Microsoft Corp

Microsoft's tussle for top spot highlights its transformation

It has drawn level with Apple thanks to cloud services but shadow of regulation looms

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Richard Waters in San Francisco NOVEMBER 28, 2018

The last time that Microsoft rose to be the world's most valuable company, in 1998, Bill Clinton had yet to be impeached, Boris Yeltsin was still president of Russia and Google was less than a month old.

On Tuesday, the company that dominated the PC era of computing reclaimed that title, albeit only for a few moments near the close of the trading day.

Microsoft has undergone a transformation from the days when the US was threatening to break it up for abusing its monopoly over PC software. It is no longer seen as the bully of the tech world. But with power concentrating again, some observers warn that a fresh round of regulatory action is almost inevitable.

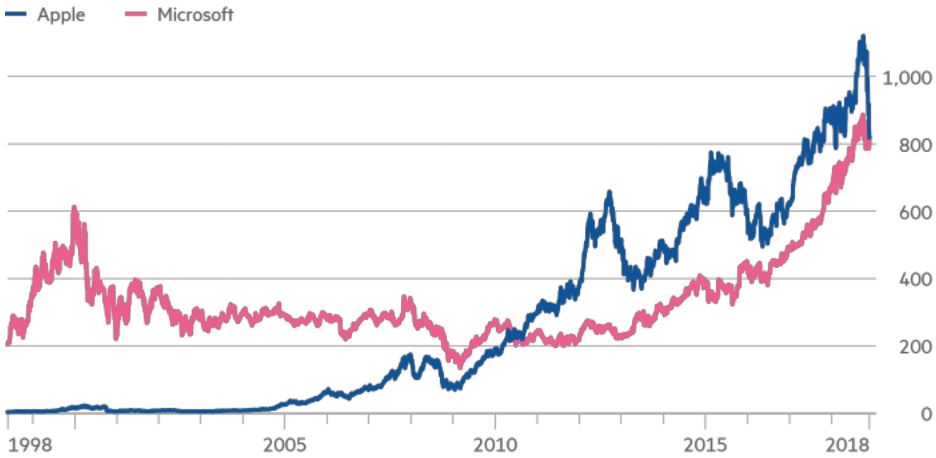
Apple has been in the top spot for seven years but has faltered in recent weeks on worries the smartphone market has run out of growth. That allowed Microsoft to draw level; its market value topped $821.5bn to Apple's $821.3bn at one point, before a late uptick by the iPhone maker put it $5bn ahead again at the end of the day.

Given the stock market's recent mood swings, a longer lasting change in leadership seems likely. Apple has lost 25 per cent of its market value from the peak at the start of October, or $270bn.

Feedback

Apple and Microsoft are neck-and-neck in race to be the world's largest company

Market capitalisation ($bn)



Source: Bloomberg
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By contrast, Microsoft has found a new and more reliable furrow to plough. Its growth last year was the strongest in a decade and its shares have held up better than most amid the recent tech rout, slipping only 9 per cent from their peak.

