FUTURE OF GOOGLE

A CASE STUDY

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ON April 17, 2014, New York Times reported Google's first-quarter earnings, released after the market closed on Wednesday, the 15th April, 2014, which surprised Wall Street. The company has traditionally gushed profits without breaking a sweat. Now it takes more of an effort.

Alexander the Great is said to have wept because he ran out of kingdoms to conquer. Google is eager to avoid such a miserable fate.

Its core digital advertising business is so dominant that analysts are questioning just how much it can continue to grow. So Google is unleashing its vast cash hoard on robotics, artificial intelligence, smart thermostats and, just this week, high-altitude drone satellites.

The only thing all these acquisitions have in common is a focus on the future - often, the distant future.

The risk in thinking about what will be big in 2050, however, is that you can lose sight of 2014.

One big reason was a problem of several years' standing: Internet users are migrating to mobile devices, but ads on phones and tablets still do not have the familiarity and appeal they do on bigger computers, and they are not as profitable for Google. Google's ad volume jumped 26% in the quarter, which sounds good but is less than expected, while the amount advertisers pay dropped 9%, which sounds bad and is.

There were other potentially worrisome notes. Operating expenses were 35% of revenue, compared with 31% in the first quarter of 2013. One reason: acquiring companies at a rapid clip entails specialist fees and other costs.

Then there were real estate and construction costs, as Google races with Amazon to build out the computing cloud for potential customers. The company needs a lot of data centers. That raised capital expenditures to $2.35 billion, up from $1.2 billion in 2013. Google said it expected expenditures to remain high.

Revenue was ostensibly impressive for the quarter, rising 19%, to $15.42 billion, but that was about $100 million short of expectations. Net income was $3.45 billion, and earnings per share were $5.04, compared with $4.97 in 2013, slightly weaker than forecast.

The stock, which was up strongly earlier in the day, immediately fell 5% before partly recovering. Google split its shares this month, a move that solidified the founders' control over the company.

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“The issue with Google is, you want to support the management in their efforts to find new revenue streams, but you don’t want them to act careless with shareholder capital,” said Colin Gillis of BGC Partners.

Google’s efforts to find those new streams have intensified recently. It acquired several robotic companies, including Boston Dynamics, maker of Big Dog, Cheetah and other mechanical creatures. It bought Nest Labs, which developed an innovative thermostat, for $3.2 billion.

Further, this week it bought Titan Aerospace, which makes drone satellites. Google said Titan, which was founded in 2012, and has about 20 employees, could help bring Internet access to millions, and help solve problems like deforestation. The purchase price was not disclosed but is believed to be around $75 million.

With $59 billion in cash in the bank, and a well-oiled machine that every quarter generates billions more, Google can clearly afford to buy all sorts of companies. Generally Wall Street has indulged these acquisitions, even the unusual ones.

“All the crazy stuff like robotics is the best thing for the company,” said Gene Munster, an analyst with Piper Jaffray. “Investors feel like it’s a company that going to continue to find ways to grow. It’s a big contrast with Apple, whose investors are begging them to do more crazy stuff.”

Gillis is more skeptical. “Do you trust Google’s management as visionaries?” he asked. The analyst questioned the Nest purchase. Making thermostats does not fit in with Google’s core advertising operation, he said. Neither do the robots.

In absolute terms, Google is doing very well. Here is one way to measure its heft: the company is projected to increase its digital ad revenue this year by more than $5 billion, which is more than the total ad revenue of Yahoo or Microsoft.

The only viable threat to Google comes from Facebook, whose ad revenue is forecasted by eMarketer to jump 50 percent this year. Facebook’s revenue is about a quarter of Google’s.

“I believe in the medium to long term that mobile pricing has to be better than desktop,” Nikesh Arora, Google’s Senior Vice President and Chief Business Officer, said on a conference call with analysts. His reasoning is that knowing where the customer physically is will command a premium. The “holy grail,” he added, will be when they start their campaign on the site instead of merely concluding it there.

One analyst noted on the call that Google had 10 percent of the worldwide advertising market.

“That tells me there’s 90% more opportunity around the world,” Arora said. “We don’t constrain ourselves and our thinking. We’d like more than we have in every market out there.”

There is another area of concern i.e., Google Plus, the company’s social network, is like a ghost town. Want to see your old roommate’s baby or post your vacation status? Chances are, you’ll use Facebook instead.

But Google isn’t worried. Google Plus may not be much of a competitor to Facebook as a social network, but it is central to Google’s future — a lens that allows the company to peer more broadly into people’s digital life, and to gather an ever-richer trove of the personal information advertisers covet. Some analysts even say that Google understands more about people’s social activity than Facebook does.

The reason is that once you sign up for Plus, it becomes your account for all Google products, from Gmail to YouTube to maps, so Google sees who you are and what you do across its services, even if you never once return to the social network itself. Before Google released Plus, the company might not have known that you were the same person when you searched, watched videos and used maps. With a single Plus account, the company can build a database of your affinities. Google says Plus has 540 million monthly active users, but almost half do not visit the social network.

"Google Plus gives you the opportunity to be yourself, and gives Google that common understanding of who you are," said Bradley Horowitz, Vice President of Product Management for Google Plus.

Plus is now so important to Google that the company requires people to sign up to use some Google services, like commenting on YouTube. The push is being done so forcefully that it has alienated some users, and raised privacy and antitrust concerns, including at the Federal Trade Commission. Larry Page, Google's Chief Executive, tied employee bonuses company wide to its success, and appointed Vic Gundotra, a senior Google executive, to lead it.

The value of Plus has only increased in the past year, as search advertising, Google's main source of profits, has slowed. At the same time, advertising based on the kind of information gleaned from what people talk about, do and share online, rather than simply what they search for, has become more important.

Questions

1. What are the reasons of decline in profitability of Google as compared to expectations?
2. What is your opinion about the recent acquisitions of Google which are beyond the core competence areas of Google? Justify with reasons and examples.
3. Is it right to push Google plus and invest further? Give reasons for your answer.
4. If you were the CEO of Google, what you would do to transform the company to the next level?