

[Transcript] Behind the Money / How Microsoft bagged Activision Blizzard

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In the video game Call of Duty,
you're dropped into the shoes of elite military forces,
advancing through combat zones.
The game puts you on a mission to attain glory
over a wide variety of enemies.
It's one of the world's best-selling video game franchises.
And as of earlier this month, it's owned by Microsoft,
a company that had to wage its own battle
to take control of the game's publisher, Activision Blizzard.
This, by anybody's standards, was an absolutely huge deal.
Given the scale in the games industry, it's caused huge waves,
and it could completely change the face of the gaming industry.
That's the FT's West Coast editor, Richard Waters.
He says this \$75 billion deal
gives Microsoft control of the company that publishes
not only Call of Duty, but also other popular video games,
like Candy Crush,
World of Warcraft,
and my personal favorite, Spyro the Dragon.
And the successful takeover of Activision
isn't just a big moment for the video gaming industry.
It's also a big moment for Microsoft,
and Big Tech's historically acrimonious relationship with regulators.
If he went back a couple of years and somebody told you
that a Big Tech company was going to pull off a \$75 billion acquisition,
you probably wouldn't have believed it,
because regulators around the world have their lives out for Big Tech.
They're very concerned about these companies expanding their power.
Now, Microsoft's takeover of Activision
didn't come easily, quickly, or cheaply.
It was nearly two years in the making.
But recently, the regulatory tides have turned in Microsoft's favor.
What we've seen in the last few months, I think,
is some very clever legal and policy maneuvering by Microsoft
to get into a position where it could close the transaction.

[Transcript] Behind the Money / How Microsoft bagged Activision Blizzard

This deal is now done, and they can go ahead and integrate the companies.
So it's a huge step forward.

So how did Microsoft pull it off?

Music

I'm Michaela Tindera from The Financial Times.

Today on Behind the Money, we're looking at how Microsoft reinvented its image in the eyes of regulators and managed to acquire Activision Blizzard.

Music

Hi, Richard. Welcome to the show.

Well, hi. Nice to talk to you.

So in recent years, we've seen governments and regulators have more and more concerns around Big Tech companies and their power.

Just the other week, behind the money covered, the U.S. Federal Trade Commission's battle with Amazon.

And Meta's been caught up in a lot of allegations around misinformation.

You know, the list goes on here.

But I feel like I don't really hear that much about Microsoft.

I mean, I know, of course, that they're a huge tech firm, but where do they fit into this conversation around regulation?

I think Microsoft has benefited from the fact that its business practices are not so visible, certainly not so visible to politicians.

It's involved in business markets, and where it is involved in consumer markets, it doesn't have the power that it once had.

It's gone a long way to smoothing the edges on some of those practices that were controversial.

So because of all of that, you know, it's managed to cast itself, and it's actually gone out of its way deliberately to cast itself as the tech company that is listening, a tech company that will do for regulators what other tech companies won't.

Hmm, interesting.

So because of the types of markets that Microsoft operates in, less consumer-facing than, say, Meta or Facebook, Microsoft's been able to fly more under the radar.

But you said that it hasn't always been like this.

What do you mean?

It's hard now to imagine the power that Microsoft exerted over the tech world in the 1990s.

Remember back then, the PC was the only means for accessing technology for most people, and there were no smartphones.

There were no app stores.

There was just the PC and Microsoft's monopoly of software on the PC.

And the way they used that in the tech industry made them a lot of enemies.

[Transcript] Behind the Money / How Microsoft bagged Activision Blizzard

Right, of course.

And a few decades ago, they were sort of the big baddies in the tech world.

I think some people might remember back to 1998 when the U.S. Department of Justice sued Microsoft, accusing it of abusing its Windows software monopoly, and they tried to break the company up.

How'd Microsoft handle that back then?

What was their strategy?

Faced with these government challenges, Microsoft dug its heels in, and it decided to adopt a very aggressive legal strategy.

And the real low point, I think, of this strategy was when Bill Gates testified, he was deposed and testified about Microsoft's business practices, and throughout his testimony said he didn't recall various things.

Did you send this email?

It appears I did.

Did you discuss this email with anyone?

I don't remember that.

Remember, this was a man who was very hands-on, made all the big policy and business decisions inside Microsoft, and the judge in that case made no bones about the fact that he essentially didn't believe what Gates said.

He really made the judge angry, and I think helped the judge form his own view, which was that Microsoft should be broken up.

Yeah, and so what was the outcome of that case with the Department of Justice?

So the judge in the federal case ordered a breakup with the company.

Microsoft appealed, the case went back to court,

but in the meantime, the political environment changed,

and I think we have to remember that all antitrust is essentially political at the end of the day.

Does the government of the day want to break up one of the greatest companies in the US?

Well, the new Bush administration came to power and decided to broker a deal with Microsoft.

