TEACHING NOTE 5: Alphabet Inc.: REORGANIZING GOOGLE
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Case synopsis

In October 2015 Google restructured itself as Alphabet Inc, a new holding company under which Google's noncore business were spun off as distinct entities and separated from the company's internet operations. Senior management realized that the company had become too complex to manage and that a change was required to allow for cleaner operations and more accountability. Since its inception, Google started to invest heavily in developing technologies which were both related and unrelated to its origin as an internet search engine. Google came under pressure as investors began to question the heavy investments it was making in non-core businesses and complained about the lack of clarity regarding risky investments. As Google continued to grow at a rapid pace, problems began to emerge due to its cross-functional organizational structure. Under the new structure, a number of companies, including Google, operated as subsidiaries of Alphabet organized into two reporting segments: 'Google' and 'Other Bets'. This new structure was a smart way for Google to pursue long-term growth while simultaneously increasing transparency and management focus on the core business. But there was also criticism that it was not clear how the reorganization would increase the profitability and valuation of Google, that a compelling tangible corporate strategy was missing and they faced management challenges, resulting in the exit of some of the key executives.

Teaching objectives

When used in conjunction with Chapter 5, this case can be used to meet the following teaching objectives:

- *Understanding the difference between the 'portfolio organization perspective' and the 'integrated organization perspective'.* Alphabet very clearly made the shift from an integrated organization to a portfolio organization. To remain relevant in the quickly shifting landscape of technological enterprises, companies need to always be looking for the 'next best thing'. Google has been doing so admirably for the past decade, resulting in very wide ranging horizontal diversification. Although product and market insights were leveraged highly successfully on the central level, external pressure from shareholders for the increased transparency of a portfolio organization. This shift gives students insights in some of the reasons to be engaged in either of the perspectives.

Teaching guideline

Students can learn from google restructuring itself into a holding company named Alphabet. Starting as a clever way to index websites, Google has grown to a multi-billion-dollar company through both horizontal integration and diversification. Within its core business of search and ads lie such enterprises as Chrome, Android and YouTube. The link to these activities is obvious, as they are means that allow users to interface with Google money making activity – showing you relevant ads. In its search for the next big thing, Google has dabbled in biotech, self-driving cars, smart homes and wearables. Completely separate from this core business, although insights from the vast amount of data that Google gathers from its users were surely leveraged to ensure its success. Discussing whether or not the different activities Alphabet engages in are core- or non-core will make for an interesting class discussion.
Furthermore, students can delve deeper into the reasons for Google's Alphabet restructuring. As investor found in difficult to separate and evaluate core- and non-core activities, Google created the transparency

they have asked for. This has, in turn, led to an increase in share prices. In fiscal 2016, Alphabet brought in US$90.3 billion in revenue, a 20% growth from US$75 billion in 2015. Revenues from the Google segment were US$89.5 billion while that of 'Other Bets' were US$809 million. Besides investor pressure, talent retention was an important reason for the restructuring. In the tech world, many talented engineers and leaders leave large behemoths such as Google in favor of smaller, newer and faster-growing firms. By splitting of the high-tech products and investment funds, it has become easier to create a culture which made employees feel purposeful and relevant to be a part of the organization. Having people believe that by working for you they are changing the world tends to achieve this goal. The restructuring made this easier. Analysts also speculate that, although Google hardly has any debt, the restructuring would make lending money easier, possibly hinting towards a share buy-back in the future. Lastly, potential challenges of this move can be discussed with students. Google tries to remain relevant by being a 21st-century innovator by creating bold new products, rather than harvesting profits from its lucrative search engine business. By rigorously handling capital allocation and work to make sure each business is executing well, sounds well, but it is a rather different modus operandi than employed before the restructuring. Several projects have incurred billion dollar losses but can still be carried on with because their time horizon demands it and the financial problems are compensated by the enormous returns from search engine ads. Will this remain the case once investors get more transparency? And will talent indeed be attracted to these 'start-ups' within the incumbent, or would they rather join up with a fresher and faster alternative?

Case questions

1. *Group Alphabet's activities according to the four growth directions in Figure 5.1*
2. *What are the reasons behind the Alphabet restructuring?*
3. *What are the potential challenges of the Alphabet restructuring?*

Case analysis

1. *Group Alphabet's activities according to the four growth directions in Figure 5.1*

Nest: smart thermostats are interesting for Google as they are one of the first steps towards the internet-of-things where physical things are added to the internet, yet is completely unrelated to the core business of search and advertising, hence it is considered horizontal diversification.

