Google Strategic Audit

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GOOGLE STRATEGIC AUDIT

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Abstract

This thesis fulfills the requirement for the strategic audit in MNGT 475H/RAIK 476. It discusses Google's competitors and the rest of the technology industry along with how Google fits into it all. It's a red ocean industry, so Google must continually innovate to maintain its competitive advantage. In addition to a summary of the current strategy and how Google competes, the thesis explores alternative strategies for Google to pursue given their strengths and weaknesses and the opportunities and threats in the industry. It includes a timeline, potential budget, and contingency plan for the best strategy.

Keywords: strategy, compete, brand, strength, weakness, opportunity, threat
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Background and Issues

Company Background

Over the past twenty-one years, Google has grown from a dorm room project to a household name in technology. Google’s main products include Android, Search, Maps, Ads, YouTube, Cloud, and Drive. With such a wide range of products, Google has a stake in all of the corresponding markets: search, advertising, productivity suites, mobile, and office suites. It has over 88,000 employees in over 70 offices worldwide and is continually innovating (“Number of Google Employees 2017”).

Company History

In 1995, Larry Page and Sergey Brin met at Stanford University. A year after meeting, they built the search engine, Backrub, from their dorm rooms. They soon renamed it to Google to reflect their mission “to organize the world’s information and make it universally accessible and useful.” In 1998, Andy Bechtolsheim invested $100,000 in the birth of Google Inc. and with this first loan, Google was able to rent its first office: a garage in Menlo Park. It has an unconventional history with the first server made of Legos and the first Google “Doodle” notifying users that the entire staff was at Burning Man. The company eventually grew enough to open its current headquarters in Mountain View, California (“How We Started and Where We Are Today”).

Current Situation

As Google has grown, it has entered a wide variety of markets. The brand was beginning to get diluted, so in 2015 Larry and Sergey created Alphabet. Alphabet is the parent company of Google, X, Nest, Google Ventures, Fiber, and more. Larry Page is the CEO and Sergey Brin is
the president, while Sundar Pichai is now the Google CEO. Alphabet was created in order to slim down Google and separate the companies that aren’t as directly related to Google’s mission, allowing for more scalable management (Tweedie). Alphabet continues to grow and had a 2017 revenue of $110.9 billion with a 23% year on year growth (Alphabet).

Though Google is much larger today than in its founding, it still holds the same mission. The company vision is to provide access to the world's information in one click and its strategy is diversification into a wide variety of products and markets while making a societal impact. Growth never comes without issues though. Since Google hasn’t updated its mission statement throughout the years, the current strategy does not align with the mission. According to Larry Page, making a societal impact is Google’s primary goal. This doesn’t line up with the mission of organizing the world’s information, and this could cause issues in the future.

**Situation Analysis**

*Business Model*

According to Alphabet’s annual report, its customer value is created by “helping people get online by tailoring digital experiences to the needs of emerging markets.” This includes ensuring that the core Google products are accessible in areas that have speed and connectivity concerns (Alphabet). The value is created in the free services that address the customer’s every need with sleek and easy to use interfaces.

Since most of Google’s products are offered for free, its primary revenue stream comes from Advertising. AdWords, AdSense, and Search Advertising made up 86% of its 2017 revenue (Alphabet). Additional revenue came from apps (in-app purchases and digital content in the Google Play Store), cloud offerings, and hardware.
**External Analysis**

Google is in a strategic group of technology powerhouses. This means that Google’s competitors are Amazon, Apple, Microsoft, and Facebook. Amazon competes with shopping, ads, home products, subscription video, and delivery (Amit). Apple competes with Chromebooks, Android, Pixels, and Apple TV, and Facebook competes with its targeted ads and apps (Enge). Microsoft, the final major competitor, competes primarily with Chromebooks, Search, and Drive.

Google can succeed thanks to its critical success factors. Employees are allowed to innovate on paid company time, which leads to a well-rounded corporate culture. It acquires companies that allow for smart diversification, and it does so in a well-timed manner. Finally, it constantly seeks new information and uses the information in new, innovative ways (Faille).

The quality and abundance of critical success factors lead to a strong competitive strategy for Google. Google has strong brand recognition that’s built off of it’s accurate and speedy searches and quality of associated products. Its strategy is scale in both search and advertising. The more searches completed and the more ads purchased, the better the quality of both moving forward. Google's advantage is centered around its availability and use of data. Though the search algorithm isn't patented, the bulk of code associated makes it nearly impossible to be replicated. In addition to the household products, Google has many patents on different products in Research and Development (Kennedy).

An analysis of Porter’s five forces helps to create a better picture of the industry today (“Google: Porter’s 5 Forces Analysis”).

