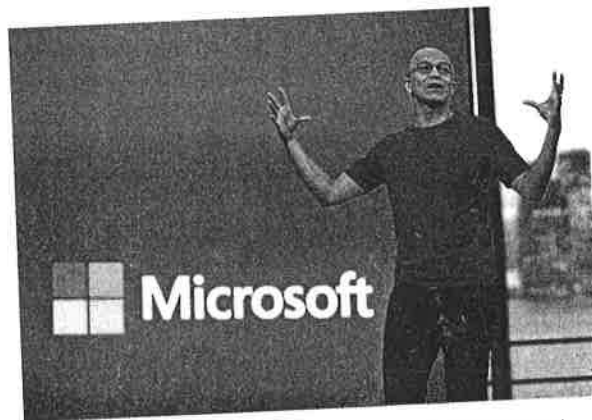


## Competing on Business Models: Google vs. Microsoft

**RIVALS OFTEN USE** different business models to compete with one another. Because of competitive dynamics and industry convergence, Google and Microsoft progressively move on to the other's turf. In many areas, Google and Microsoft are now direct competitors. In 2014, Microsoft had \$90 billion in revenues and Google \$66 billion. Although Google started as an online search and advertising company, it now offers software applications (Google Docs, word processing, spreadsheet, e-mail, interactive calendar, and presentation software) hosted on the cloud (Google Drive), and also operating systems (Chrome OS for the web and Android for mobile applications), among many other online products and services. In contrast, Microsoft began its life by offering an operating system (since 1985, called Windows), then moved into software applications with its Office Suite, and later into online search and advertising with Bing as well as gaming with Xbox One. Both also compete in mobile devices by offering smartphones. The stage is set for a clash of the technology titans.

In competing with each other, Google and Microsoft pursue very different business models, as detailed in Exhibit MC15.1. Google offers its applications software Google Docs and hosting service Google Drive for free to induce and retain as many users as possible for its search engine. Although Google's flagship search engine is free for the end user, Google makes money from sponsored links by advertisers. The advertisers pay for the placement of their ad on the results pages and each time a user clicks through an ad (which Google calls a "sponsored link"). Many billion mini-transactions add up to a substantial business. Exhibit MC15.2 shows how advertising revenues account for some 90 percent of Google's total revenues.

Google uses part of the profits earned from its lucrative online advertising business to subsidize Google Docs (see Exhibit MC15.1). Giving away products and services to induce widespread use allows

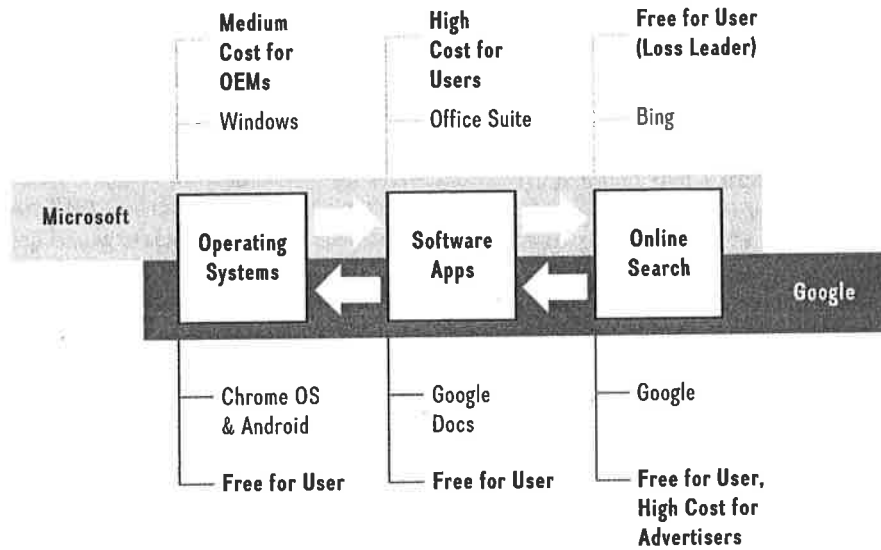


Sundar Pichai, Google CEO (top), and Satya Nadella, Microsoft CEO (Bottom)  
(top): © Pichi Chuang/Reuters/Corbis; (bottom): © AP Photo/Eric Risberg

Google to benefit from *network effects*—the increase in the value of a product or service as more people use it. Google can charge advertisers for highly targeted and effective ads, allowing it to subsidize other product offerings that compete directly with Microsoft.

Microsoft's business model, however, is almost the reverse of Google's (see the opposing arrows in Exhibit MC15.1). Initially, Microsoft focused on creating a large installed base of users for its PC operating system Windows. It holds some 90 percent market share in operating system software for personal computers worldwide, although the PC has become less important as mobile devices have become more important in

EXHIBIT MC15.1 / Competing Business Models: Google vs. Microsoft



Source: Depiction of publicly available data.

