**Hitt 13e Case Teaching Notes**

**Case 1: Alphabet Inc.: Reorganizing Google**

**Case Synopsis**

Co-founded by Larry Page and Sergey Brin in 1998, Google’s original mission was “to organize the world’s information and make it universally accessible and useful.” Over the years, Google has come to dominate that space, but the company has also diversified in numerous ways. Some projects and acquisitions were directly relevant to the company’s original mission, while other ambitious “moonshot” projects and acquisitions (for example, in health care, self-driving cars, and smart-home appliances) seemed to fall far from Google’s core competencies. Many analysts and investors questioned the heavy investments in R&D for these projects, especially since the lack of clarity in Google’s financial reporting on individual projects made it difficult to discern whether these investments were generating or would eventually yield any dividends for investors.

In response to increasing pressure from investors and in the face of stagnant share prices, Google announced an unusual restructuring plan in October 2015. It created a new firm—Alphabet, Inc.—to act as a holding company for Google and quite a few other independent subsidiaries under the Alphabet umbrella. The businesses within Alphabet were organized into two reporting segments—Google (and related core businesses) and Other Bets—and each subsidiary was set up to run independently under the leadership of individual CEOs. Executive-level leadership and the board of directors remained largely unchanged, and investors’ shares of the former Google simply became shares in Alphabet, Inc.

Under the new structure, subsidiaries have been pushed toward greater accountability. The intended benefits of the new structure were to: enable each subsidiary to focus on its own mission, limit each subsidiary’s liability for the others’ debts, enhance greater transparency regarding cash flows and investments across the board, avert anti-trust regulation, attract and retain more entrepreneurial-minded talent, and pave the way for more strategic acquisitions. Investors’ faith in these outcomes coupled with increased revenues have led to an uptick in stock prices since the restructuring. However, several CEOs and other employees in the riskier “Other Bets” projects have since left the company, stating that the pressure to perform financially has eroded the spirit of innovation within their subsidiaries.

Analysts feel that the new Alphabet is still a work-in-progress, and criticism of the restructured company abounds, but there are already signs of a sharpening focus on growth from core competencies while simultaneously leaving room for more ambitious—or riskier—projects that require a longer timeframe to yield results.