1. Competitive Rivalry (Moderate)
There are currently lots of competitors in Google’s various markets. There are low costs of switching for virtually all products, so there is not a lot of loyalty. If someone offers a better search option or a better email service, users switch over with relative ease. Google currently has a stronghold on the search market, but it still working to maintain a foothold with their other business units.

2. Bargaining Power of Buyers (High)

Individual buyers make up very little of Google’s revenue, therefore they have very little influence or power. In the technology industry, there’s a new user in line for every user leaving a company. However, advertising buyers have lots of power since they provide a lot of revenue and can go to alternative ad platforms if their needs aren’t met.

3. Bargaining Power of Suppliers (Moderate)

Google has so many products that are in completely separate markets. Each product is made up of diverse materials, so it’s relatively easy for companies to switch suppliers. However, some of the products (such as phones) require more selective materials and allow suppliers some level of power.

4. Threat of Substitutes (Low)

There are few substitutes available for technology products today. Devices and convenience are ingrained in nearly everyone, and there are no viable options available as alternatives. There’s a high threat of substitutes for Google since it’s so easy to switch to competitors, but this is not true for the industry overall.

5. Threat of New Entrants (Moderate)
There are very few barriers to enter the technology industry, but it is difficult for new entrants to gain the same traction and brand recognition that the tech giants have. All it takes is some technical skills to compete, so while it is easy to enter the market, it is difficult for new entrants to maintain competition long term.

A look into the PEST issues that both Google and the industry are facing rounds out the industry analysis further.

1. Political: The technology industry overall is facing threats from the political environment. After the 2016 election, technology companies (especially those involved with user data and advertising) came under fire and are at risk of regulation. This also affects Google directly. There is a lot of skepticism of Google after the European Union fined them for skewing shopping results. This, along with the recent Cambridge Analytics data scandal, will lead to further regulation of tech monoliths soon.

2. Economic: There are an immense number of new technology companies entering the industry every year. The transition from private to public affects many of these companies each year and affects competitors. For example, Spotify filed a DPO rather than an IPO which saves them lots of money but will have a negative effect on the banks (Warren). In the future, it is likely that other companies will follow in Spotify’s footsteps, thereby changing the economic environment of the industry. However, the economy is doing very well right now, so people have more of a disposable income and the ability to spend money on shopping and specialty products. This contributes to a higher level of ads sales and purchases of hardware.
3. Social/Demographic/Physical Environment: In both the overall industry and Google itself, antitrust and privacy concerns are large points of concern. This ties to the Political issues as well due to the possibility of regulation as a result. Given the recent events tied to privacy concerns, people are even more hesitant to allow companies access to personal data. This has huge implications for Google as its ad targeting is founded in personal user data.

4. Technology: Ad-blockers currently pose a huge threat to Google. The free software is becoming more common and is now available for phones too. Since Google’s main source of revenue is advertising, ad-blockers have a very negative effect on the company.

To conclude the external analysis, it is worth examining Google’s threats and opportunities. Major threats facing the company today are ad-blocker software, anti-trust lawsuits, and potential government regulation to prevent monopolies. In addition to these threats, Google also has many opportunities available. This includes, but is not limited to, the smartphone market (with both the Pixel and the Android operating system), the possibility of diversification into new, paid markets outside advertising, and the cloud computing market.

**Internal Analysis**

Alphabet is known for having a vast amount of cash at its disposal. In 2017, it had $152.5 billion total shareholder equity, $40.3 billion common and capital stock at par value and additional at par value, and $113.3 billion in retained earnings. Relatively low compared to the earnings, Alphabet had $992 million in accumulated other comprehensive loss. With such a mass of cash, it is to be expected that Alphabet holds little debt capital, with up to $8.9 billion of total debt capital in 2017. That’s a 0.058% percent of debt to shareholder equity, so debt has a very
minimal role in the company’s capital structure (Alphabet). As of March 24, 2018, Alphabet had a capital structure of $612.39 billion.

After depreciation, Alphabet’s net property and equipment was worth $42.38 billion in 2017. Its primary physical asset was land and buildings, worth $23.18 billion (“Analysis of Property, Plant and Equipment”). Data centers and office complexes make up a large amount of the company’s physical assets. On the other hand, Alphabet had $19.45 billion of net goodwill and intangible assets in 2017. This amount was primarily composed of $16.75 of goodwill. Goodwill is when a company purchases another for a premium value, and it includes the value of the brand name, the customer base, patents, and quality of employee relations (“Goodwill and Intangible Assets Disclosure”). There's no figure for the value of human capital, however, it's undeniably Google's most important asset. Without the 88,000 engineers, salespeople, and other employees, Google would be unable to innovate and keep up with competitors.