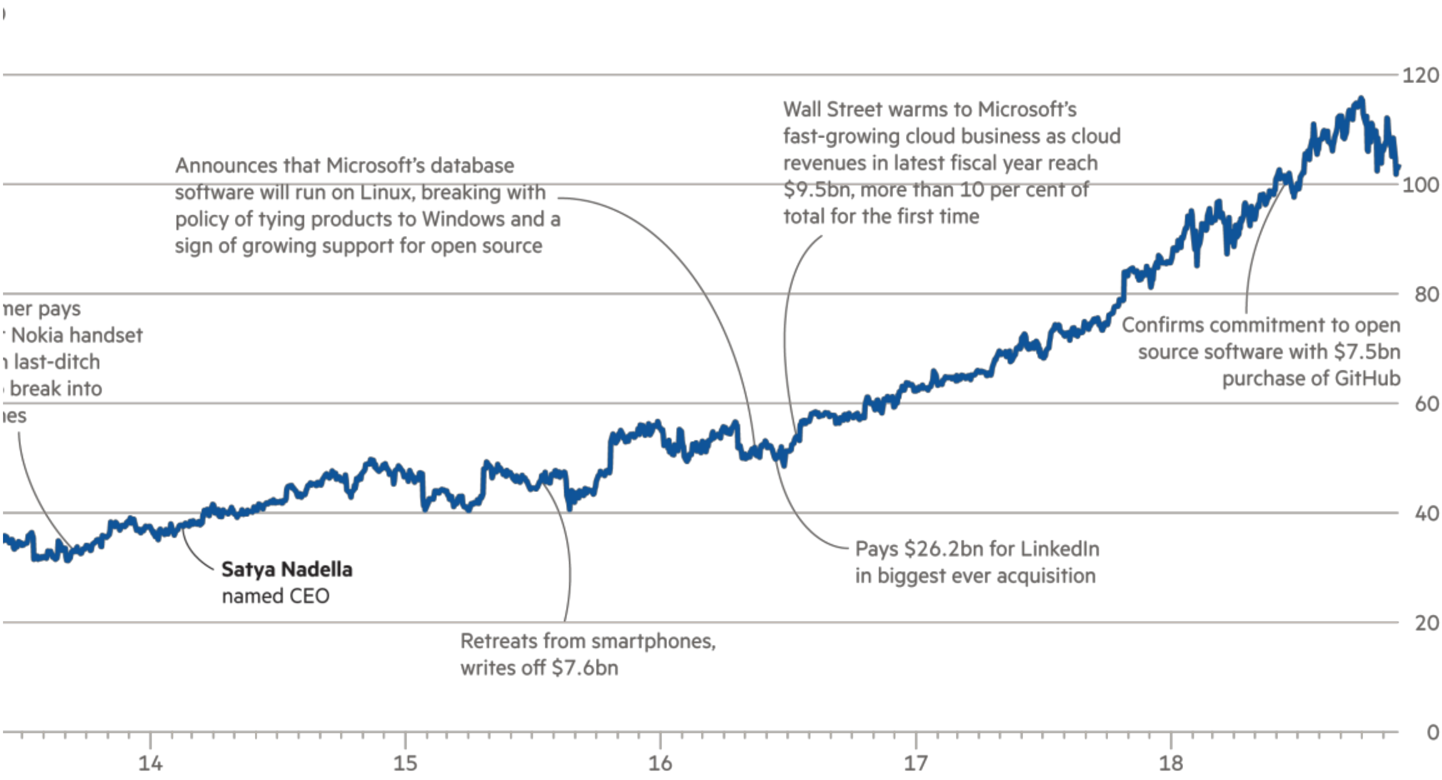
Overtaking Apple would cap a five-year run during which Microsoft’s share price rose nearly three-fold. Compared to the peak it hit in the tech boom nearly two decades ago, however, the rally looks less impressive. Its shares have managed a compound growth of only about 3 per cent a year since then.

As often in tech, the changing fortunes point to a deeper shift. It took the arrival of the smartphone to weaken Microsoft’s PC dominance. Now the smartphone market is mature, and the focus of growth has moved again, this time to the cloud.

After four quarters of contraction, the number of smartphones sold this year is likely to fall about 3 per cent from 2017, according to Morgan Stanley. The PC market, meanwhile, fell heavily after peaking in 2011 but has now levelled off.

By contrast, the cloud business — selling centralised computing services to corporate and government customers — is in its infancy. This year it will reach only 9 per cent of a market potentially worth $650bn, according to Goldman Sachs.

as positive impact on Microsoft's shares



Satya Nadella, Microsoft's chief executive since early 2014, has been the beneficiary of a transition that began before he took over.

"What he's done was teed up before him," said Kevin Walkush of Jensen Investment Management, a long-term Microsoft shareholder. But under Mr Nadella a nascent cloud business has turned into the company's main engine of growth: "The proof was quarter after quarter of strong growth — they just kept building. It's just really strong, stable fundamentals."

Mr Nadella also pushed Microsoft faster beyond its old, Windows-centric business model, in which all its other businesses once supported the PC operating system, the source of most of its profits. That included announcing in 2016 that Microsoft would release a version of its database software to run on the rival Linux — an open source operating system once described by former CEO Steve Ballmer as a "cancer" on the software industry.

The new CEO has also brought a change in personal style, burying the hatchet with old rivals such as Google and recasting Microsoft as a more reliable partner for other tech companies.

But even if today's Microsoft looks a different animal from the once-feared monopolist, it still relies on many of the same business practices, said Rob Helm, an analyst at Directions on Microsoft, an independent research firm that advises Microsoft customers.

Recommended

These include bundling products together under a single licence to outflank competitors. Faced with competition from corporate messaging service Slack, for instance, Microsoft created an alternative service of its own and included it, free of charge, in Office 365 — something that could discourage its large base of Office customers from turning to Slack.

It has also used licensing arrangements such as this to promote Azure, the cloud infrastructure and platform business that competes directly with Amazon Web Services. Azure has been a harder sell with some customers than Office 365, said Mr Helm: but by negotiating a single licence fee to cover both, Microsoft has been able to maintain the service's rapid growth. That could backfire if, at the end of their three-year licences, some customers find they have not used the Azure service and choose not to renew.

The highly concentrated nature of the cloud market could also bring renewed attention from regulators. Amazon and Microsoft are estimated to account for 70 per cent of the cloud infrastructure and platform business between them. "They're running what amount to utility businesses that lots of other businesses depend on," said Mr Helm.

For now, the new Microsoft does not provoke the same fear and dread as the old one. But its growing power — and wealth — could change that.

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