

Microsoft corporation
is a public
multinational
company



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Introduction

Microsoft Corporation is a public multinational company, headquartered in Redmond, Washington USA. Microsoft generates revenues from the development, the production, the licensing and the supporting of computer – related products. To be more specific, products related to software applications, operating systems, PC’s programs and accessories.

History

Following, there is a brief presentation of the most significant moments in the company’s history, during its functions for over 30 years, in terms of products releases and important strategic decisions:

1975: Bill Gates and Paul Allen established a new company called Micro-soft, short for the words Microcomputers and Software.

1980: Microsoft signed contract with IBM for the provision of operating systems which was used from the IBM's Personal Computers (PC). Their alliance dominated the market of home computers. After some years (1990) it will be the cause of accusations for possible collusion between the two companies against the competition, by the Federal Trade Commission of the USA.

1983: The most solid and reliable (until then) Microsoft's Operating System, MS-DOS, was released. That made the company the largest player in the industry of creating top-of-line software. This system will be the fundamental of future successful systems. (Microsoft Mouse, Microsoft Windows)

1985: The first version of Microsoft Windows was introduced and almost immediately had great success. After some years, Windows would become one of the most known and recognizable brand names.

1990: Microsoft released new software, specified in a variety of businesses applications, which was the first version of Microsoft Office.

1995: The Company expanded into computer networking and Internet. (Internet Explorer)

2001: Xbox, a game platform, was released and Microsoft entered the game console industry.

2008: Bill Gates (CEO and founder of the company) announced that he is stopping from day to day management of the company.

2010: Operating system for mobile phones and cloud-based internet services are considered as the future of the company's development.

Microsoft Products and Divisions

The vast majority of Microsoft's products refer to several software applications. As we discussed before, the company develops, produces, sales and supports these products. In order to be more efficient and productive, Microsoft organizes and allocates the businesses operations in five segments. Each segment is responsible for specific products and different functions of the company. The five segments, as well as their basic services and products are the following ones:

Windows and Windows Live Division. This segment is responsible for the development of the most profitable and well known product of Microsoft, Windows Operating Systems. Windows Live and Internet Explorer are also in that division. (Windows Vista, Windows XP, Windows 7, Internet Explorer 8)

Servers and Tools. Server software, server tools for developers and others consulting services and solutions are designed and sold in this segment. The main objective of those products is to help IT professionals and developers.

Online Services Division. This segment develops systems that can provide online information to consumers. The main purpose of those products is the provision of advertising opportunities to merchants.(BING, MSN, Atlas)

Microsoft Business Division. This division develops and market products that are designed to execute business applications. Enterprises use the software

to increase their productivity and their efficiency. (Microsoft Office, Microsoft Dynamics CRM/ERP)

Entertainment and Devices Division. This segment is responsible for a large amount of products that are related to entertainment and technological "gadgets". The Xbox 360 game platform, Xbox game titles, PC games, PC/Xbox accessories, Mobile phone's operating systems and everything else that could provide entertainment. Furthermore, this segment designs the marketing and the promotion strategy of Microsoft Windows systems.

Employers and Customers

Microsoft employs almost 89000 people on a full time term. 54000 of them are in the USA and 35000 abroad. Most of them occupy positions related to either product research and development or sales-marketing operations. (35000 in R&D, 25000 in sales) Other working positions are in manufacturing and in product support. The following chart presents the percentage allocation of Microsoft's employees in specific functions of the company.

Allocation of Microsoft's employees

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The customers of Microsoft's products are spread in many different categories; individual consumers, public and private organizations, governmental institutions, universities, application developers are only some of the main company's clients.

Microsoft is a typical multinational company that operates and retains offices in over 100 countries. . In addition, it sells products to over 150 countries. As a result, great part of company's revenues is coming from outside the USA.

Macroeconomic Analysis

Global Economy

The analysis of the global economical environment is essential in one efficient top-down analysis. We will investigate the situation of the global economy, in terms of macroeconomic variables, such as GDP, Foreign exchange rates, labor, inflation and interest rates. In this topic, we will clarify the meaning of the previous macroeconomical measures, we will observe their performance during the last decade and finally we will explain how their values inflect the global economy and finally the company itself.

Gross Domestic Product (GPD)

GPD represents the overall economical output of a country, in other words, it measures the total production of goods and services of one economy. (GPD = Private Consumption + Gross Investments + Government Spending + (Exports - Imports)).

According to data from the International Monetary Fund the global GDP is expected to reach US\$ 619, 634. 29 billion in 2010, which is a total increase of 4. 8% compared to 2009. If we observe the performance of the world's GDP growth since 2000 (chart 1), we could note that according to the data, the global economy stands in a recovery pattern from the recession of 2007. In 2008, when the consequences of the crisis were starting to affect the GDP,

the growth was 2.8%, while the worst year, the trough, was in 2009, when the growth had negative value, -0.6%.

Figure 1. Percentage growth of World's Gross Domestic Product .

