Clinton's Survival Strategy in the Impeachment Fight

The Markets Go Haywire

The Best Funds for Hard Times

Behind the Embassy Bombings: <u>Terror I</u>nc.

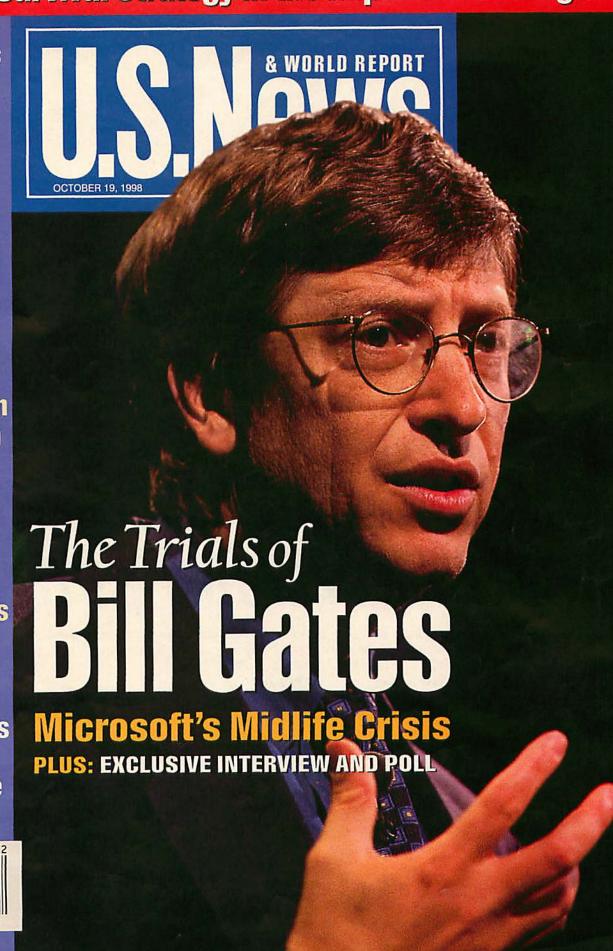
Shootings on the Mexican Border

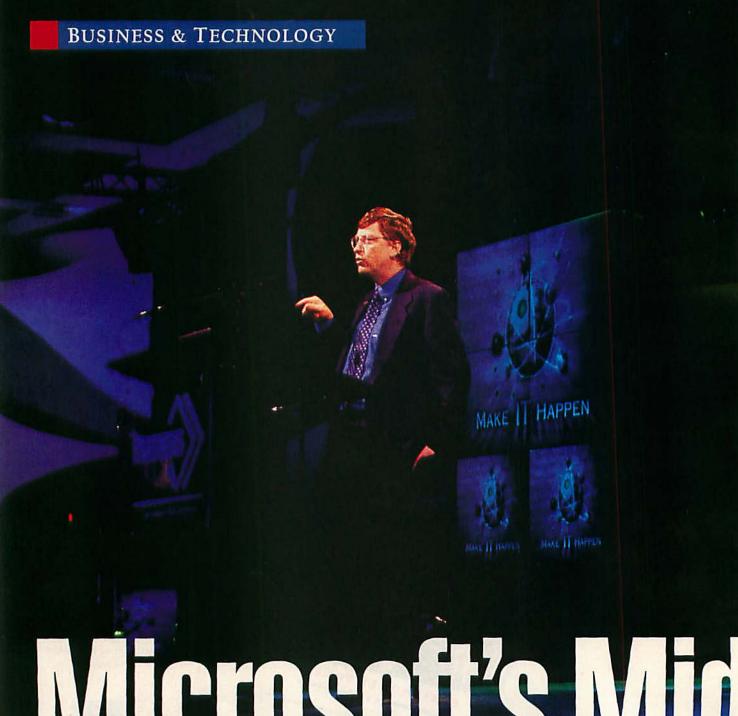
Hot Line for Hackers

John Glenn's New Space Odyssey

Cool Gadgets for the Home Office





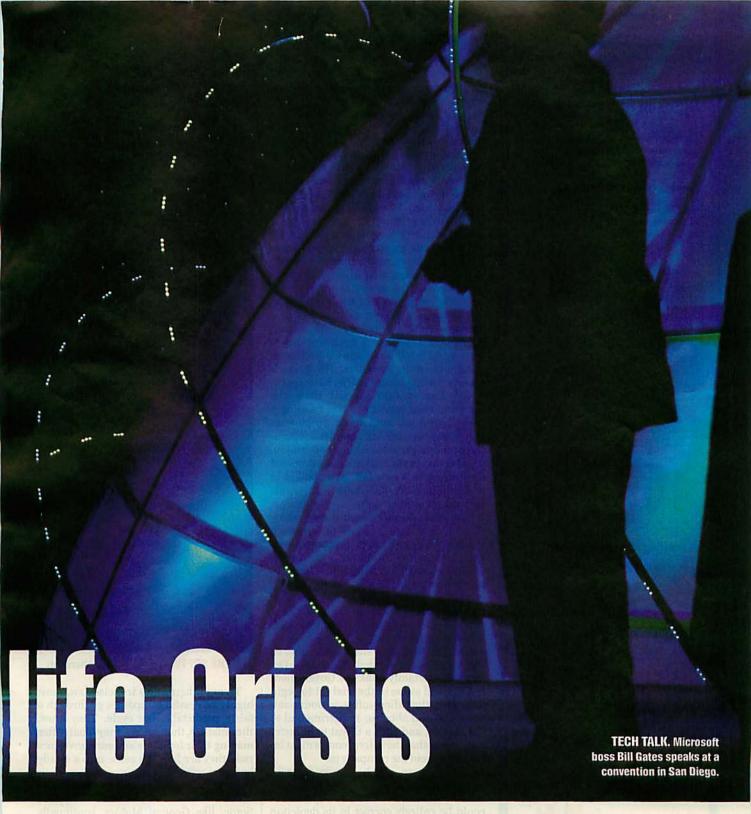


Microsoft's Min

With the big antitrust trial ready to roll, the software giant looks in the mirror and sees a touch of gray. Can Bill Gates keep the company hungry?

BY RUSS MITCHELL

ill Gates rocks. Literally. When his brain cells really start firing, Gates has a habit of leaning forward in his chair, putting his elbows on his knees, interlocking his fingers, and pumping the balls of his feet against the floor, going at it like Grandma Moses on a triple espresso.



What's got Gates rocking this particular October morning is concern about the future of Microsoft. Yes, Gates is worried—but it has nothing to do with the big antitrust case that starts October 19 (story, Page 48). He's worried instead about complacency. About bureaucracy. About customer dissatisfaction. He's worried about the possibility that Microsoft, the most stunning entrepreneurial success

story of the computer age, could end up as just another stodgy blue-chip company. Or worse—that it could miss an unexpected, sudden shift in technology and fall right off the map.