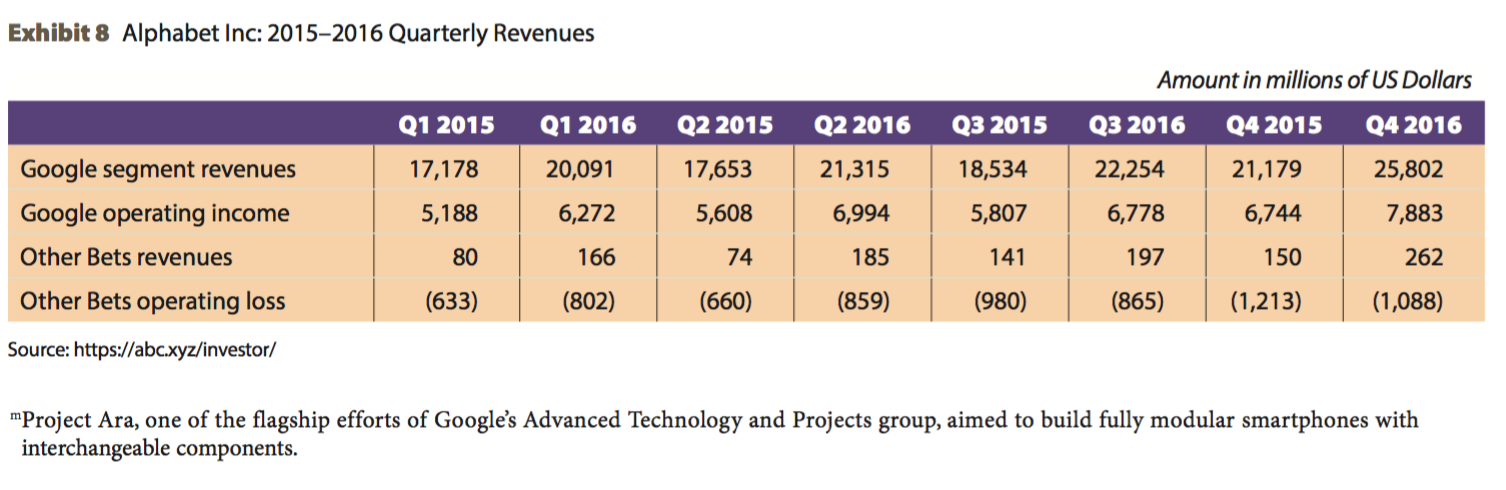
**Learning Objectives**

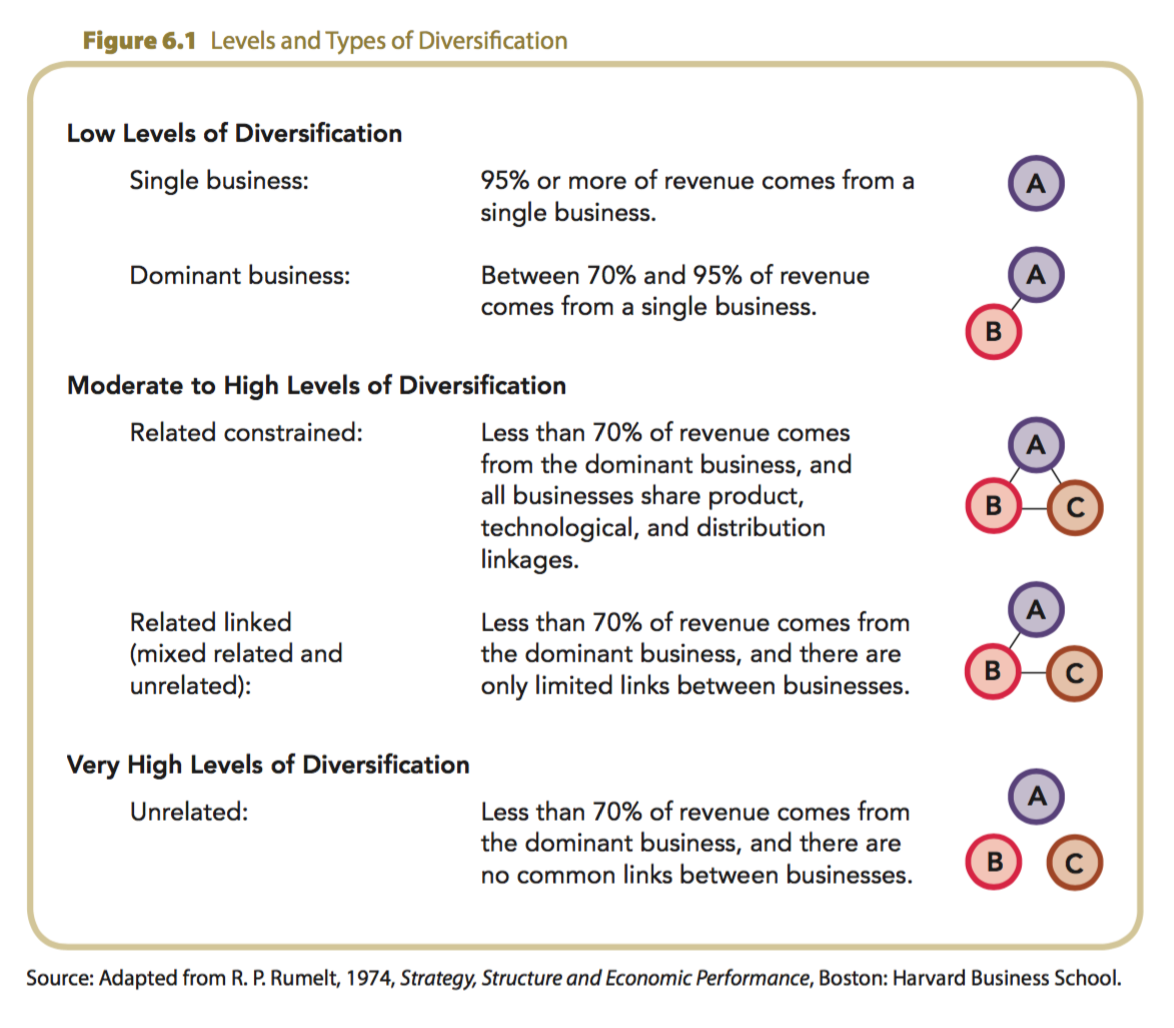
* Describe different levels of diversification achieved using different corporate-level strategies. (Chapter 6)
* Describe how firms can create value by using a related diversification strategy. (Chapter 6)
* Discuss the incentives and resources that encourage diversification. (Chapter 6)
* Describe motives that can encourage managers to over diversify a firm. (Chapter 6)
* Explain the popularity of merger and acquisition strategies in firms competing in the global economy. (Chapter 7)
* Discuss reasons why firms use an acquisition strategy to achieve strategic competitiveness. (Chapter 7)
* Explain the use of three internal governance mechanisms to monitor and control managers’ decisions. (Chapter 10)
* Describe how corporate governance fosters ethical decisions by a firm’s top-level managers. (Chapter 10)
* Define organizational structure and controls and discuss the difference between strategic and financial controls. (Chapter 11)
* Describe the relationship between strategy and structure. (Chapter 11)
* Explain the use of three versions of the multidivisional (M-form) structure to implement different diversification strategies. (Chapter 11)
* Define strategic entrepreneurship and corporate entrepreneurship. (Chapter 13)
* Define invention, innovation, and imitation, and describe the relationship among them. (Chapter 13)
* Describe entrepreneurs and the entrepreneurial mind-set. (Chapter 13)
* Describe how firms use acquisitions as a means of innovation. (Chapter 13)
* Explain how strategic entrepreneurship helps firms create value. (Chapter 13)