Google’s core competency relies on its ability to change and innovate continually. According to Ben Fried, Google’s CIO:

> The ability to change is essential to stay competitive. Google is so worried about practices becoming ossified that they hold what are referred to as bureaucracy buster days. Employees from across the company identify areas where bureaucracy has seeped into the company, note them, and projects are devised to destroy them (High).

The company’s distinctive competencies that help them to change a lot are that they constantly hire new employees from a wide range of backgrounds and treat them well. They take public stances on issues that garner the public’s support, and they acquire companies that would be beneficial additions to their core suite of products.
In summary, Google’s main strengths come from their ability to generate user traffic, their brand name, the information and data they gather, and the fact that they’re the primary search engine for most people. However, the falling rates of advertisement and reliance on ads for revenue are a definite weakness. Additionally, their reputation among small businesses that compete with it is another weakness as well as the public’s security and privacy concerns.

**Strategy Goals**

*Goals and Objectives*

Google's new strategy should focus on continuing to bring in high-profit margins. Additionally, it should appease the public's privacy concerns and lessen the importance of ad sales and use of personal user data for profit.

**Evaluation Criteria**

The strategic alternatives will be evaluated on the following three criteria:

1. Sustainability: Does it address key opportunities and constraints Google faces?
2. Acceptability: Does it meet the expectations of stakeholders? Is the risk level acceptable? Is the likely return rate acceptable?
3. Feasibility: Would the proposed strategy work in practice? Could it be financed? Do people and their skills exist or can they be obtained?

**Strategy Alternatives**

*Focus on Cloud Computing*

The cloud computing industry is rapidly growing and has potential to increase revenue moving forward. In this proposed strategy, Google would pull resources from ads and focus them on expanding and building out Google Cloud.
1. **Sustainability**: The strategy moves away from Google’s reliance on ads and appeases the public. The cloud computing market has a 75% growth rate and expanding in this arena would allow Google to compete more actively with Amazon AWS and Microsoft Azure. It has high-profit potential (Columbus).

2. **Feasibility**: This is a somewhat realistic strategy; however it involves a huge shift in structure. Right now, all of Google’s sales efforts are focused on advertising so large organizational changes would be required. Google has a lot of cash and resources, so the shift is possible, just expensive.

3. **Acceptability**: If the strategy works, it would meet expectations of both investors and the public. However, it has a high-risk level since it requires such large organizational changes. It would be a difficult sell since investors wouldn't be keen on taking such a large risk.

*Focus on Android Ads*

Should Google shift their advertising focus to mobile ads on the Android operating system, the company could get more ads in front of more users. Since it is Google’s operating system, it doesn’t have to pay a portion of profit (as is required for ads on Apple devices). In addition, there are more Android users than iOS users.

1. **Sustainability**: This strategy doesn’t address any of Google’s weakness, but it utilizes the opportunity provided by the Android market and the strength that Google has with its ad targeting capabilities.

2. **Feasibility**: Google hires so many people every day, so instead of funneling them into the existing ad teams, it would be simple to create more teams that specialize in
Android advertisements. It would take minor organizational changes, but is very feasible.

3. Acceptability: It is not an extremely radical idea, so it would be an easier sell from the risk viewpoint. However, there’s less opportunity for major growth in this arena, so that could make it more difficult. Since there’s less room for profit, investors wouldn’t find it as appealing.

*Make Pixel a Luxury Brand*

Create an exclusive reputation around the Pixel in order to appeal to the iPhone market more. Though it’s a smaller market, it’s a higher income bracket and has more room for profit (Petrovan). This way, Google can begin shifting its attention from advertising.

1. Sustainability: This proposal utilizes the strength of the existing Android brand and ecosystem. It also is a slight shift from the weakness of the ads market and user data.

2. Feasibility: Though it will require organizational shifts since this proposal is not severing all ties with ads, it should not be too major. The biggest difficulty comes from changing the image of the Pixel brand. It currently doesn’t have the reputation of being luxury, so the brand will have to increase its price-point and image.

3. Acceptability: It’s very likely that this would be accepted by stakeholders. It would provide an opportunity to increase profit while moving away from the reliance on user data. It appeases both investors and the public.