So before this case was re-heard and came to an ultimate legal conclusion,

a deal was struck, and Microsoft agreed to a number of restrictions on its business that lasted for many years, and so it survived,

but it was a huge setback, and it left the company facing some close regulation for years to come.

Microsoft learned its lesson coming out of these battles with the US government, and that led to a big change.

In 2002, Microsoft top brass Bill Gates and Steve Ballmer

replaced their existing general counsel with a new person who had new ideas about how to deal with regulators.

This was an internal lawyer by the name of Brad Smith, who had nearly a decade of experience inside Microsoft, and Smith raised the top with a completely different strategy, and it was one that top management embraced.

Smith said, look, what we've learned is that Microsoft will never escape regulation again.

It will never escape the close attention of regulators,

[Transcript] Behind the Money / How Microsoft bagged Activision Blizzard

but more importantly, the entire tech industry is now going to be under scrutiny because it is so much more powerful and going to become so much more central to business and society.

We just have to accept that the world has changed, that we can't fight this.

We have to instead try to shape it, try to communicate with regulators, listen to regulators, push regulators in directions they're going to benefit us,

and it was a major change in direction, and I think it shaped a lot of what Microsoft has become.

So tell me more about Brad Smith's strategy that he has implemented over the last 20-plus years. What has he really been doing and how has he changed the company?

Smith's first real challenge was to just end the previous wave of antitrust cases against Microsoft. Then he became renowned for closing deals,

but in a very considered way that didn't leave the other side feeling they'd been burned.

And I think, you know, Smith learned very early on that it was all about personal contact.

Smith will show up in person to talk, and that is something that Microsoft didn't always do before.

And I think that was the start of something that, you know, Microsoft and he learned that if you can be seen

as being willing to resolve a situation that you want to find a solution that is going to meet the other party's concerns

without sacrificing too much of your own, then you can make a lot more headway.

And that's been Smith's strategy. Now, around that he's done a few other things that I think are very notable.

Yeah, what are some other examples of things he's done?

Just one sign of the level that Smith operates at is the office that Microsoft has set up at the UN in New York.

It's taken a floor in a building close to the UN where some other member states have their missions.

And it's realized that this is the best place to communicate with an exerted influence over many different governments.

And, you know, just as one sign of the strategic importance of that to Microsoft, this office has set up in 2020.

The first head of state to visit was President Zelensky of Ukraine.

Zelensky was there because obviously he wanted to encourage Microsoft to invest in Ukraine.

Microsoft wanted to talk to him because they wanted to promote their cybersecurity expertise.

And so to be able to operate at that level inside the UN and to try to influence important policy debates that are going to affect both Microsoft and its customers,

you know, I think gave it a real foothold at a level that other tech companies then operate.

So it sounds like that Brad Smith has really changed the game for Microsoft in terms of the way it handles relationships with regulators and governments.

Do you have any sense for how much all this is costing Microsoft?

Brad Smith's operation doesn't come cheap. He runs all of Microsoft's legal operations, its government affairs, its corporate affairs.

It includes more than 2,000 people. And amongst the people who report to him, there's a substantial cybersecurity team.

And Microsoft is out there reporting to governments on cyber attacks.

So all of that resource is costing Microsoft more than a billion dollars a year.

[Transcript] Behind the Money / How Microsoft bagged Activision Blizzard

And we have sources that have given us those numbers and Microsoft doesn't contest them. I've talked to other big tech companies. They don't want to talk about their own budgets, but they're all amazed at the amount that Microsoft is spending.

So Microsoft finally got this deal with Activision over the line earlier this month.

What was the role that Smith played in getting this deal passed regulators?

To get the Activision deal over the line, Brad Smith really pulled off a couple of very impressive maneuvers, legal maneuvers, regulatory maneuvers, at moments when it looked like Microsoft might be in real trouble.

One was in the US when the Federal Trade Commission said it was going to challenge the deal in its own internal court.

And for any company, that really is a dangerous moment because if the FTC's own commissioners rule that what you're doing is wrong,

it can take years to unscramble that and a deal can die.

Microsoft actually succeeded in bouncing the FTC into federal court.

They managed to get the FTC to challenge their deal in open court and Microsoft won.

So that was a big moment that happened this summer and it was a clever legal strategy that left it on top.

In the UK, if it's a different challenge, the regulator, the competition and markets authority had actually decided to oppose this deal.

But the CMA had a problem.

It was politically exposed because it was the only regulator in the world that was going to block this deal.

And so just because of the position in the UK, an entire global transaction was going to die.

It came under intense pressure from Microsoft, from Activision, and it said it was going to stick to its guns.

I think the clever thing from Brad Smith's point of view was to come to the British regulators with an olive branch.

He managed to find an extra concession at the last minute that allowed the regulators to clear the deal while still claiming victory.