**Strategic Issues and Suggested Discussion Questions & Answers**

1. ***How would you characterize Alphabet’s current level of diversification, and how did the organization achieve this? Do you think the firm is over diversified?***

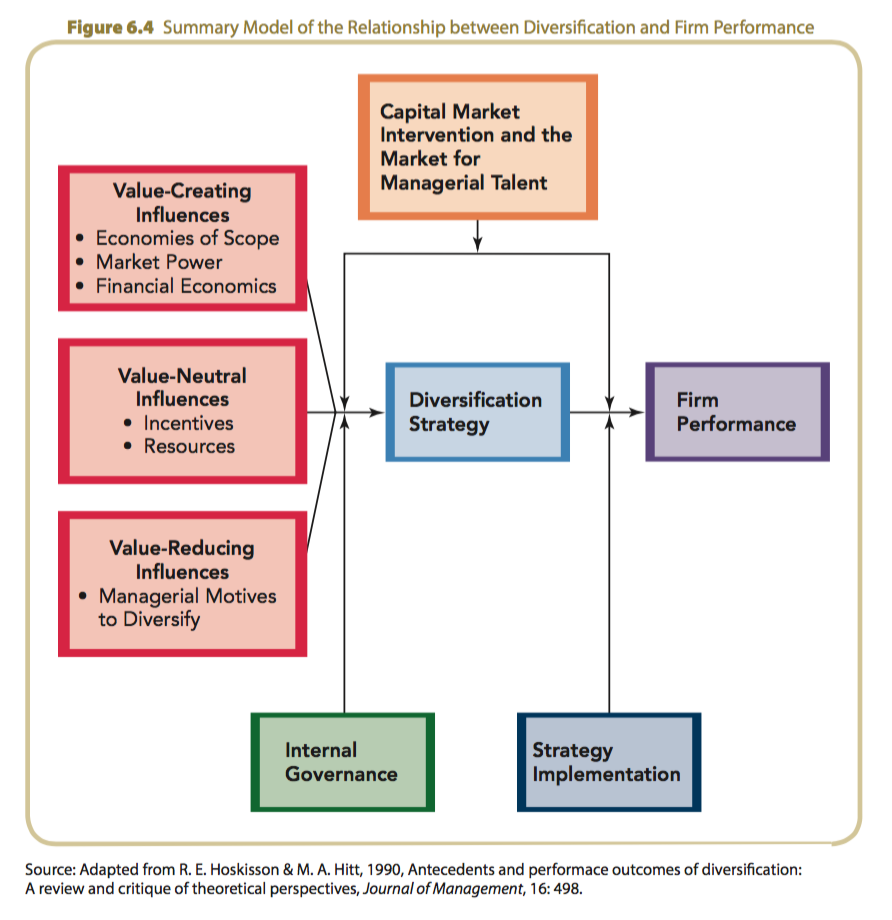
Given Alphabet’s many businesses in a number of industries, it might be easy to assume that the firm is a highly diversified company pursuing an unrelated diversification strategy. However, upon closer examination of Alphabet’s businesses, we can see that many are related. For example, both YouTube and Google Maps support the core mission of the Google search engine—to organize the world’s information and make it accessible. Annual revenues also show that approximately 85 to 90 percent of the firm’s revenues are coming from Google’s online advertising (Exhibit 8). Thus, we can conclude that Alphabet should be characterized as having only a moderate to high level of diversification through the use of a related linked diversification strategy (Figures 6.1).