"All you have to do is slack off for one period and it's quite damaging," says Gates, who broke his trial-induced media seclusion to talk with *U.S. News* at Microsoft's Redmond, Wash., headquarters.

■ Percentage of Americans who have a favorable impression of Bill Gates: 73%

Who have a favorable impression of Microsoft: 80%

Signs of aging? Microsoft continues to grow impressively in many important categories. But a steep upward trend can't last forever. Employee growth continues . . . Total Microsoft 25,000 employees - 15,000 5,000 '98 ... but revenue growth is slowing ... Annual 45% revenue growth rate -35% 25% '98 1994 '95 '96 '97 ... cutting into profit growth ... 60% Annual profit growth rate 40% 20% '95 '97 ... that may bring the company's share price back to earth. Stock price at \$100 end of fiscal year \$80 \$60 \$40 \$20 1994 '96 '98 Oct. 8 '95 '97 Note: All figures are for fiscal-year end (June 30)

Sources: Microsoft, NationsBanc Montgomery Securities

"Will we be replaced tomorrow? No. In a very short time frame, Microsoft is an incredibly strong company. But when you look to the two-to-three-year time frame, I don't think anyone can say with a straight face that any technology company has a guaranteed position. Not Intel, not Microsoft, not Compaq, not Dell, take any of your favorites. And that's totally honest."