International Monetary Fund, World Economic Outlook Database, October 2010

However, the GPD analysis does not only provide us with information about the global economical performance; it also demonstrates the most productive countries in the world and subsequently the countries with the most profitable business opportunities for Microsoft. These opportunities are emerging either from business clients and partners (information technology companies, organizations, institutions, etc...) or from higher consumption (Computer users). As a result, it would be useful for our analysis to examine the structure of the Global GPD constant prices in specific countries. (Figure 2)

Observing figure 2, we can conclude that the European Union, USA, China and Japan are the global leaders in production, thus these are the most important economies regarding the operations of Microsoft and they have the greatest impact on the world economy. Therefore from this point and on, our macro-analysis will be focused on those countries.

We should examine the GPD growth rates of these countries during the last decade. {figure 3} We can observe that in terms of GPD growth, the performance of US, EU and Japan is both similar in each other and significantly low in contrast with China. Since 2007, China's economy growth

rate was consecutively 14.2%, 9.6% and 9.1% and 10.5%, while USA's rate, which was on average the best between the three "leaders" was 1.9%, 0.0%, -2.6%, 2.6%. India is also another example of an emerging country with notable GDP percentage of the world's product and outstanding growth. (India: GDP 2.3% of world's GDP or US\$ 1430.02 billion, GDP growth rate for 2010, 9.7%).

Figure 3. Percentage growth of Gross Domestic Product

International Monetary Fund, World Economic Outlook Database, October 2010

(table in excel)

Figure 2. (Gross Domestic Products \$ / Aggregate global \$ GDP)%

International Monetary Fund, World Economic Outlook Database, October 2010

The overall GDP observations lead us to the following conclusions:

The world is showing signs of recovery from the recession, which is a good opportunity for companies regarding advanced technology like Microsoft.

USA, EU, Japan and China are the most important economies where Microsoft can be developed

China and India are showing great potential for the future.

Foreign Exchange Rates

The Foreign Exchange Rate specifies how much one currency is worth, in terms of one other. One of the main reasons why we are interested in this economic measure is the fact that, it affects the exports and the imports of the economy. Furthermore, the exchange rate value of currencies is a factor that can shift the aggregate demand of the economies (e. g. demand for domestic products vs. demand for foreign products). As we pointed out previously, Microsoft sells goods to over 100 countries. As a result of this fact, its sales and its profitability depend on the exchange rate.

The following figures (4-6) are presenting the performance of US\$ in terms of Euro, Chinese Yuan and Japanese Yen. At the beginning of the last decade, US\$ was still strong in contrast with the newborn Euro and the Asian currencies. However, we can easily observe that Dollar lost value during the last decade. The main fall is originating from the great depreciation of USD in contrast with Chinese Yuan since 2004. The last 6 years the currency between USD-YUAN has changed almost 20%. During 2010, Euro also depreciated against US\$, as a result of the debt problems of many Eurozone members (Greece, Ireland, Portugal etc...).

Microsoft is affected from the depreciation of the dollar; we can mention that on the one hand it is an opportunity for the expansion of its exporting activities (outside the USA); however, on the other hand the continuous depreciation of the global exchange currency (US Dollar) leads markets to uncertainty. Hence, in the long term, the company prefers a strong and stable US Dollar.

Figure 4, Euro/US\$

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Figure 5

Figure 6

Labor

Employment or Labor is a key factor of the economy. Firstly, it affects the aggregate demand of the economy, because peoples' income is hugely affected from their employment (Income elasticity = $\frac{\% \hat{Q}}{\% \hat{I}}$ Quantity of Products/ $\% \hat{I}$ Income); secondly, it affects the aggregate supply, because it is one of the most fundamental imported resources of the production.

The unemployment rate is the key factor of the conditions in the Labor market. It describes the number of people who although belong in the labor force (they are able to work and they are looking for a job), they cannot find one. (NUMBER OF UNEMPLOYED/LABOR FORCE)

Regarding Figure 7, in all periods from 2000 to 2010, China and Japan have significantly lower unemployment rates in contrast with the EU. At the beginning of the decade, USA economy showed also very low levels of unemployment, however after the recession of 2007, the USA's employment affected more from the other countries. From the recession of 2007 to 2010, USA managed to overlap EU's unemployment rate (USA 9.73%, EU 9.6%), while Japan and China levels of unemployment stayed almost unaffected (China 4.1%, Japan 5.1%).

Figure number 7

International Monetary Fund, World Economic Outlook Database, October 2010

Inflation

Inflation shows the increase of the level of prices in a specific period of time. As the aggregate demand goes up more quickly than the aggregate supply, the inflation rate rises. Moreover, it can be defined as the decline of the purchasing power of money in an economy, as a result of explanatory monetary policy (increasing money supply).

