How to Sink the Tech Comeback

By LAWRENCE B. LINDSEY

Now that the Nasdaq has closed consistently back above 2000 it appears that much of the healing process from the collapse of the 1990s technology bubble is finally behind us. Sound macroeconomic policy prevented the resulting wealth destruction from producing a downward economic spiral like that of the '30s.

Going forward we must adhere to sound microeconomic policy as well if America is to retain its global leadership in technology. After the initial speculative frenzy and its collapse, the successful financing of new industries over the longer term requires a more stable environment. Clearly, competitive pressures are intense both within the existing market and from even newer technologies. But an equally important risk comes from public policy that is subject to a variety of political pressures to control the emerging market environment.

As a result, bad public-policy choices, especially in antitrust, can easily destabilize the new financial arrangements in the market. Today, there are four key factors that policy makers must take into consideration if we wish to preserve the newly found stability of our capital markets.

• First, public policy should respect the underlying franchise value of the recently created firms and industries. Although the Nasdaq bubble would have burst in any event, the actual timing of its collapse coincided with two public policy events that cast doubt on these franchise values. First, the antitrust division of the Justice Department announced its Microsoft suit and suggested remedies that many felt threatened its business model. Although some of Microsoft's competitors would supposedly have benefited from the suit, they soon found that their stock values plummeted as well as the viability of the industry was questioned.

Several weeks later, President Clinton joined Prime Minister Blair in declaring the human genome to be the common heritage of mankind. The biotech sector soon saw its equity values collapse too. If the human genome belongs to all of mankind, what is the value of patents on products developed from human-genome research?

Today, regulators must show more forbearance regarding policies that would harm the market value of the technology industry. As the economy continues to strengthen, more mergers will take place as the natural process of creative destruction continues. We have seen consolidation occur in a number of technology fields, including computer hardware and media players, and there is more consolidation planned in fields like business application software. The prospect of buyouts, in fact, is part of the market value of all technology firms. But if this route for business development is closed, the market value of technology firms will drop.

Of course, regulators must vigorously enforce laws that prohibit anticompetitive conduct. But whether emerging market structures will allow anticompetitive conduct in the future based on established rules of market concentration is a purely hypothetical exercise. It is far more important to focus on the reality of performance than the theoretical possibilities of what might happen based on structure.

• Second, market pricing is underpinned by the development of effective shareholder control. The regulatory environment should defer to shareholder decisions as much as possible regarding corporate control. The shareholders of an industry that has just seen its market value decimated are primarily focused on preserving what value is left and finding a way to rebuild. Both sustained economic growth and the long-term competitiveness of our high-tech industries requires that these shareholders succeed.

In the beginning, high-tech companies are owned chiefly by founders and a few key sponsors. As the market value rises, the shares are distributed more widely to a public that buys the shares because they like the concept the firm presents or the momentum of its stock price. These shareholders often back the founders in establishing poison pills that limit the possibility of a buyout because they believe they are betting on a winner and don't want to be part of some other organization.

After the market collapses and these shareholders liquidate, professional financial managers take over seeking value in stocks that have been knocked down too far. These value-oriented investors have no particular attachment to the original business model or its founders and are simply seeking to make a profit by acquiring undervalued assets and restructuring them in a way that will allow their resale to higher bidders. This process is key to rationalizing an industry and making it viable in the long term. Public-policy actions that inhibit this process -- by blocking mergers and takeovers on allegedly competitive grounds or by overly protecting the poison pill arrangements of the initial founders -- can do substantial damage to the long-term viability of the high-tech marketplace.

• Third, public-policy must recognize that the competitive threats to the high-tech industry are numerous and by themselves sharply limit the scope for anticompetitive conduct. This is particularly true in our highly globalized market. A famous historical example from the late 1960s and early '70s was the antitrust position that General Motors could not exceed a 60% market share of U.S. auto production. This position was quickly made ridiculous by the invasion of Japanese cars. Similarly, the once dominant positions of IBM and Xerox quickly eroded. The reality is that the extreme amount of competition in the global market is the best check to anticompetitive business practices.

• Finally, mergers can also be a way to increase competition. If two medium-size firms merge, they may end up better positioned to challenge the largest firm in the market. Leveraging new economies of scale is a way for smaller firms to reclaim market share lost to the largest firms.

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It is somewhat ironic that, after all the high-tech equity market has been through, one of the greater threats to its overall valuation is not technological or even competitive, it is public policy. The months ahead will determine whether the recent rise in the Nasdaq reflects a new level of maturity for these emerging industries, or whether it will disappear because public-policy makers are unwilling to allow time for these industries to fully recover from the excesses of the '90s.

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