And what was that olive branch?

Microsoft very cleverly separated out its licensing rights and sold them off to another company.

And what that means is that in future, Microsoft will not be able to make games exclusive when it comes to streaming.

It guarantees that other companies will be able to stream the same games.

OK, so what that essentially means is that if one day in the future I want to stream Call of Duty or my favorite Spyro game over the internet,

I won't have to pay to be on a Microsoft service. I'll be able to use other cloud gaming companies.

Yeah. And so that separation, that structural move was something that doesn't change the economics.

Microsoft still owns those games and it still benefits from the licensing.

But it was enough to assure the regulators that it wouldn't be able to dominate cloud gaming.

Yeah. So now that this deal with Microsoft and Activision has closed, I mean, surely this won't be Microsoft's last battle with regulators.

So what's next in this realm?

[Transcript] Behind the Money / How Microsoft bagged Activision Blizzard

In many ways, the very success of the Activision deal has made Microsoft a target again for regulators.

For many years, it was flying under the radar. It wasn't in the firing line, for instance, when U.S. legislators held a series of hearings into big tech and called the CEOs of all of these companies to testify in Washington. Microsoft wasn't even there. But now everybody can see that Microsoft has become even more powerful.

Back in 2000, when it was under attack before, annual revenue was \$23 billion.

This year, its revenue is expected to be \$235 billion. It's 10 times the size.

Its impact in the economy is so much greater. And I think people are starting to wake up to that.

And we're going to see much closer scrutiny now.

Its business practice is particularly around cloud computing.

Yeah. So what is happening in cloud computing that there could be a future regulatory squabble or investigation?

Regulators around the world are only just getting to grips with cloud computing.

And remember, this is an industry that's essentially taking over a lot of the role that IT has played for the world.

It accounts for around 20% of all IT spending at the moment, but it's going to grow tremendously in the coming years.

And it's entirely dominated by Amazon, Microsoft and Google.

So regulators are trying to work out what kind of practices this oligopoly of companies has that might prevent competition,

that might limit the ability of customers to switch between them or bargain for better pricing.

And we've seen the UK start an investigation into this very recently.

We know that Brussels is looking into it. The Federal Trade Commission in the US has started a review.

These are early days, but we know that all of this is going to become under very close scrutiny.

Yeah. So there's no doubt that other big tech firms have been watching what Microsoft's been doing with regulators around the world with intense interest here.

What do you think they might take away from that? And how do you think it might change how these other companies operate going forward?

I think we've seen all the big tech companies learn from Microsoft.

And I think in two ways. One is that they all saw the antitrust fights that Microsoft got into 20 years ago,

and they realized that they had to develop a different playbook. They couldn't go down that path themselves.

And I think even now as Google is being dragged into court by the US government,

in a case that looks very much like the case that Microsoft faced 20 years ago,

Google has learned from Microsoft's lessons. It hasn't presented the government with the evidence that Microsoft did.

Its executives have been far more careful about their communications.

It hasn't thrown its weight around in the way that Microsoft did.

So I think that's one area where the rest of the tech industry learned from Microsoft.

I think the second is that they have developed their own geopolitical strategies.

And again, I think it's Google that has been the most obvious in this regard.

[Transcript] Behind the Money / How Microsoft bagged Activision Blizzard

Google, when it came under pressure, for instance, from the news industry several years ago for allegedly taking content for helping to undermine the economics of the news business, Google has mounted a huge campaign around the world, working with news companies, subsidizing efforts to help companies digitize, in some cases providing finance to those companies to help them. So Google learned that lesson. Google is the most similar to Microsoft in many ways. But it hasn't been able to avoid just direct antitrust challenges it now faces. Well, Richard, thank you so much for coming on the show. Absolutely. It's been great to talk to you. Behind the Money is hosted by me, Mikayla Tindera. Sophia Ethmed is our producer. Manuela Saragosa and Topher Forhaz are our executive producers. Sound Design and Mixing by Sam Giavinko. Cheryl Brumley is the global head of audio. Thanks for listening. See you next week. Support for this podcast and the following message comes from Corriant. Corriant provides wealth management services centered around you as one of the largest integrated fee only registered investment advisors in the U.S. Corriant has experienced teams who can craft custom solutions designed to help you reach your financial goals, no matter how complex. Real wealth requires real solutions. Connect to a wealth advisor today at Corriant.com. The latest episode of the Next 5 podcast is all about the oceans. I speak to environmental advocate Celine Cousteau. There's about 8 million tons of plastic waste that ends up in our oceans. Carine Biasson at the EIB. The ocean economy was projected to increase to \$3 trillion in 2013. And Miguel Stillwell Dandrade, CEO of EDP. Global installed offshore wind capacity should reach around 600 gigawatts by 2050. Listen to the full episode where review get your podcasts. Enjoy.