

# Personal computer operating system

[Technology](#), [Internet](#)



Microsoft was founded in 1975 by William (hereafter Bill) Gates. Since its founding this firm has developed in one of the most controversial and powerful company's in the world. Further, Bill Gates the Chairman and leading software architect of Microsoft has emerged as the world richest man and even as the world largest philanthropist. Indeed, by 2004, less than 30 years after its founding, Microsoft had annual revenues of over \$34bn, invested over \$6bn in 2004 and employed more than 55, 000 people in 85 countries. This case will outline this firms' development and consider the particular issue of dividend policy for this firm.

The initial inspiration for Microsoft emerged from Bill Gates' development of a programming language for the world first microcomputer. This new computer language developed whilst an undergraduate student forms the building block which influenced the direction and future development of this company. After dropping out of his undergraduate degree at Harvard, Bill Gates, founded Microsoft with his friend Paul Allen in 1975. This company continued Gate's work on developing software for microcomputers, following the belief that one day personal computers would become widely employed technology.

This firm developed throughout the 1970's into the 1980s, moving from New Mexico to Settle in Washington State and launching the Ms-Dos operating system for the IBM PC in 1981. This development grew in importance with the success of the IBM PC, leading to the public offering of Microsoft stock in 1986. This growth continued with the launch of a number of versions of the Windows operating system of PCs throughout the 1990s, a system which

eventually became a dominant operating system, throughout the developed world.

Throughout this growth Microsoft emerged from being a innovation centred and unstructured high technology start up firm into becoming a huge international corporation in a very brief period of time (see Herbold 2002). Further Microsoft throughout this period widened its areas of activity by supplying more of the applications which personal computers increasingly depend, such as the very successful Office Suite of applications. A time line of these developments is presented over the page.

Overtime and due to Microsoft's increasing size and potential dominance in certain high technology markets increasing litigation occurred between Microsoft and its competitors, over access of many of the different patents and innovations which lie at the bedrock of much of the this industry.

Microsoft quickly developed a reputation for being an effective competitor in these markets, with Bill Gates famously being nicknamed 'Darth Vader' by Scott McNealy of Sun Microsystems, a key competitor of Microsoft. In addition to these forms of competition was the suggestion that Microsoft had developed a monopolistic or dominant position in the PC operating system and application market.

This dominance has been a concern of the Competition and Antitrust authorities both within Europe and the USA. These competition authorities are charged under antitrust or competition law to investigate the degree of monopoly or market dominance and provide remedies to these concerns, be these structural such as breaking up the firm into competitive and separate

parts, or behavioural, to alter the firms' conduct to prevent exploitation of a monopoly position. Due to its dominant position and ability to produce vast profits Microsoft was placed under investigation both in the USA and Europe for antitrust and competition reasons.

Apart from these problems of success Microsoft like many other high technology firms had developed substantial financial resources and in particular large revenues and associated cash resources throughout the late 1990's and early 2000's. Indeed by 2003 many of the large high technology firms, in addition to Microsoft, also accumulated very large cash piles. For example by 2003 Microsoft had \$40bn in cash, Cisco Systems had a \$10 billion cash pile, Nokia over \$8bn in cash and Dell \$4bn in cash. Considering this success, it is perhaps all the more surprising that firms' generally and this type of high technology firm particularly, has traditionally issued virtually no dividends at all.

This trend of high technology firms not paying out dividends to their shareholders is part of a wider change in financial markets. For example in the USA during the 1950's 9 out of every 10 US companies paid dividends, by 2001 this proportion had fallen to only one in five companies. Principal among the reasons for this dramatic decline in the proportion of firms both in the USA and internationally paying dividends has been the type of firm listed on International stock exchanges (French and Fama 2001). Until the 1970s generally only a limited proportion of all firms, and generally only, mature, large and profitable firms were listed on the stock exchange. After the 1970s and with the advent of new stock markets such as Nasdaq which

accommodate different types of company, newer, more innovative and less profitable companies were listed on stock exchanges (Fama and French 2004).

These companies by their youth and often high risk areas of operation needed to reinvest much of their earnings to allow future development. Indeed many of the new stock market offerings in the 1990s did not even create any earnings as the requirement for a profitable business was not central to many new high technology companies. As the practice for many of the high technology firms, including Microsoft, of not paying dividends increasingly became a habit, resulting in these newer, mature profitable firms not paying dividends in the 1990s.

This process of reducing dividends has also been linked to the particularly high rates of taxation on dividends as opposed to capital gains which have existed in the USA and have increased in the UK in the last decade. For example in reaction to these taxation concerns in the USA George Bush has signalled a desire to remove all income tax on dividends. This movement developed in reaction to the sharply different rates of taxation on capital gains and dividends, these being in 2001 in the USA, 39.6% for dividends whilst capital gains on the increase in a share price were only taxed at 20%.

This practice of not paying dividends was further complicated at Microsoft due to the particular high proportion of shares held internally. It has long been a practice in Microsoft for employees and particularly managers to be offered share options as part of their remuneration package. In addition Microsoft has spent vast sums in repurchasing shares held externally to

support these employee option schemes and bolster the generally already healthy share price (Microsoft shares have for a long time had a very high trading at a price earnings ratio of around 40). Following this development a significant proportion of Microsoft is owned by its managers and its employees. Indeed this makes the possible take over of Microsoft a very difficult proposition for disgruntled shareholders who may be upset by the lack of dividends. A graphic of the key shareholders of Microsoft is displayed in Figure 1.

Despite this tradition of non-payment of dividends, Microsoft made an astonishing announcement in 2003 that it would start paying a dividend (the first since 1986 when the company was floated on public markets). This initial announcement in 2003 indicated a range of measures; that one, a dividend of 16 cents per share, would be paid initially, two, for one stock split would be undertaken, and three a major share repurchases would occur. Later Microsoft announced it would provide a special dividend of \$32bn or \$3 a share and a share repurchase scheme, providing a significant injection of cash into the US economy, further the regular dividend of 16 cents per share was to be increased to 32 cents a year, paid quarterly. Further this pay back of cash to shareholders was to be increased to \$75 bn in total in 2004.