EXHIBIT MC15.2 /

Breakdown of Google's Revenues by Business Segment, (\$ millions) 2012–2014

Revenues	2014	2013	2012
Google Websites	\$45,085	\$37,422	\$31,221
Google Network Members' Websites	13,971	13,125	12,465
Total Advertising Revenues	59,056	50,547	43,686
Other Revenues	6,945	4,972	2,354
<b>Total Revenues</b>	<b>66,001</b>	<b>55,519</b>	<b>46,040</b>

Source: Google annual reports.

recent years. Roughly 60 percent of Microsoft's profits are tied to the Windows franchise. Moreover, PC users are locked into a Microsoft operating system that generally comes preloaded with the computer they purchase; they then want to buy applications that run seamlessly with the operating system. The obvious choice for most users is Microsoft's Office Suite containing Word, Excel, PowerPoint, Outlook, and Access. But they need to pay several hundred dollars for the latest standalone version. More recently, Microsoft offers "rental" of its

EXHIBIT MC15.3 /

Breakdown of Microsoft's Revenues by Business Segment, (\$ millions) 2013–2015

Revenues	12 months ending June 30		
	2015	2014	2013
Devices and Consumer Licensing	\$14,969	\$19,528	\$19,021
Computing and Gaming Hardware	10,183	9,093	6,461
Phone Hardware	7,524	1,982	0
Devices and Consumer Other	8,825	7,014	6,618
Commercial Licensing	41,039	42,085	39,686
Commercial Other	10,836	7,546	5,660
Corporate and Other	204	(415)	403
<b>Total Revenues</b>	<b>93,580</b>	<b>86,833</b>	<b>77,849</b>

Source: Microsoft annual reports.

cloud-based Office 365: It costs either \$99.99 a year, or \$9.99 a month. Exhibit MC15.3 details Microsoft's revenues by business segment.

Currently, Microsoft faces two immediate problems. The first is that people and businesses are buying fewer and fewer PCs (including both desktops and laptops) as personal and business computing move increasingly to mobile devices. The second is the increasing use of cloud-based rather than standalone PC-based computing. The demand for Microsoft's Office is driven by its installed base of Windows. The gross margin for the "classic" Office sitting on your computer is 90 percent, while that for the cloud-hosted Office 365 is only some 50 percent. To maximize the number of users that will upgrade from Windows 7 and the disappointing Windows 8 to Windows 10 launched in summer 2015, users of current versions of the operating system will get a free upgrade. (Microsoft did not offer a Windows 9 version.) On top of the aforementioned problems, Microsoft just wrote off almost \$8 billion of its \$9.4 billion ill-fated acquisition of smartphone maker Nokia, combined with cutting some 8,000 jobs.

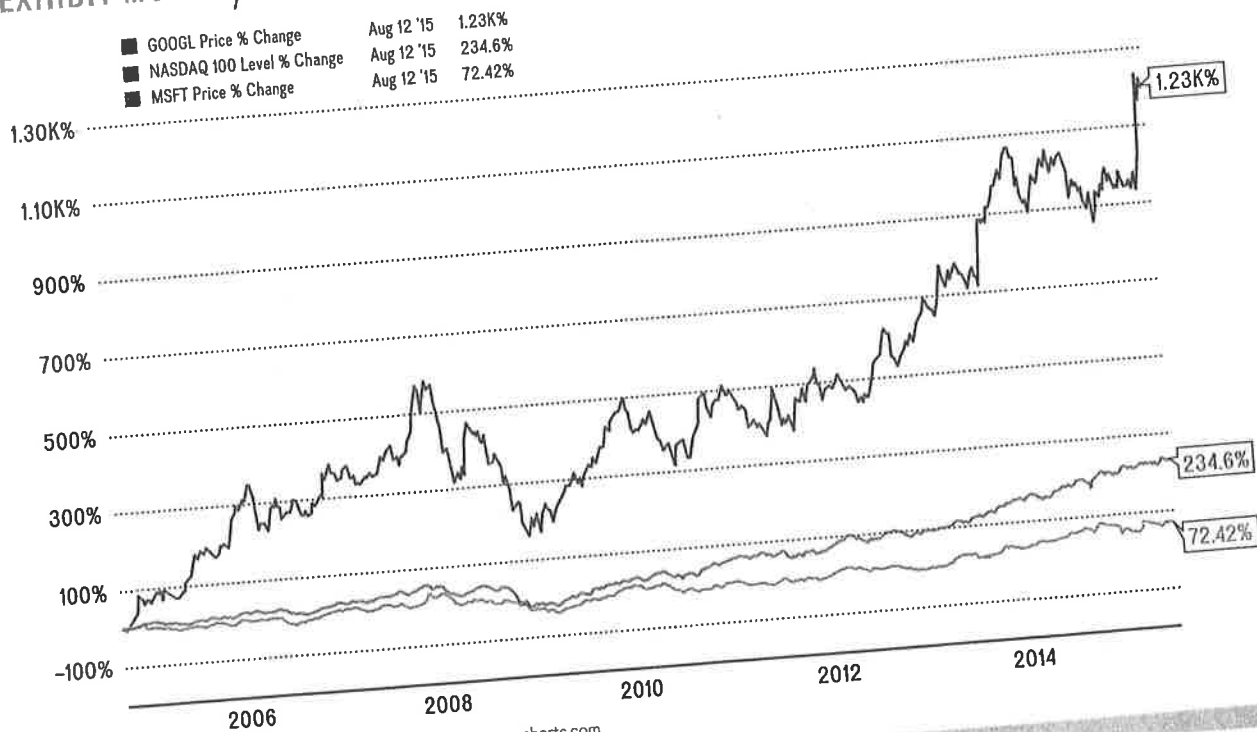
As shown in Exhibit MC15.1, Microsoft uses the profits from its application software business to subsidize its search engine Bing, which is—just like