According to figure 10, Inflation is another macroeconomic factor in which the performance of the USA and the EU is quite similar. Again America showed larger sensitivity during the recession, but in general the performance of the two west economies is much better than in China. China's inflation rates were very volatile during the last decade (WHY IS IT VOLATILE). This can be illustrated if we observe the inflation rates since in 2004 when there was a huge rise of the inflation to 3.90% from -0.77% two years earlier (2002). Furthermore, inflation rate was 6% after the first year of the financial crisis (2008) and a deflation of -0.7% one year later. Japan is facing deflation rate (decreasing prices). Especially, during the recession the deflation rate was more than -1%.

Figure 8

International Monetary Fund, World Economic Outlook Database, October 2010

Interest rates

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An interest rate is the rate at which interests are paid by borrowers and investors to lenders and issuers of money market products and bonds respectively. Interest rates are fundamental of the capital system and they interact with many factors of the economy such as, the aggregate demand, investments, level of prices (inflation) and money supply. Because of the inverse relationship between interest rate and money demand, low interest rate will encourage consumer expenditure and reduce savings. The level of rates affects Microsoft's debt costs, its investments in securities and its receivables from clients. Nevertheless, the most important consequence of the interest rates regarding the company is the influence of the interest rates in the level of investments in an economy and thus, in the demand for the company's products. (e. g. High interest rates tend to reduce investments, therefore growth declines, thus demand for IT services is lower and vice versa)

The levels of the 3-month US T-bills are a benchmark of the level of interest rates in the USA. According to the following table the interest rates are in the lowest level of the last years. Just before the financial crisis (07/2007) the rates were almost 5%, while after one year (09/2008-12/2010) were under 1%.

Figure 9. 3-month Treasury bill secondary market rate discount basis

USA Federal Reserve

Governments regulation fiscal and monetary policy.

Protective function of Government

The government has two significant roles to play inside a country's economy. The first one is the "protective role" which has target to protect the private property of individuals against invasion by others. The second important role of the government is to contribute to economic stability mainly through the fiscal and monetary policy. Firstly, we will be looking at the protective role of the government and then we will analyze the recent trend of fiscal and monetary policy. We are focusing our analysis to the government of the USA because firstly, it is the home country of Microsoft and secondly, it affects directly or indirectly the policy of the world's governments.

The protective function of the government is essential for Microsoft. As we explained earlier, the company spends a huge proportion of its sources in research and developing projects, therefore intellectual property rights are essential for Microsoft's operations, as it shields the company against illegal copying.

Furthermore, another protective function of the government is to ensure that the market operates efficiently by prohibiting monopolies or cartels. Thus, Microsoft is under domestic (USA) and foreign (eg EU) government supervision and legislation. As a result of that, Microsoft has many court issues to deal with. The first clash took part in 1990 in which the Federal Trade Commission of the USA accused Microsoft for potential collusion with IBM. Since then, Microsoft has been facing a lot of different court cases against anti-competitive behavior. One of the most influential cases

happened in 2004 when EU Commission took antitrust legal action against Microsoft for its domination in the market, which penalized the company with US\$ 613 million and forced it to disclose certain product's information. In the financial statement analysis we will face the financial affections of that ban.

Fiscal Policy

Fiscal police is the use of government public expenditure and the taxation policy in order to stimulus output, employment and aggregate demand of the economy during a recession (explanatory fiscal policy). On the other hand, when an economy is at the peak, the government might reduce expenditure and increase taxation to restrain the growth of the economy to avoid inflation (restrictive monetary policy). Although the overall trend of the US Federal budget deficit tend to be increasing (total spending exceeds its total revenue), there was a period that the deficit experienced a decreasing pattern.

More specifically there was a huge increase in government's debt between 2001 and 2004 (9/11 incident and dot-com burst) because of the massive military spending in war and tax cut. Between 2005 and 2007, the federal government tried to decrease its budget deficit by increasing taxation. However in the period between 2008 and 2010 (financial crisis), the federal began to cut tax and increase expenditure in bailout package to stimulus the economy. From the Microsoft perspective, the huge outstanding federal debt can be a risk factor for the future economic instability (potential debt crisis like some members of the Eurozone). However in the short run, this might signal a potential opportunity for increasing consumer expenditure and

recovery from the recession, which might increase the demand for Microsoft's products.

Monetary Policy

Monetary policy can be defined by the actions of the US government Federal Reserve (central Bank of the USA) in determining the size and the growth rate of money supply.

Because of the slow recovery of the US economy from the 2008 financial crisis, the Federal Reserve tries to stimulate growth and cut unemployment by expansionary monetary policy. In order to achieve that, Federal Reserve has recently launched a quantitative easing. This tool of expansionary monetary policy aims to keep the interest rate at a low level by buying USD\$ 75bn long term T-bills.

Expansionary monetary policy means increasing money supply in the economy. This will drive down the interest rates. As mentioned in the macroeconomic analysis, low interest rate encourages consumption and private investment and it will also depreciate the US dollars. Therefore expansionary monetary policy can benefit Microsoft by increasing consumer expenditure (higher demand for software systems) and rising of private investments, thus more Microsoft's business users. Furthermore, company's exports can be increased as a result of the depreciation of US\$. However, in the long term the high inflation can be a negative consequence of high money supply which can harm the economy and the company as well.