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While some of Google/Alphabet’s new businesses have been developed internally, many have been the result of horizontal and related acquisitions, typically with the intention of creating value through the synergy of their resources and capabilities. Over time, these acquisitions have actually reshaped the competitive scope of the organization. However, like most firms, Google/Alphabet has faced challenges with some of these acquisitions, and that hoped-for synergy has not always been realized. Some of these businesses have been shut down or sold off, and those that remain are now under increased pressure to perform.

Larry Page and other top-level managers have pursued diversification for a variety of both value-creating motives (market power and financial gain) and value-neutral motives (incentives and resources). However, some of these acquisitions have been made for more personal reasons stemming from managers’ own interests and a desire to invest some of Google’s resources in “moonshot” projects that may ultimately benefit humankind. Whether they have reached the point of over diversification is debatable. Corporate governance mechanisms are working, forcing Google’s executive leadership to explain and justify their acquisitions, which is what led to the restructuring and creation of the Alphabet holding company and to the new degree of transparency and accountability (Figure 6.4).

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1. ***In the years leading up to 2015, which internal governance mechanism most heavily influenced Google’s top-level managers to restructure the company and create a new parent holding company, Alphabet?***

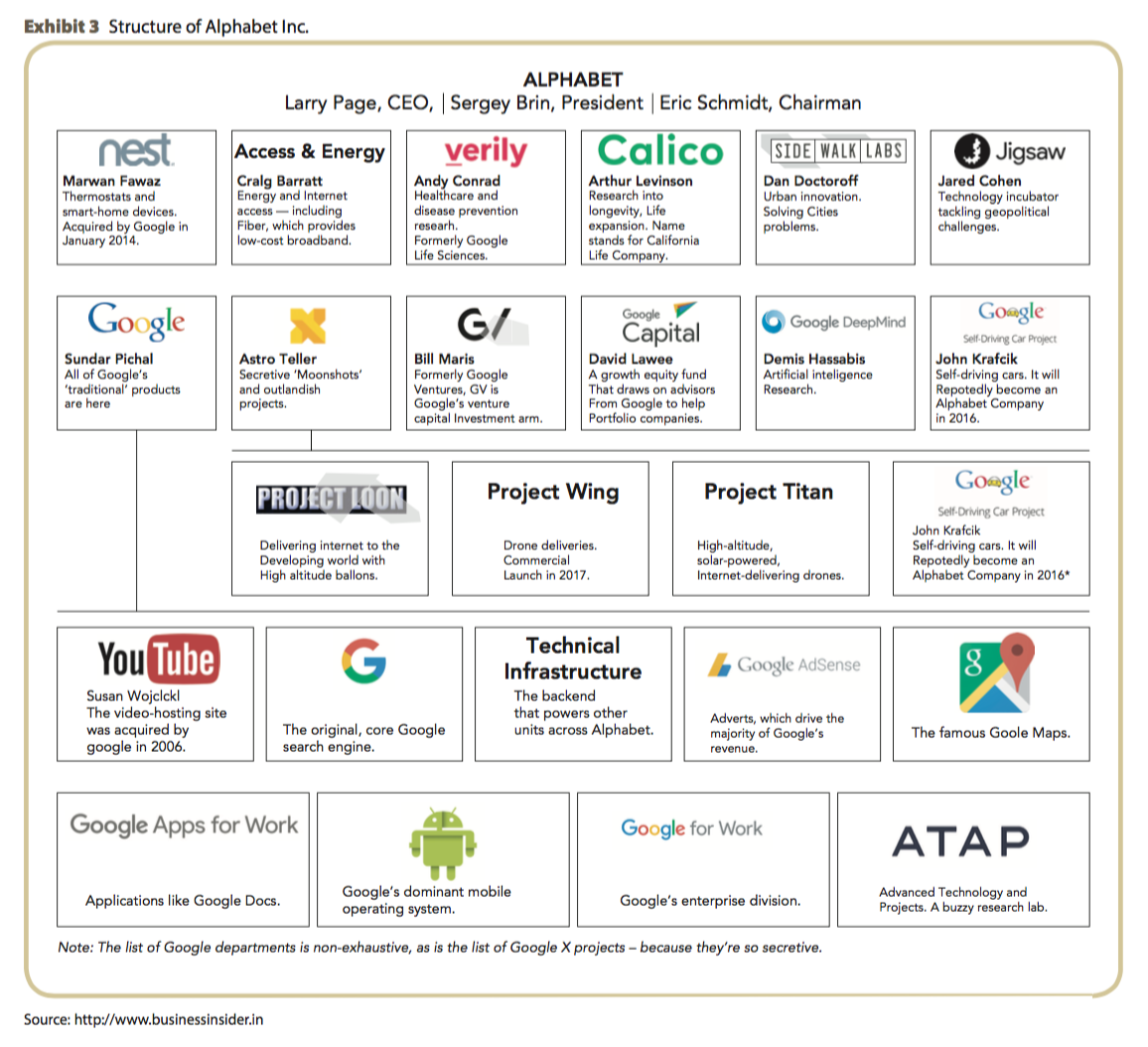
While Google’s board of directors surely influenced the firm’s decision to restructure as Alphabet, Inc., ownership concentration was undoubtedly the driving force behind the overhaul. From the time of its IPO in April 2004, Google’s founders Page and Brin were criticized for their unusual share structure, which gave them significant management control. Although many investors went along with the share structure, they put increasing pressure on Google’s management team to be more transparent, especially when it came to investments in R&D and decisions about acquisitions that occasionally seemed confusing and ill-conceived. Fueled by stagnant share prices, investors demanded a change. Google’s answer was to reorganize as a multidivisional structure that distinguishes the Google search engine and related businesses from other technological pursuits and projects. Greater transparency has allowed industry experts and investors to more accurately analyze and value the individual businesses within Alphabet, thus increasing shareholder value.