Calico: biotechnology, especially focused on understanding the process of aging requires a surprisingly large amount of behavioral data that Google has quite a lot of. Its main premise is quite alien from Google's core business though and it is therefore considered horizontal diversification.

Google X: most of the far-fetched self-proclaimed moonshot programs are housed in this subsidiary. Its inner workings are semi-secret and its projects have very long time span. This is also a clear case of horizontal diversification.

Google Ventures: focusses on funding early-stage companies, Google ventures is an interesting case of backward vertical integration. Google creates products and services that are to be funded by venture capital. Through this construction, it can fund good ideas from both employees and entrepreneurs.

Google Capital: similar to Google ventures, Google capital funds the growth of businesses, making this also a case of vertical integration. The main difference lies in its focus on late-stage growth companies. This requires a very different skill set, though it can still leverage a lot of Google's user data.

Sidewalk Labs: aims to use the developments concerning digitalization to help develop the next generation of cities. Cities are currently considered to main unit of analysis to improve the lives of people through innovative governance and services. It leverages insights from all other business units, making it a very interesting case of forward vertical integration.

Google fiber: aims to supply everybody with fiber internet, reaching speeds from 1000 megabits/second and upwards. This is a case of backward vertical integration, as it provides a (better) framework for all other services to work on.

2. *What are the reasons behind the Alphabet restructuring?*

The reasons behind the Alphabet restructuring are twofold.

- First, investors demanded more transparency regarding the financial performance of Googles core business of search and advertising, versus its long-term high risk moonshot projects. While the search and ad business are booming, moonshot projects have incurred a €6 billion loss. While the argument that looking for the next big thing is required to avoid becoming redundant is sound, investors become nervous due to lack of transparency of their investment objects. As moonshot projects require a large amount of funds, keeping investors in the loop was an important reason.
- Second, by turning the company into a portfolio organization, talent can be more easily retained. Many talented engineers would rather work for fresher and faster growing start-ups. Through this restructuring, such start-ups can be created under the umbrella of a very rich and well known firm, thus combining the benefits of working for an old behemoth with the excitement of working for a fast-growing start-up. As will be outlined in the next section, this goal has not turned out to be successful.

3. *What are the potential challenges of the Alphabet restructuring?*

Rigorous handling of capital allocation and working hard to make sure each business is executing well is a very worthwhile ambition. Analysts, however, pose several concerns:

- It is difficult to leverage the benefits of a big cash cow with a high-risk venture capital firm that focusses on early-stage, capital-intensive new ventures;
- It is hard to prove the previous point to investors;
- It has hard for core and non-core parts of the firm the work together. By their nature they require different staff, human resources, culture, etcetera;
- By becoming more transparent, all divisions face the glare of intense scrutiny from its shareholders, whereas large losses could earlier be compensated by the large benefits from the core business
- Rational strategic management on the level of individual divisions could be good for the optimization of stock price, but also creates the risk of seriously damping the spirit of innovation

What happened after the case?
Advertising still amounts to 90% of Google's revenues. The separate business units that would serve to achieve more commercial viability have not yet served their purpose. The units are still within Alphabet and will not disclose more financial details than before. Furthermore, executives overseeing several initiatives (venture capital, drones, self-driving cars, high-speed internet and smart thermostats) have left. Attempts to sell the malfunctioning robotics business, Boston Dynamics, have also yielded little result.

The reason for these departures is Alphabet's ambivalence with regards to how tightly it should manage costs. When thermostat start-up Nest was acquired in 2014, its executives were promised they could invest and expand their business for years. When Alphabet was adopted, however, this message changed. Units now needed to pay for their share of the overhead, which annoyed executives as the mother company insisted on giving out high salaries and luxuries earlier on. Also, few are optimistic that Alphabet will ever devise something as lucrative and large as the search business continues to be.

The way people use the internet is changing as quickly as ever. Google has until now been able to keep up, yet two developments might spoil this track record. First is the emergence of voice search – one fifth of the searches on Android devises is already queried by voice and will only increase as voice recognition software improves. Second is the rise of virtual assistants. Whereas now people rely on their devises to help them get the job done for them, this might shift towards more complex interactions in which people outsource some of their tasks completely. Both these developments lead to more direct search patterns in which ads play an ever smaller role.