

Micro Economics



The Next Chapter at Google

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Once upon a time, a couple of smart fellows perceived a technological and business opportunity. They founded a firm, leaving academic programs. They worked hard, caught a break, and began living an economic fairy tale. Their new company grew, making profits every year, even during difficult economic times. The firm hired with abandon, taking its pick from among the best talent.

After a dozen years, the firm's hallways overflowed with a lively entrepreneurial spirit. Seasoned executives and sophisticated technical staff had ample cash to explore almost every ambitious idea. For the next dozen years, the firm's managers aspired to undertake something audacious and ambitious—to build the most innovative firm of all time.

.....Who does this economic fairy tale describe? It describes two firms: Google in 2010 and, by ticklish coincidence, Microsoft almost 20 years earlier.

Can history repeat itself? Surely not. Past events at Microsoft cannot forecast with precision what Google will do tomorrow.

It is tempting to scratch this itch, nonetheless. Comparing two leading firms at the crest of their teen years could generate insights into why (and how) Google's fairy tale might or might not reach a happy ending.

Comparing economic fairy tales

After its first dozen years, Google possesses some economic similarities to Microsoft at age 15, as well as a few key differences.

First, the product portfolios of both firms extend in many directions, but only a few of the businesses account for most of the revenues, costs, and profits.

Google offers an extensive array of services and continues to explore more. Many beta services are a click away from search—Gmail, mapping, and other fun stuff. Yet, the profitable list is short: AdWords and AdSense are its current lucrative businesses. The former is built on top of Google's extensive page-rank searching of the Web, and both use keyword auctions.

Microsoft in 1990 also explored and developed dozens of software applications for PCs. Yet, profitability arose from only two businesses, DOS and Word, which soon morphed into more lucrative upgrades, Windows and Office Suite.

Both Microsoft's operating system business and Google's search/advertising businesses require the firms to assume the economic role of intermediary. Intermediaries stand between industry participants, helping to coordinate their transactions. For both firms, large up-front costs have generated revenue (sometimes much later). In both cases, one division supports

developers and application firms and another division performs large-scale software development. None of this is easy to do.

The comparison only goes so far because other important divisions do not resemble each other. A division at Google supports advertisers, whereas at Microsoft a division distributes the end product to original equipment manufacturers. The difference reflects the source of revenue—another key difference. Google today only makes money if many users click on what advertisers pay to show them. In 1990, Microsoft made the lion's share of its revenue when users bought software as part of a PC purchase.

How the fairy tale might end

Despite the differences, enough similarities exist to frame issues Google will face in its next dozen years.

The first potential parallel concerns the firms' transparency—that is, how much information they give to business partners, especially application developers. Microsoft faced many issues over its transparency, and, despite its seemingly different policies, Google might too.

Specifically, although Microsoft gave some information to applications developers, it always kept its source code a trade secret. In fact, Microsoft's holding back of information almost defined it as a proprietary software provider. To be fair, that was the norm for the day, so this

policy did not initially concern most developers. (And some firms, such as Apple, still operate this way.)

Alarms began to ring, however, when Microsoft's ambitions took it into competition with many of its former business partners. Developers who had committed to Windows loved how Microsoft helped, but learned to hate their dependence, and some learned from bitter experience to mistrust some Microsoft employees and executives.

Google will face similar tensions in its next dozen years. That might not be apparent yet because Google's transparency largely mimics the norms of open source, not proprietary software as found at Microsoft. For example, if Google can attract more developers by giving away information about a beta service, such as Android, its new handset project, it does. However, Google does not reveal how page rank works, or how its keyword auction ranks the quality of distinct bids. The company never will, because both lie at the core of AdSense and Adwords. Now that Google's ambitions have begun to take it into competition with other firms who depend on the results of AdSense and Adwords, questions arise about the neutrality of its proprietary processes.

Other Internet participants also increasingly depend on Google. This dependency leads to a second parallel, albeit one with a big open question for the next dozen years. Specifically, does the increasing dependence mean Google faces serious antitrust scrutiny?