Gates's legal foes scoff at the suggestion that the mighty Microsoft may be at all vulnerable. They privately dismiss all the worry talk as posturing, a public-relations ploy to avoid the image of greedy monopolist. Here, after all, is a company that provides the essential software for well over 90 percent of the world's personal computers, even as it blitzes new markets. It is a company with a cash hoard of \$13 billion. A company that is earning \$4.5 billion in annual profits on \$14.5 billion in revenues. It's a stock market darling whose shares have appreciated over 38,000 percent since the company went public in 1986, creating a large crowd of millionaire employees, and compounding its founder's Microsoft stock to an astonishing \$50 billion. It's also one of the nation's most admired companies. In a new U.S. News poll, 4 in 5 Americans say they have a favorable impression of Microsoft.

Hard drive. Gates himself doesn't show the remotest sign of slacking off, even though he's a family man now, with a wife and 2-year-old daughter and a new 66,000-square-foot, \$53 million home to putter around in. "You've got to come in every day and work hard," he says. "Our jobs are as intense as they've ever been." His main focus now: making Microsoft software easier to use.

Given all that, shouldn't competitors be the ones who are worried? The Justice Department certainly thinks so. Government lawyers will argue in the trial set to begin next week that Microsoft is so dominant, powerful, and abusive; so detrimental to consumers; and such a threat to industry innovation that the federal courts must intervene to rein the company in.

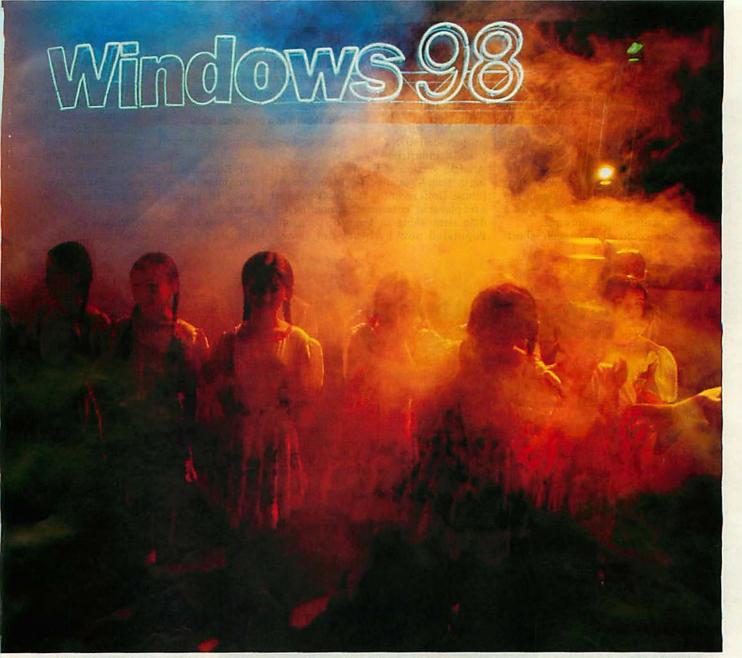
In fact, there may be reason for concern on all sides. One fear doesn't cancel out the other. The Justice Department could be entirely correct in its depiction of the company as a lawbreaking behemoth that abuses its monopoly power; the courts might be justified in taking firm action against the company. Or not. Either way, it remains perfectly rational for Gates and his executives to be mulling the possibility that Microsoft is about to leave its glory days behind, even as they dedicate themselves to preventing that from happening.



ALL THE SOFTWARE IN CHINA, Microsoft

Though there is no ironclad law, most highly successful companies go through a fairly predictable life cycle. They grow, they mature, they get big, they bloat. After making their founders and early investors rich, they are lucky to settle into a steady but unspectacular earnings stream, their stock suitable for unadventurous retirement accounts. Some of them disappear. Some, like General Motors, continually struggle. Others, like General Electric, figure out ways to beat the system and keep up robust growth despite their massive size.

Microsoft is a long way from stuffy maturity, but the company is sprouting its first gray hairs. Its income statement already betrays a loss of youthful vitality. Profit growth is slowing dramatically. After barreling along at 48 percent in 1996



launched a Chinese version of Windows in style. The company has not been immune to the economic woes currently spreading across the globe.

and nearly 53 percent in 1997, the growth rate has eased back to 27 percent for fiscal 1998 (which ended in June) and is expected to drop even more by next summer. A 20 percent-plus growth rate is

healthy by anybody's measure; it's the trend that is troublesome.

