim that is still being litigated.

Here's how we measured the effects these events had on stock prices: Around the dates of these events—specifically, a three-day window beginning on the trading day prior to the appearance of the article—we examined the abnormal stock returns experienced by Microsoft itself and by a broad index of 159 computer companies. (We included every hardware and software firm listed in Hoover's Guide to Computer Companies that was publicly listed and operated primarily in the computer sector, excluding Microsoft, weighted each firm equally in each of nine computer industry segments, and then weighted each industry segment equally when estimating aggregate industry returns.)

We divided the events into "positive," "negative," and "ambiguous" news categories. (A positive story was one that would tend to help Microsoft, by announcing a withdrawal of enforcement action—say, the circuit court overruling Judge Sporkin.) If investors expect antitrust intervention to increase competition, then the returns to Microsoft shareholders (subtracting out marketwide effects) should be negatively correlated with the returns for the rest of the computer sector.

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Average Abnormal 3-Day Stock Returns Around Microsoft Antitrust Events, 1991-97

	Pro-enforcement actions (n=29)	Anti-enforcement actions (n=8)
Microsoft	-1.2%	+2.4%
Computer Industry (159 companies excluding MS)	- 0.6%	+1.2%

When Microsoft takes a negative hit, the computer index should blip up—and vice versa.

The actual results, however, came out strongly the other way, as shown in the table above. Unsurprisingly, when Microsoft receives good news, its stockholders experience average market-adjusted returns of 2.4% (per each of eight events). But the news is also good for the industry as a whole, which sees average returns of 1.2% over the same dates. (Both returns are significantly greater than zero at standard levels of statistical inference.) During negative event windows (29 in total), Microsoft stockholders incur average returns of minus 1.2% per event, while the non-Microsoft computer portfolio declines 0.6%. (Again, both are statistically significant.)

The returns for a few companies—including Netscape, which is leading the charge for the recent antitrust enforcement actions—do exhibit some positive reaction during antitrust event windows, thus helping to explain why such companies would lobby for sanctions. Yet the overall conclusion is inescapable: As goes Microsoft, so goes the computer industry.

The movement of the market, when the Justice Department announced its latest action against Microsoft, appears to fit the pattern we found. Microsoft stock declined 3.8%. Compaq—Microsoft's biggest customer—saw its share price drop 3.5%, while both Intel and the Nasdaq computer sector index were down 1.2%.

The evidence strongly suggests that Wall Street does not see federal antitrust action against Microsoft as a solution to whatever monopoly power it may possess. Customers want operating-system software that works, and upgraded software that works better—sooner rather than later. The rest of the industry prospers when consumers are able to plug their products into friendlier, more functional computers. Disrupting the release of new Microsoft products due to legal action can upset the entire sector. It is significant that the Justice Department's antitrust actions increased the uncertainty surrounding the introduction of both Windows 95 and Windows 98, unsettling large segments of the computer industry.

California was one of the twenty states which joined the US Department of Justice's antitrust suit against Microsoft. Many of Microsoft's fiercest industrial competitors—among them Netscape, Sun, and Oracle—are headquartered here and have a substantial political presence. Overall, Silicon Valley's software sector is decidedly hostile to their rival from Redmond. But much of the state's computer manufacturing sector believes it stands to lose from prosecution of Microsoft.

Intimidating Shadow?

The recent letter sent to the Justice Department by 26 computer company CEOs—including the leaders of Intel, Compaq, Hewlett-Packard, Dell, and CompUSA—should give the antitrust enforcers pause. The companies whose names appear on that letter stand to benefit monetarily from actions that would make operating system software better, cheaper, more reliable, more open to innovation, and easier to use. The techie trade press has derided these executives for lining up behind Microsoft as evidence of Microsoft's long, intimidating shadow.

But investors in global capital markets stand in broad daylight. Their verdict is compelling because they are fearlessly independent wealth maximizers, and they have—over seven years—also lined up solidly behind Microsoft and against federal regulators. The smart money is shorting the government's case that antitrust enforcement will promote competition and enhance consumer welfare.

A version of this article appeared in The Wall Street Journal *on May 26, 1998. Both of these articles are based on the research paper,* DOS Kapital: Has Antitrust Action Against Microsoft Created Value in the Computer Industry?, *which is available in Adobe Acrobat format at http://www.gsm.ucdavis.edu/~gnbittli.*
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