An evocative historical parallel with Microsoft—both firms held dominant market shares at young ages—suggests this question will remain unsettled for a while. Dominant market share is a step toward antitrust scrutiny, but that alone is insufficient. Microsoft's experience can frame some observations.

Microsoft seemed in the clear in 1990, but by 1996 it had built an ecosystem that entangled virtually every

participant in the PC market. Few PC market participants could escape dependence on Microsoft without enormous loss of livelihood. That became a problem when Microsoft put hard bargains in front of participants, even anticompetitive ones. For example, Microsoft only had to arm-twist a few firms to raise the cost of entry for Netscape and its partners.

Look, building an ecosystem around AdSense and AdWords is a sound business strategy for Google. But what if Google succeeds in building even more than it presently has, and many advertisers and developers become dependent? Is that anticompetitive?

Not necessarily. Antitrust law makes a clear (and sensible) distinction between obtaining market power and abusing it. Only the latter is illegal. In short, Microsoft's experience suggests that Google should aspire to obtain enough business success to possess market power, and, at the same time, aspire to understand which actions abuse it, and avoid them.

This comparison can go further, focusing on a third and related parallel about planning for antitrust issues.

Like Microsoft, Google could tie different markets to each other. This is easy to do deliberately or even inadvertently. For example, look at the many technical relationships between Android and Google's other existing businesses, such as Maps. They blend into one another.

Learning from Microsoft, this interdependence will raise few legal issues until courts rule that Google possesses market power. So Google has a get-out-of-jail card for now. However, the potential for such a legal finding creates incentives for heat-seeking lawyers to publically make accusations, merited or not. Such a lawyer could become rich and/or famous if any charges stick.

Google should learn from Microsoft's experience that educating management in advance of such accusations saves later headaches. Microsoft's lackadaisical attitude about

doing so suggests why it can matter. When subpoenaed email showed that executives considered illegal or unethical acts, it did not matter that most were not undertaken. One example of an actual bad act made many other questionable actions look ten times worse, whether innocent or deliberate. Just ask the judge.

A less formal court?

Here is a last parallel: Like Microsoft, Google will inevitably face some trials in the amorphous court of public opinion. Why is it inevitable? Because Google manages, creates, and upgrades a big part of many users' online experience, just as Microsoft did for PC users.

Google faces a bigger challenge than Microsoft ever did. Google collects information about users' private appetites, whether bizarre, shady, or mundane. They could easily do something offensive or careless with such information. There is no law against a misstep, and missteps will be noticed.

Once again, Google could learn from the mistakes of Gates and his brain trust. Gates and company cared about legal technicalities, but did not seem to fully account for the type of scrutiny that came with prominence. Yet, prominence invited skepticism, and skepticism invited ridicule. That led to lack of trust, which hurt the firm's relationship with users and developers.

More bluntly, Gates seems rarely to have worried about giving editorial cartoonists lots to work with. I still laugh when I think of one cartoonist's rendition of Bill Gates, drawn as a Girl Scout selling cookies to a dazed homeowner, declaring that the cookies "come bundled with a browser." Winning on legal technicalities provided scant shelter against such ridicule.

Not that Google should eschew legal advice, but gaining trust requires an additional sensibility at a prominent firm. There is no hiding a questionable decision, such as accepting restrictions in China—or withdrawing from there—or violating copyright law with YouTube.

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Let me rephrase. Gates rarely consulted anyone from outside Microsoft, even when he needed to hear from contrarians in advance. If Brin, Page, and Schmidt follow the example of Ballmer and Gates when making decisions, they probably also face difficulties getting the views of someone outside Google's inner circle, especially contrary views.

More to the point, contrarians are costly to ignore. If Google makes a misstep, it's the cartoonists and late-night television anchors—Stephen Colbert, Jon Stewart, David Letterman, and Jay Leno—who deliver the message. After that, no public relations cleanup squad can easily win back the trust of developers or wary users.

Do Google's executives and their spouses watch late-night television? I hope we never have to find out.

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