A lot of Microsoft watchers also are keeping a wary eye on its stock. For years, Gates and his finance executives have insisted that Microsoft shares are overvalued. "If there's ever been a company in the history of capitalism that downplays its [stock] valuation, it's got to be Microsoft," says

Gates. Microsoft has found itself caught up in what its chief financial officer, Greg Maffei, calls "the nutty, nutty, nutty Internet world" of absurd stock valuations.

The company's flagging growth pros-

pects have been well known to savvy investors for quite some time, yet Microsoft stock climbed 60 percent over the past 12 months while the stock market as a whole is back where it started a year ago. (The company did take a beating last week, however, plunging 10 points as the Nasdaq continued its nose dive.) Microsoft's price-toearnings ratio, meanwhile, is at a lofty 58, a measure young, booming, growth companies typically

Only one thing keeps this enthusiasm from bubbling into total lunacy: faith in Gates's ability to break established patterns, defy corporate middle age, and resume turbocharged growth. Can it be done? Perhaps. But in the short term at least, Microsoft will have to struggle to maintain even a 25 percent growth rate.

Overseas troubles. The most immediate problems are outside the company's control. Asian markets are in turmoil and a question mark hangs over the global economy. Microsoft, which draws nearly 60 percent of its revenues from overseas, is feeling the heat like most companies. The firm does 10 percent of total business in Japan, and its software sales there are

Americans who believe Microsoft plays fair in the marketplace: 49%

Who believe Microsoft is not playing fair and creating a monopoly: 33%

plummeting. The Asian crisis as a whole will cut 3 percentage points, perhaps more, off the company's 1999 growth rate, Microsoft says.

Meanwhile, industry analysts expect that many industrial customers will put off major software installations in the face of the year 2000 problem while they rush to repair their existing systems and try to keep computer-system chaos to a minimum as the millennium ends.

term shocks with far less pain were things going more smoothly with a project called NT 5.0. An industrial-

strength version of its Windows operating system, NT is pivotal to the company's future. Until recently, Microsoft was just a bit player in "enterprise" computing, the data networking in large corporations. Microsoft could absorb such short- Populated now by heavy-duty work-

Americans who believe the Justice Department's suit against Microsoft for alleged antitrust violations is a good idea: 32%

Who think it is a bad idea: 45%

stations, minicomputers, and mainframes provided by the likes of Sun Microsystems, Hewlett-Packard, Digi-

tal Equipment, and IBM, enterprise computing offers up rich profits and revenues in a huge and growing global

NT was first released in July 1993, but the latest version, 5.0, will enable Micro-

SEE YOU IN COURT

Finally, the trial is about to begin

he Microsoft antitrust trial, set to begin next week, has grown a bit complicated. What started out as a fairly straightforward complaint about the Internet browser market has mushroomed into a far wider set of allegations about illegal bully tactics employed by Microsoft against both friends and foes. On October 7, the U.S. Department of Justice asked the court to allow it to expand its proposed remedies against the company should it win the case.

Like Democrats trying to keep the impeachment inquiry from spreading beyond Monica, Microsoft protests that Justice is steering into irrelevant territory-but to no avail. Trial Judge Thomas Penfield Jackson is flashing a bright green light on the department's approach.

The original allegation (which is still the centerpiece of the trial) claims Microsoft has abused its Windows monopoly in an attempt to drive rival Netscape out of the Internet browser market. The most incendiary charge concerns a meeting in which Microsoft allegedly tried to pressure Netscape into carving up the browser market. Microsoft describes the meeting as a routine attempt to form a partnership.

In addition, Justice, together with attorneys general from 20 states who have

signed on to the lawsuit, says Microsoft strong-armed computer makers, Internet service providers, and others into offering only Microsoft's Internet Explorer to their customers while hiding the fact that Netscape was an option. Microsoft will argue that Netscape lost ground in the browser market partly

government interference in a company's product innovation—such as bundling a browser with Windowswould face a high hurdle on appeal. A Justice Department official at the time called the decision a "good hard punch in the face."

Subsequently, Justice widened its probe. A steady



WANT A PIECE OF US? Janet Reno and trustbuster Joel Klein

through its own strategic and management errors.