1. ***Briefly explain what type of structure the new Alphabet, Inc. is using, and describe four of the six specific outcomes top-level managers and analysts expected from this restructuring*.**

Alphabet, Inc. consists of a corporate office and operating divisions, each representing a separate business or profit center in which responsibilities for day-to-day operations and business-unit strategy have been delegated to division CEOs (Exhibit 3). Each division, such as Google, YouTube, Verily, Nest, and Project Loon, represents a distinct, self-contained business with its own functional hierarchy. Therefore, Alphabet is using a multidivisional (M-form) structure.

Google insiders as well as industry analysts identified six specific outcomes that could be expected from this new structure:

1. The multidivisional (M-form) structure gave each division within Alphabet *greater autonomy and decision-making power*, which made the businesses more nimble and responsive. Each division could be assessed on its own merits and flourish without concern for the potential impact on the core business. However, that meant that the company’s more ambitious and risky “moonshot” projects had to operate more transparently, with greater oversight and accountability.
2. The new structure also *limited Alphabet’s liability* for the debts of its subsidiaries, and limited each subsidiary’s liability for other divisions’ debts. Similarly, it suggested that the failure of any one subsidiary would not significantly impact the rest of the organization.

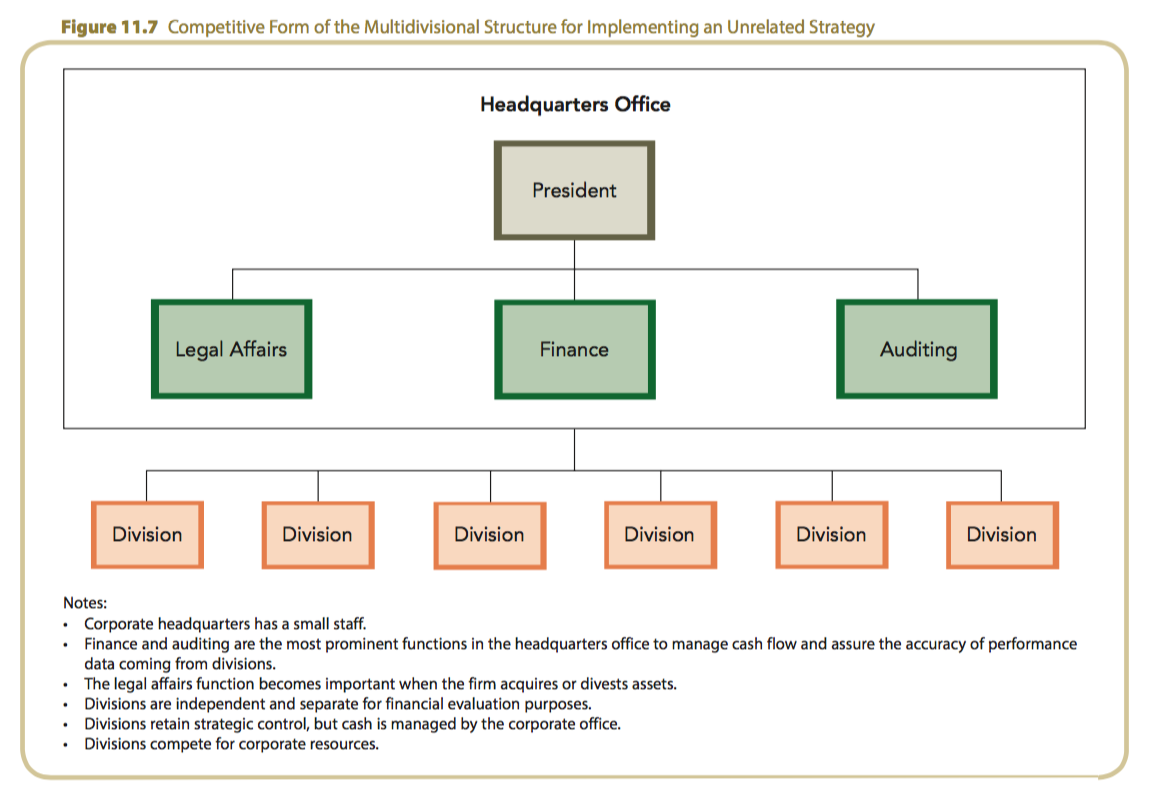


1. Prior to the restructuring, Google did not have to disclose specific information regarding individual components of its business, such as YouTube, mobile search, and online advertising, because each component’s performance was combined with all others. The greater transparency of both cash flows and investmentsinherent in the restructuring *allowed industry experts and investors to more accurately analyze and value the individual businesses within Alphabet, thus increasing shareholder value*. It also prompted greater discipline and accountability across the company.
2. Over the years, Google as a single entity had come under intense legal scrutiny and had been the target of anti-trust legislation in the United States and Europe. The new structure implied *greater legal protection of each subsidiary*, helped to avert anti-trust legislation, and made each brand less susceptible to being tainted by scandal.
3. Some analysts believed that creating separate, independent divisions within Alphabet would create more opportunities for talented senior executives, thus helping to *retain top talent*, and be *more* *attractive to entrepreneurial-minded individuals*. (As it has turned out, however, the restructuring has actually led to the exit of quite a few division heads.)
4. Finally, many felt the new structure would create an “*unparalleled value proposition” for future acquisition targets* that would want to gain access to Google’s talent pool and corporate relationships while retaining a high level of independence. Not having to rationalize how each acquisition contributes to Google’s core business would also make it easier to bring in new acquisitions.
5. ***How has the relationship between structure and corporate-level strategy at Google changed over time? How have these transitions affected the organization, and how do you think Alphabet will respond to the new structure in the future?***

For many years, Google used a functional structure, but as the company grew and diversified, its structure no longer matched its strategy, causing a breakdown. It was inevitable that the increasing level of diversification would eventually create information processing, coordination, and control problems. Google had to adjust its structure accordingly, which is why it opted for a multidivisional (M-form) structure and created a holding company called Alphabet, Inc.

By the time Google acknowledged it needed a new structure, the company had diversified in both related and unrelated ways. Given the company’s related linked strategy, it could have gone with an SBU form of the structure, but instead it went with the competitive form (Figure 11.7). Under Alphabet’s new structure, the firm’s divisions—each with their own strengths and competencies—have complete independence and are expected to compete for corporate resources. This is a dramatic departure from the past, when innovative “moonshot” projects enjoyed a fair amount of security in spite of heavy R&D investments and steep financial losses. The CEOs and other leaders of these subdivisions are now forced to be more accountable and transparent, and some feel this dampens their ability to be creative.

