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# Microsoft and Google Set to Wage Arms Race

By [STEVE LOHR](#) and [SAUL HANSELL](#)  
Published: May 2, 2006

[Bill Gates](#), the chairman of [Microsoft](#), described [Google](#) in an interview late last year as a worthy adversary, a company to test Microsoft's mettle. "This is hypercompetition, make no mistake," Mr. Gates observed.

The rivalry between the companies is growing more combative, and with good reason: the outcome is likely to shape the future of competition in computing and the way people use information technology.

A measure of how seriously Microsoft takes the challenge came last Thursday when it announced that its spending would rise sharply next year, about \$2 billion higher than previous estimates. Much of the extra money, analysts say, is going to meet the threat from companies offering advertising-supported Internet services and software, led by Google.

"Microsoft doesn't have to kill Google, but it has to narrow the gap," said Richard Sherlund, an analyst at [Goldman Sachs](#) & Company. "It has to be in the same ZIP code."

To succeed, Microsoft has to make strong inroads into Internet services and software, where Google is a leader. "It's clear that if we fail to do so, our business as we know it is at risk," Ray Ozzie, a chief technical officer, warned in an e-mail memo to Microsoft employees last year.

Microsoft enters that battle from a stronghold: its lucrative, powerful business in personal computer software. Google has asserted that Microsoft's next Web browser typically steers users to Microsoft's search service, limiting consumer choice and potentially hurting Google, the leading Internet search engine.

Microsoft says Google's objections are mistaken, and that its new browser, Internet Explorer 7, increases a user's search options.

But Google has advantages of its own, and the Internet services business is very different from the desktop software industry.


The Internet model is one that offers search, e-mail, calendar, contacts and even word processing as services accessible remotely with a PC or hand-held device with a Web browser. Typically, Google invents a new service or feature, makes it a free Web-based service, and only later figures out how to make money on it from advertising of some kind.

That ad-supported software, distributed as a Web service, is a threat to Microsoft's model of selling licensed desktop software, at least in the consumer market. Corporations have so far shown less interest in ad-supported software as an Internet service.

To smaller software companies, Google's strategy appears to have the same competitive

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impact as Microsoft's tried-and-true practice of bundling more software programs and features into its Windows operating system.

Danny Sullivan, editor of Search Engine Watch, a Web newsletter, said that in some niches of the software business, Google is casting the same sort of shadow over Silicon Valley that Microsoft once did.

"You've got people who don't even feel they can launch a product for fear that Google will get in," Mr. Sullivan said.

Google, he said, has acquired companies and then made their products free, roiling the markets in which they compete. Google has introduced free versions of the graphics software made by SketchUp and of the Internet analytics service from Urchin, two companies that it bought.

And Google won a bid to offer wireless Internet service in San Francisco at no charge, hoping to make money by selling local advertising. If this model proves to be successful, it could cut into the business of other Internet providers and wireless phone companies.

Now Google is starting to move directly into Microsoft's core market. It recently acquired Writely, a Web-based word processor.

How far Google can eat into Microsoft's software franchise is uncertain. But Microsoft fears that Google could become a kind of operating system of the Internet in the same way that Windows is the dominant operating system of personal computing.

For its part, Google wants to avoid becoming the "next Netscape," a reference to the early leader in the browser market that Microsoft eventually thwarted.

"A lot of the people who are at the center of Google had done hand-to-hand combat with Microsoft in the 90's, and I don't think they have forgotten," observed John Battelle, the editor of SearchBlog, a Web log on search technology.

The group includes Eric E. Schmidt, Google's chief executive and former executive of [Sun Microsystems](#); Omid Kordestani, its senior vice president for sales and a former Netscape executive; and John Doerr, a Google director and venture capitalist who was a prime backer of Netscape, Sun Microsystems and other Microsoft rivals.

"They are very worried," Mr. Battelle said, "about Microsoft leveraging their I.E. monopoly," referring to Microsoft's commanding share of the browser market, which Microsoft includes in Windows.

The fears of both companies may well be exaggerated. For Microsoft, the PC promises to remain a powerful business and technology franchise for years to come. And Google should benefit from the fact that Microsoft, after a federal antitrust judgment against it and a settlement with the government, is more restrained in its tactics and behavior than it once was.

A major expense of their escalating battle lies in the very nature of the Internet services realm: the digital engine rooms and power plants that must be built to support it. Google does not disclose technical details, but estimates of the number of computer servers in its data centers range up to a million.

Last month, when reporting its quarterly earnings, Google reported a doubling in its rate of capital investment, mainly in computer servers, network equipment and space for data centers, and said it would spend at least \$1.5 billion over the next year.

As Google grows, so does its need to store and handle more Web site information, video and e-mail content on its servers. "Those machines are full," Mr. Schmidt, the chief executive, said in an interview last month. "We have a huge machine crisis."

To catch up, Microsoft is also stepping up capital spending as it invests aggressively to build data centers worldwide. "It is becoming more capital intensive," said Mr. Sherlund of Goldman Sachs. "But the company has a bulging cash position and no debt. That's not

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a constraint for Microsoft."

However deep their pockets and established their names, the two companies will mainly compete on one point. "In the long run," Mr. Battelle said, "it's about whether you have the best service."

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