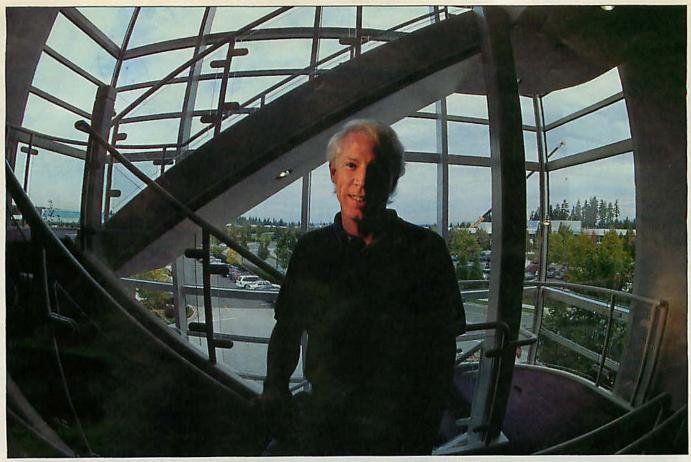
Higher hurdles. The remedy currently sought by Justice boils down to forcing Microsoft to offer Netscape's product along with its own browser on Windows, or to offer no browser at all. But a federal appeals court ruling in a related case last June indicated that any remedy involving

stream of accusations began appearing in court papers and leaked press accounts depicting Microsoft not as a tough negotiator but as a back-alley enforcer. For example, Justice alleges that when Microsoft found out that chip maker Intel Corp., its longtime ally, was developing operating software for multimedia systems, Microsoft in effect told Intel to stay off its turf-and Intel relented. Justice has offered evidence of similar episodes involving Apple and a video software company called Real Networks.

Microsoft responds that the evidence is taken out of context and involves no illegal activity. In a recent interview with U.S. News, Gates termed Justice's approach to Microsoft "absurd."

If Justice succeeds in proving a pattern of anticompetitive abuse, the remedy of including the Netscape browser or no browser at all clearly would be insufficient to the crime. But it's unclear what other remedy the department might ask for. The most extreme would be a carving up of Microsoft.

Both sides hope to wrap up the trial within a couple months. But a trip to the appeals court is a certainty, and a Supreme Court hearing is a good possibility. The case could also be knocked back down to the lower court a time or two. "It's the pingpong effect," says Tom Christo, an attorney specializing in technology. By the time the matter is settled, he predicts, "no one in the industry will care anymore, because we'll have moved on to a new set of technological imperatives." The Justice Department will certainly try to avoid a repeat of its action against IBM, which dragged on for nearly 13 years before the government finally dropped the case. -R.M.



WINDOWS BOSS. James Allchin, who runs the Windows group, outside his office on the Microsoft campus

soft to truly compete in the big-time enterprise market. Expected to be up and running by now, contributing to Microsoft's bottom line, the company says NT 5.0 won't be out until mid-1999 at the soonest. GartnerGroup research director Michael Gartenberg says the product is so late that the first reliable versions won't hit the market for another two years.

Slow going. What's taking so long? NT 5.0 is by far the most complicated project Microsoft has ever undertaken. The 1993 version of NT uses 5 million lines of computer code. NT 5.0 is at 35 million lines now-and climbing. As the company delays, Sun, IBM, Novell, and others have a chance to cement their relationships with customers and come up with better products to

challenge Microsoft, and upstarts like the Linux operating system, developed on the Internet, have a chance to take hold.

Another speed bump that could slow Microsoft is market saturation. More than 70 percent of the company's revenues come from Windows and from desktop applications software such as wordprocessing and spreadsheet programs. Those products continue to deliver tons of cash. But PC growth has slowed, and market penetration has nearly stalled.

Microsoft's newest database, server, Email, and business "collaboration" programs are taking off nicely. But its flagship applications program, Office, which accounts for 40 percent of Microsoft sales, has already penetrated 89 percent of its target market. For years the firm has been

raking in dollars by upgrading customers to newer, bigger, and fancier versions of its existing programs-derisively called "bloatware." But customers, especially in the big corporate market, are asking themselves just how many new functions they really need.

Microsoft's answer is that less will be more. "Simplicity is now a jihad at Microsoft," says spokes-

person Greg Shaw. "If we don't really focus on simplicity, we're not going to be able to succeed." By shifting its emphasis from adding features to reducing complexity, Microsoft is hoping customers will continually buy new versions of software that are easier to use. At the same time, the company wants to lure the huge population of computerphobic people who Microsoft believes will never become customers unless computers become a lot less complicated.