Eventually, however, Alphabet’s new structure can be expected to result in an efficient internal capital market. Alphabet can expect to enjoy three benefits: First, it will be more flexible, with various divisions creating, bringing in, and working on different projects while corporate headquarters determines which of those have the greatest potential and deserve more capital. Second, division heads will have to reject the status quo and pursue top-performing products that will help them secure more resources into the future. And third, when its divisions “compete” for resources with each other, it will motivate effort within each division. The highest corporate level will focus on performance appraisal, resource allocation, and long-range planning, such as new acquisitions.



1. ***How would you characterize the level of corporate entrepreneurship within Alphabet? Name several examples of how the firm exhibits an entrepreneurial mind-set and creates value for customers.***

Founded by entrepreneurs Larry Page and Sergei Brin in 1998, Google, now a subsidiary of its parent holding company called Alphabet, Inc., still exhibits a high level of corporate entrepreneurship, despite the vast size and complexity of the organization. With the founders and other executives leading by example, the various subsidiaries within Alphabet have a long history of recognizing and exploiting opportunities through innovations and invention, thus confirming the widespread presence of an entrepreneurial mind-set within the organization. While some analysts and investors feel the company’s portfolio may be getting overly diversified in too many unrelated ways, all of the businesses within Alphabet share a common theme: using technology to create value for customers around the globe.

Many divisions within the firm have been internally inventive and innovative, and these innovations have been both incremental and radical. For example, Google’s initial development of its namesake search engine led to a radical innovation in online advertising. This service is seen as extremely valuable, which explains why revenues from online advertising account for about 85 to 90 percent of Google’s total revenues. However, Alphabet (and before that Google) has also made numerous acquisitions to gain access to innovative resources and knowledge, typically in the form of technology firms—some of which were related to Google’s core search engine business, whereas others were completely unrelated but appeared to offer promising entrepreneurial opportunities. For example, Google acquired YouTube (video hosting), Motorola Mobility (hardware for smartphones, tablets, and other devices), Nest Labs (smart-home appliance manufacturer), and more.

1. ***Google, now Alphabet, is known for sponsoring quite a few “moonshot” projects, which are bold, risky, and typically expensive explorations into innovations that will hopefully generate value-adding products and services but that may or may not pay out in the long run. Should investors support this type of project? Why or why not?***

Students’ answers will vary, but they need to support their opinion with logical reasoning. Some of Alphabet’s moonshot projects include Project Loon (delivering Internet service to developing economies through the use of high-altitude balloons), Project Wing (decreasing traffic through drone deliveries), and Calico (research into options for enhancing human life and longevity). Some students will argue that investors have a reasonable expectation of a return on their investment, and thus it is wise to only invest in projects that are fairly safe and likely to result in dividends. Others will argue that investors need to be willing to risk at least some financial resources on bold and daring projects if large organizations and entrepreneurs alike are going to have any chance of creating a better future for humankind and the planet. What all students should agree on—and which is an underlying theme of this case—is that any firm that is engaging in radical innovations still has a responsibility to be transparent, ethical, and financially accountable to all stakeholders.

**Additional Resources**

Reuters’s company profile gives in-depth background on Alphabet’s current financials, leadership, valuation, news, and more:

<https://www.reuters.com/finance/stocks/company-profile/GOOG.O>

Yahoo! Finance’s company profile offers additional background on Alphabet’s current financials, leadership, valuation, news, and more:

<https://finance.yahoo.com/quote/GOOG/financials?p=GOOG>

CNN’s Tech site features links to several articles and videos about Alphabet’s structure and leadership:

<https://money.cnn.com/interactive/technology/what-is-googles-new-alphabet/index.html>

In December 2018, Business Insider provided an update on the Google/Alphabet restructuring:

https://www.businessinsider.com/alphabet-google-company-list-2017-4

One day after the restructuring announcement, analysts from The Verge recorded this analysis:

<https://www.youtube.com/watch?v=FVtMbhCV3YE>

At the Fortune Global Forum 2015, Larry Page answered questions about the restructuring:

<https://www.youtube.com/watch?v=blAOPCNCszM>

In July 2018, CNBC gave this report on Alphabet’s performance:

<https://www.youtube.com/watch?v=L9Ova8m3-aA>