**Strategy Recommendation**

Competing against Apple in the luxury phone market is Google's best option. It has the lowest risk while still providing an opportunity for profit.
Financial Reasoning

In 2017 alone, 217 million iPhones were sold (‘Apple iPhone Sales by Year 2007-2017’). With that many sales and a higher price tag, Apple had a gross margin of 59%. Looking at the Pixel, only 3.9 million phones were sold in 2017 with a gross margin of approximately 25% (Roberts). As is clear, the luxury phone market has room for much higher margins. It’s a large market in both the US, where it is dominated by Apple, and globally, where it’s dominated by Huawei and Oppo). Since Google already has brand recognition, this would be a great financial opportunity for them.

Levels of Strategy

1. Enterprise Strategy: Create an intuitive, usable phone that appeals to users and helps them find information easily.
2. Inter-Organizational Strategy: Compete with Apple’s iPhone luxury phone business.
3. Corporate Strategy: Pull back on ad sales and turn the Pixel into a luxury phone brand.
4. Business Unit Strategy: Sell based on the product image. Right now, the Pixel has a plastic coated aluminum body. While this is more functional, it isn’t nearly as beautiful.
5. Operational/Functional Strategy: Marketing sells the brand as high end and competitive while hardware and software create a product that can compete at that level.

Implementation Plan

December 2018
Early nonfunctional prototype and model are done. Marketing campaign proposal complete, and suppliers of materials are identified. Some financial ads resources have moved over to focus on research and development.

*May 2019*

A functional prototype is complete with some level of user testing. Beta version of the software is in progress and is being tested continually. Some sales resources from ads are moved to Pixel to coordinate with vendors. The marketing plan is complete.

*December 2019*

Bugs worked out of the software and the phone being dog food tested by Google employees. The marketing campaign is built out and a price point has been decided. A "Something big coming" marketing campaign is released.

*March 2020*

Re-release the phone to testers with fixes in for all of the bugs found. The final version of the phone is completed and suppliers have been sent specifications.

*May 2020*

Launch the new Pixel at Google IO and begin running a marketing campaign for the phone. Begin distribution of phone to vendors nationwide.

*June 2020*

Start selling the new Pixel in stores globally. Continue promoting the phone on television, online, and other marketing mediums.

**Resources and Projected Results**
**Capital**

Google has $101.7 billion in cash, so this will help fund the research and development of the new pixel. The company currently has a research and development budget of $14 billion, so that will be where the funds directly come from (“Alphabet Cash and Short Term Investments (Quarterly)”). Since this is already built into their budget, it won’t have a large impact on their debt to shareholder equity ratio.

**Pro Forma Balance Statement**

The following numbers are in millions. Assumed in this balance sheet are the retail cost of the phone (approximately $1000), and the production cost of $250 per phone.

<table>
<thead>
<tr>
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<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
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<tbody>
<tr>
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<td>0</td>
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<td>11,925</td>
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<td>500</td>
<td>1,000</td>
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<tr>
<td><strong>Materials</strong></td>
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<td>1,500</td>
<td>3,500</td>
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<tr>
<td><strong>Labor (Sales, Engineers, etc.)</strong></td>
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<td>75</td>
<td>75</td>
<td>75</td>
</tr>
<tr>
<td><strong>Total Expenses</strong></td>
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<td>105</td>
<td>1,575</td>
<td>3,575</td>
</tr>
<tr>
<td><strong>Total Cash</strong></td>
<td>11,925</td>
<td>11,820</td>
<td>16,245</td>
<td>26,670</td>
</tr>
</tbody>
</table>

**Contingency Plan**

If the recommendation doesn’t work, then Google will lose up to 20 billion dollars from retail sales. Therefore it won’t make back some of the money spent on research and development,
production, sales, and marketing. Ideally, Google won’t have to pay much more money for the development of the phone than the normal Pixel. If it doesn’t succeed in the luxury market, Google can drop the price to the standard price of the Pixel.

The biggest concern is that iPhone users won’t make the switch to a Pixel, even if it’s of the same quality or better. Apple traps people in its ecosystem, so it will be a harder sell to convince people to switch. It’s a red ocean market, so Google essentially must poach users from other phone companies.

**Conclusion**

Google has grown significantly since its founding in a Stanford dorm. With a year on year growth rate of 23% and 2017 revenue of $110.9 billion, Google is one of the biggest players in the technology industry today. Given recent events with the Cambridge Analytics data exploitation, companies like Google and Facebook are coming under fire for their use of user data. Google's ad business brings in 87% of their annual revenue, however, it relies on user data for targeting. Given this public distrust, Google should pursue strategies that detract from their ads business and increase profit. The company has enough cash on hand to experiment and venture into new businesses. The future looks bright for Google, especially should it address its main weaknesses and threats.
Works Cited


“Alphabet Cash and Short Term Investments (Quarterly)” *YCharts*, ycharts.com/companies/GOOG/cash_on_hand.