Although 92 percent of Windows users surveyed by U.S. News call it "very user friendly," even Microsoft execs beg to differ. Gates himself recalls his frustration at receiving a Windows error message on a home machine that read: "The DHCP client could not obtain an IP address. If you want to see DHCP messages in the future, choose Yes, otherwise, choose No." That "totally unhelpful" language popped up, Gates says, because "I have my network at home configured the wrong way. Of course that message didn't really help me know that in any direct sense."

To Gates, the gobbledygook he encountered is only the worst of countless examples found in Windows. "There are so many," he laments. But this one "is so clear cut that everybody has to say, 'Whoa!'" Gates highlighted his example in a 14page call to arms for the simplicity campaign he says he E-mailed to his executive staff and top technologists in September.

One glaring question: Why wasn't simplicity a top priority all along? James Allchin, who runs Microsoft's Windows group, says it's a "travesty" that it wasn't, although he notes that computers have continued to improve over the years. "Unfortunately, in my view," he says, "consumers didn't complain." Allchin agrees with Microsoft competitor Eric Schmidt,

Americans who have a favorable impression of the Windows operating system: 75%

Who have an unfavorable impression: 7%

chief executive at Novell, who says, "If people understood how much better computers are supposed to be, the dissatisfaction with the industry as a whole would be a lot worse. The people buying the products are nerds." So far, technology-savvy users have been enough to sustain the computer industry's rapid growth. Not anymore.

Help wanted. Ironically, creating simpler software requires higher levels of professional skill—programmers who not only write brilliant code but also understand, even empathize with, the inexperienced computer user. Finding such workers is a tall order. There's a worldwide shortage of computer software engineers of any kind. For Microsoft, it may be harder than ever to attract them. Why? One effect of Gates's astounding personal success is his role as a model for those with ambition and technical skill who want, at least in their daydreams, to

become the next Bill Gates.

You can't become a Bill Gates if you join a large company. It's the little start-ups that offer the ambitious the possibility of fortunemaking payoffs. When Microsoft was a young company, rich stock options caused a rush to the firm and created Seattle's Microsoft mil-

lionaires. But with growth slowing and the company getting older, the top talent know that they can get better equity deals elsewhere.

Size hampers recruiting in another way: A GartnerGroup report notes that many of the brightest young talents have a negative image of the company and that Microsoft is seen as "too big, too

■ Americans who think Gates, whose fortune is estimated at \$58 billion, has more money than any one person is entitled to have: 21%

Who think he is an innovative business-man who has worked hard and deserves his fortune: 71%

corporate, and too dominant." The company's Freddy Krueger reputation among competitors and the Justice Department's depiction of Microsoft as a slasher that forces its will on friend and foe alike hasn't helped matters. Microsoft must hire about 2,500 employees over the next year. Trying to counter any resistance,

Microsoft executives are telling prospective recruits that Microsoft is an exciting, challenging workplace, loaded with resources and talent, a place where their work will make a difference in the world, affecting the day-to-day lives of their friends and family. Still, Allchin allows, recruiting is "a big problem."

But it's hardly the only problem. To

BILL'S DOWNTIME

Chairman Gates, up close and personal

fter an animated discussion of Microsoft's future at the company's Redmond, Wash., headquarters, Bill Gates sat still for a few personal questions

Your company recently topped General Electric as No. 1 in market value, if only momentarily. How did it feel to surpass GE Chief Executive Officer Jack Welch?

I played golf with him recently, and I can tell you I didn't surpass him in any way.

What's the biggest lesson you've learned from your 2year-old daughter?

I'm very lucky. My daughter is a very happy, joyful person who, when you show her something new or teach her something new, her level of excitement and joy—maybe it's because she's my daughter—but it's such an amazing thing. It reminds me how fun life is. I love dealing with complex problems at work, but the joy of solving simple things and doing simple things, just that raw



STILL GOING. Gates shows no signs of slacking off.

happiness she has is so incredible.

You regularly take what you call a "think week" to explore something new. What's got your interest this time?

I've got one coming up in two weeks. It's all work related. This time I'm reading a little bit about optic fiber and the advances there, just to understand, wow, is this stuff going to keep improving as fast as it has been, is there any limit there, how does it all work?

What do you read for pleasure these days?