Google's—a free product for the end user. Given Bing's relatively small market share, however, and the tremendous cost in developing the search engine, Microsoft, unlike Google, does not make any money from its online search offering; rather, it is a big money loser. The logic behind Bing is to provide a countervailing power to Google's dominant position in online search. The logic behind Google Docs is to create a threat to Microsoft's dominant position in application software.

The computing industry is undergoing a shift away from personal computers to mobile devices and cloud-based computing. Although Microsoft set the standard and dominates the industry with Windows, Google holds some 75 percent market share in mobile operating systems software with Android, while Microsoft's market share is less than 3 percent. These tactics create *multi-point competition* between the two technology firms. Taken together, Google and Microsoft compete with one another for market share in several different product categories through quite different business models.

As shown in MC15.4, the stock market has valued Google's business model much more highly. Since

EXHIBIT MC15.4 / Stock Performance Comparison of Google, Microsoft, and NASDAQ-100 index, 2004–2015



Source: Depiction of publicly available data using YCharts, www.ycharts.com.

its initial public offering in 2004, Google's stock has appreciated by more than 1,200 percent (or 12x), while Microsoft's stock has increased 72 percent over the same period. Also noteworthy is that Google has outperformed the tech-heavy NASDAQ-100 stock market index by a wide margin, while Microsoft has underperformed it. Google was able to gain and sustain a competitive advantage over Microsoft.

Under its new CEO, Satya Nadella, Microsoft is attempting to reinvent itself with a new "mobile first, cloud first" strategy. Microsoft is shifting quickly from being a Windows-only firm to a company offering diversified online services to its customers via the cloud, supported by its strong network of data centers. Nadella realizes that as more computing moves toward the cloud, Microsoft's tried-and-tested model of tightly integrating standalone software with hardware is no longer working. The absence of a sole focus on Windows in Microsoft's new mantra is evidence of where the new CEO sees the future of computing. Nadella is also looking to transform Microsoft's culture into one that is more entrepreneurial. Whether Nadella can engineer a turnaround at Microsoft, which is entering its fifth decade, remains to be seen.

### DISCUSSION QUESTIONS

1. How is a strategy different from a business model? How is it similar?
2. Why are Microsoft and Google becoming increasingly direct competitors?
3. Identify other examples of companies that were not competing in the past but are becoming competitors. Why are we seeing such a trend?
4. What recommendations would you give to Satya Nadella, CEO of Microsoft, to compete more effectively against Google? To engineer a turnaround at Microsoft?
5. What recommendations would you give to Sundar Pichai, CEO of Google, to compete more effectively against Microsoft? To continue to sustain its competitive advantage?

Sources: This MiniCase is based on: "Microsoft at middle age: Opening windows," *The Economist*, April 4, 2015; "Microsoft to cut 7,800 jobs on Nokia woes," *The Wall Street Journal*, July 8, 2015; "Google takes stricter approach to costs," *The Wall Street Journal*, July 13, 2015; "Google's share price hits all-time high," *The Wall Street Journal*, July 17, 2015; "The quest for a third mobile platform," *The Wall Street Journal*, May 6, 2013; Adner, R. (2012), *The Wide Lens: A New Strategy for Innovation* (New York: Portfolio); Levy, S. (2011), *In the Plex: How Google Thinks, Works, and Shapes Our Lives* (New York: Simon & Schuster); Anderson, C. (2009), *Free: The Future of a Radical Price* (New York: Hyperion); Gimeno, J. (1999), "Reciprocal threats in multimarket rivalry: Staking out 'spheres of influence' in the U.S. airline industry," *Strategic Management Journal* 20: 101-128; and Gimeno, J., and C.Y. Woo (1999), "Multimarket competition, economies of scale, and firm performance," *Academy of Management Journal* 42: 239-259; Chen, M.J. (1996), "Competitor analysis and interfirm rivalry: Toward a theoretical integration," *Academy of Management Review* 21:100-134; and various Google and Microsoft annual reports.