tech talent, that creates headaches elsewhere. Some startups, for instance, say the talent drain has made their own hiring more difficult. Joe Kraus, a co-founder of early portal Excite Inc. and now the CEO of collaborative software startup JotSpot Inc., says Google has been especially tough to go up against. "If you're talking to someone great, they're invariably talking to Google, and they often have an offer."

It can be equally difficult for technology mainstays, including Microsoft. Not only has the software giant lost several top minds to Google in recent years, the Redmond (Wash.) company is also facing tougher competition for talent coming out of universities, even in its own backyard. Oren Etzioni, a professor of computer science at the University of Washington in Seattle, says Google has hired most of the top one-third of his search class in each of the past two years.

Microsoft is hardly standing still. With both boundless cash and massive industry influence, the software giant can pay what it needs to hire the leading lights of industry. But clearly, it's feeling stung. It has filed suit against Google and recently departed Kai-Fu Lee for allegedly breaching a noncompete clause in Lee's contract with Microsoft. Google has filed a countersuit against Microsoft. Neither company would comment on the legal battle.

Talent is following the sexier problems posed by the Net

Clearly, Microsoft's motives reach far beyond Lee. Although it is not the only company feeling the hiring pinch of its search competitors, it desperately needs to hire and retain top talent if it wants to gain ground on Google and Yahoo. The company's recently released search technology has been met with praise. But with only about 15% of the U.S. search market, Microsoft badly trails its rivals. It needs to come up with innovations to set itself apart from the pack. By going after Google and Lee, it may help deter other talented techies with similar ideas.

Such moves appear to be stopgap measures at best. With torrid growth and booming profits, Google and Yahoo clearly have the cachet to keep their hiring momentum going. Frustrated rivals shouldn't expect that sucking sound to abate anytime soon.

–With Robert D. Hof, in San Mateo, Calif., and Jay Greene in Seattle

ILLUSTRATION BY DAVID RUDES/BW; PHOTOGRAPH OF BILL GATES BY RANDALL SCOTT/AURORA; CHART BY ALBERTO MENA/BW

DIVIDEND PAYOUTS

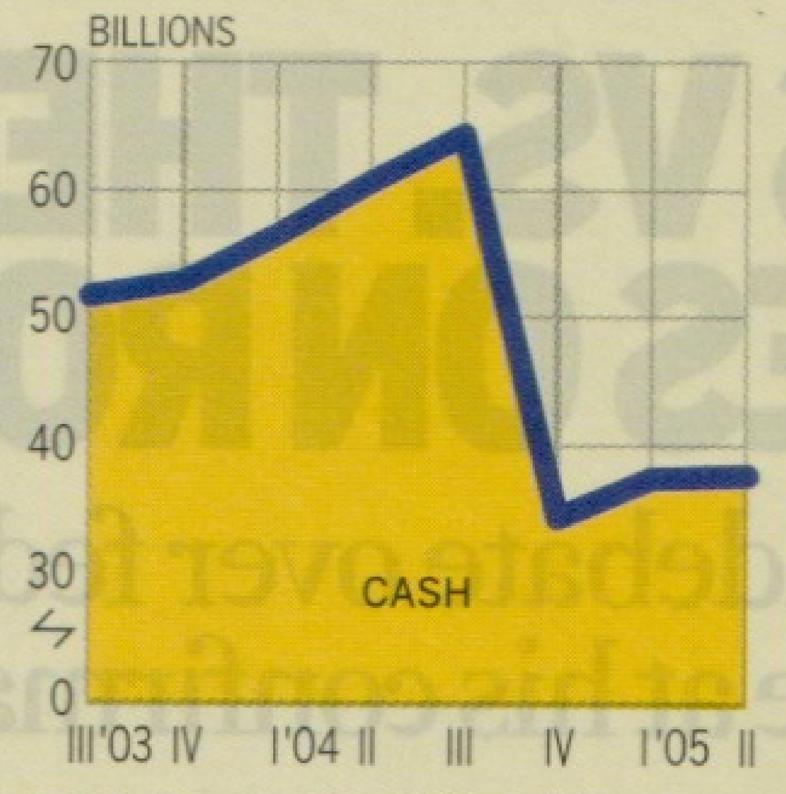
Please, Sir, I Want More

Microsoft Corp. Chairman William H. Gates III marveled a year ago when strangers came up to him at the movies to say thank you. At first, the world's most recognizable businessman wasn't quite sure what he had done to merit the gratitude. But it soon became clear. Microsoft had announced plans to dole out $33 billion to shareholders, the largest one-time cash dividend in history. And investors—who also got more than $3 billion in regular dividends and $8 billion in stock buybacks in the past fiscal year—couldn't have been happier.

Turns out it wasn't enough. Shareholders are beginning to press for more dough. After the special dividend in December, Microsoft's cash holdings fell from $64.4 billion to $34.5 billion. But with its twin monopolies—the Windows operating system and the Office productivity software—generating roughly $1 billion a month in excess cash, the money is piling up once again. Even after spending $756 million in the past quarter on private antitrust claims, Microsoft's cash hoard had bounced back to $37.8 billion by June 30. "People expect another dividend increase pretty soon now," says Mark Demos, an analyst for Fifth Third Asset Management.

This isn't simply a case of greed. Investors have long pressed for a piece of Microsoft's stash, arguing that they could earn better returns investing the money themselves. Now shareholders are growing impatient with Microsoft's stock as well. It closed at $25.72 on July 27—roughly where it was three years ago. With Microsoft's lackluster growth tempering its price appreciation, investors are demanding returns from elsewhere. "Shareholders are getting frustrated with the stock trading sideways," says Mark A. Lebovitz, portfolio manager for the Munder Internet Fund.

MICROSOFT'S MONEY MACHINE



Data: Bloomberg Financial Markets

So will Gates open up the corporate wallet once again? It took immense pressure for Microsoft to issue its first dividend in January, 2003—an annual 8¢-a-share payout. An iconic growth stock through the 1990s, the software maker hesitated to stoop to a strategy that suggested otherwise. What's more, it needed to keep enough cash on hand to cover potential liabilities from its epic antitrust battles. But with those days seemingly gone, Microsoft has increased that dividend to 8¢ a share each quarter, putting its yield at 1.2%. While in line with tech peers such as Intel Corp. and Hewlett-Packard Co., the payout is still well below the 1.8% average yield for companies in the Standard & Poor's 500-stock index. "At this point, it makes sense to go right to that level," says Goldman, Sachs & Co. analyst Rick Sherlund. He argues this would bring Microsoft a new breed of shareholders—value investors who've been cool to the smallish current dividend.

Yet even if Microsoft raised its quarterly dividend to 12 cents a share, roughly in line with the S&P yield, it would spend about $1.3 billion a quarter on dividends. That only begins to curb the flow of cash flooding its coffers. Last year the company committed to buy back $30 billion worth of stock over four years, including the $8 billion it repurchased in the fiscal year that ended last June.

Sherlund believes the company should continue buying back $7 to $8 million in stock per year even after that plan expires, to keep the money from piling up. If Microsoft plans to shell out more to shareholders, it's not letting on: Executives declined to discuss their plans. But with Wall Street starting to push for the company to reopen the vault, Gates could once again find himself on the receiving end of many a thank-you.

–By Jay Greene in Seattle