Outside of technology, I just got back from a two-week trip [a journey by train through the Western United States]. Warren Buffett has got me a little into bridge, so I've been reading a lot of bridge books, talking about those. And this guy [Steven] Pinker who wrote *The Language Instinct*. It's about language, learning. The software we create as humans is so insignificant compared with the software that defines the incredible human capabilities, so you always have to be incredibly in awe of it.

You've got the family, you've got the house, you've got a little money in the bank. So what are your personal ambitions now? My ambition really goes back to the founding goal of the company, which is a computer on every desk and in every home. And we can actually glimpse the idea that if we get a natural interface, if we get simplicity, the acceptance of the Internet and all its elements, that vision is going to be achieved. It's like, whoa, there's the promised land!

And then what?

And then what? [a laugh, followed by a long pause] In terms of really making the PC an incredible tool, I will be able to work the rest of my life on that problem.

continue to grow, Microsoft must conquer new, often unfamiliar, markets-like supersmall computers. This category covers a wide array of tiny machines that range from smart cell phones to personal organizers to new-generation set-top TV boxes to networked chips "embedded" in everything from automobiles to vending machines and refrigerators.

Microsoft doesn't own the field yet-far from it. The huge success of 3Com's PalmPilot personal organizer is a good example of a product that takes advantage of the giant's vulnerabilities. The Pilot's tailormade, simple operating system has won over 2 million customers who want the device to do only a few things well.

Most customers and product reviewers have deemed competing products running Microsoft Windows CE, a strippeddown version of Windows for desktop computers, to be a clunkier alternative. The trick to CE's success is programming it tightly enough to fit into the new world of tiny machines while keeping it simple to navigate-neither of which plays to Microsoft's historic strengths.

Nice try. Microsoft faces a different set of challenges as it storms the Internet. Although the company has plenty of money and still is trying hard, most of its Internet efforts thus far have failed. Its biggest bomb was the Microsoft Network, much feared when it was launched in 1995 as a private network to go up against America Online.

Microsoft is refashioning MSN as an Internet portal-a trendy word describing a computer user's home base on the Web. Now dubbed MSN.com, its latest version went up on the Web last week. With its money and its brand name, MSN.com is likely to be a strong contender. Still, Yahoo! has emerged as the undisputed portal champ, and dozens of other competitors, including Netscape and Excite, ensure that MSN will never become the dreaded toll booth on the Internet.

More legitimate, perhaps, is the prospect that Microsoft could establish itself as the national gateway to digital TV. Its



WAY COOL. Located on the Microsoft campus, the Microsoft Home showcases the future of home technology.

WebTV technology is emerging as the leading provider of Web access and Email (including photo E-mail) to the living-room television, in addition to making VCRs and cable programming guides easier to use. With sales of only 450,000 units, some market watchers wonder whether there is a mass market for anything like WebTV.

But the cable and satellite industries must think so-they're equipping their next-generation set-top boxes for interac-

> Americans who would like their child to grow up to be like Gates: 48%

Who would not like their child to grow up to be like Gates: 34%

Asked to choose from a list which Americans would be the best role model for children:

38% said Colin Powell

21% said Oprah Winfrey

12% said Michael Jordan

10% said Tom Hanks

8% said Bill Gates

6% said Madeleine Albright

tive programming. It's worth noting that the first 5 million of cable giant Tele-Communications Inc.'s newest set-tops will come programmed with Microsoft's Windows CE junior-size operating system, the same operating system going into WebTV. Still, each of the local cable providers will ultimately determine which company serves as the customer's interactive TV gateway, and there's no guarantee it will be Microsoft. In fact, at the industry's last convention, there was a lot of muttering by cable executives about making sure they don't fall under Microsoft's sway.

No question, Microsoft is an awesomely powerful company. And if the Justice Department can prove that it has clearly and intentionally violated the law, perhaps a well-thought-out remedy is called for. But a list of all the challenges the company faces should make clear that when Microsoft execs say they're running scared, they're not kidding.

When told that some people think Microsoft is exaggerating its fears for publicrelations effect, Windows manager Allchin cups his head in his hands. "Oh my God," he sputters, and is quiet for a few moments. "That's so strange. We're justwe're paranoid! I think about it in the shower. I think about it in my car. I'm worried about us being displaced. I'm worried about us not catching the next wave. Oh my God."