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GOOGLE IN CHINA[1]

Prahar Shah wrote this case under the supervision of Professor Deborah Compeau solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

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In less than 10 years of existence, Google had truly become a global success story. The internet giant had experienced unprecedented growth, wooed highly acclaimed talent from rival Microsoft and other competitors to join the company — including the "father of the internet," Vinton Cerf — and entered new markets across the world at a rapid pace. The company prided itself on its philosophy of "Do No Evil"— something that had served them well while operating in North America. However, in early 2006, they faced an ethical dilemma that put this philosophy to the test. According to some, Google's decision to censor search results in China left their motto "in smithereens."[2] The company faced intense international criticism and a backlash that made them question if their decision had been the right one.

THE BIRTH OF THE SEARCH ENGINE

Throughout the 1990s and into the new millennium, the world had seen the creation of a new "communications superhighway" which changed the way people accessed resources and shared knowledge. Perhaps the fastest-growing and farthest-reaching creation since the telephone, the Internet and the World Wide Web had forever changed the way people communicated and delivered information, products and services without any international boundaries. By 2005, almost 14.6 per cent of the world's population — close to one billion people — accessed it.[3]

During this time, as the web blossomed so did the need for a tool that enabled users to quickly and efficiently search the hundreds and thousands of isolated web-pages available online. Computer engineers and developers all over the world attempted to create a search engine that indexed these websites, and in 1990 the first tool to search the Internet, nicknamed "Archie," was introduced by McGill University student Alan Emtage. The program downloaded directory listings of all the files located on a File Transfer

[1] *This case has been written on the basis of published sources only. Consequently, the interpretation and perspectives presented in this case are not necessarily those of Google Inc. or any of its employees.*
[2] *"Google move 'black day' for China," http://news.bbc.co.uk/2/hi/technology/4647398.stm, accessed August 2006.*
[3] *Sergey Brin and Lawrence Page, "The Anatomy of a Large-Scale Hypertextual Web Search Engine," Stanford University. 1998, accessed August 2006.*

Protocol (FTP) site into a searchable database. Shortly thereafter, Mark McCahill and a team from the University of Minnesota launched "Gopher" — the first search engine that organized and enabled access to plain text files from across the web.[4]

As it became clear that this tool could quickly become a backbone of the Internet, investors and developers began simplifying, streamlining and marketing online search engines. Competition within the industry was intense, and with minimal barriers to entry and minimal capital required to launch a successful search engine, competitive advantage was not easily sustained. Between 1990 and 1997, dozens of Internet search engines were created, including Excite, Galaxy, Yahoo, WebCrawler, Lycos, Infoseek, AltaVista, Inktomi, Overture, AskJeeves and MSN Search. They each had their own algorithm of organizing, ranking and displaying search results and serviced a multitude of users. In 1998, two students at Stanford University — as part of a research project — launched Google, using a new and unique method of inbound links to rank sites.[5]

GOOGLE.COM

Co-founders Larry Page, president of products, and Sergey Brin, president of technology, brought Google to life in September 1998. By 2006, the company had grown to more than 5,000 employees worldwide, with a management team representing some of the most experienced technology professionals in the industry. Dr. Eric Schmidt joined Google as chairman and chief executive officer in 2001 while Vinton Cerf joined in 2005 as Google's vice-president and chief Internet evangelist.[6] While Page, Brin and Schmidt were largely responsible for the company's day-to-day operations and developing sustainable longer-term strategies, Cerf focused primarily on developing new ideas to launch products and find new sources of revenue apart from its search engine business. See Exhibits 1 and 2 for Google Inc.'s 2004 and 2005 financial statements.

Google's Business Model

Google's search engine used a pay-per-click (PPC) method to earn advertising revenue and provide companies with a vehicle to promote their products and services. According to wikipedia:

> Pay-per-click is often used to kick-start website visibility when a new website or page is promoted, and is basically a bidding system for advertisers who pay a fee to the promotion vehicle (search engine or directory) whenever a surfer clicks on their advertisement. The more the customer pays, the higher the bid, and the more highly placed — prominent — the advertisement appears. Advertisers specify the words that should trigger their ads and the maximum amount they are willing to pay per click. When a user searches Google's search engine on www.google.com, ads for relevant words are shown as "sponsored link" on the right side of the screen, and sometimes above the main search results.[7]

The technology Google used to accomplish this was called AdWords. AdWords used a combination of pricing and relevance to place ads. If an ad was clicked through frequently, it would be displayed more prominently. An ad which fell below a threshold clickthrough rate would be deemed not relevant, and thus would be removed from that particular search. The key benefit of Google's approach was its targeting of

[4] *Ibid*
[5] *http://en.wikipedia.org/wiki/Search_engine, accessed August 2006.*
[6] *"Vint Cerf: Google's New Idea Man," http://www.wired.com/news/business/0,1367,68808,00.html, accessed August 2006.*
[7] *Ad Words, http://en.wikipedia.org/wiki/AdWords, accessed August 2006.*

ads. Ads were served in the places where they would be of most relevance to users, which had the dual effect of minimizing user frustration with advertising and optimizing clickthrough rates for advertisers.

Google's AdSense technology was created based on the success of AdWords. Google recognized a much more vast marketing opportunity and released a system for webmasters and site owners to publish Google advertisements on their websites. Essentially, a website owner could choose to have Google ads served up on its pages using the same process as Google used for its own sites. When users clicked through these ads, Google and the referring site shared the revenue.

Other Google Products

The AdWords promotional engine had catapulted the company's commercial worth into the multi-billion dollar league and funded development of spin-off search technology such as their desktop search. It had also led to further marketing opportunities for businesses as the search engine giant expanded into such areas as email and map marketing. In 2004, Google launched its first beta version of Google Desktop, a free downloadable application for locating one's personal computer files (including email, work files, web history and instant message chats) using Google-quality search. It also introduced Gmail in 2004, an email application service that received world-wide publicity during its launch. Gmail offered a powerful built-in search function, messages grouped by subject line into conversations and enough free storage to hold years' worth of messages.[8] Using AdSense technology, Gmail was designed to deliver relevant ads adjacent to mail messages, giving recipients a way to act on this information. By early 2006, Google offered a range of products (see Exhibit 3).

GOOGLE IN CHINA

On July 19, 2005, Google announced the opening of a product research and development center in China, to be led by renowned computer scientist and industry pioneer Dr. Kai-Fu Lee. Dr. Lee served as the company's first president and hoped to exploit China's thriving economy, excellent universities and multitude of talent to help Google develop new products and expand its international business operations. "The opening of a research and development (R&D) center in China will strengthen Google's efforts in delivering the best search experience to our users and partners worldwide," said Alan Eustace, vice-president of engineering at Google. "Under the leadership of Dr. Lee, with his proven track record of innovation and his passion for technology and research, the Google China R&D center will enable us to develop more innovative products and technologies for millions of users in China and around the world."[9]

One of the company's goals was to revitalize the Google website and offer a search engine catered specifically to the Chinese population. As Andrew McLaughlin, senior policy counsel for Google, explained in January of 2006:

> Google users in China today struggle with a service that, to be blunt, isn't very good. Google.com appears to be down around 10 per cent of the time. Even when users can reach it, the website is slow, and sometimes produces results that when clicked on, stall out the user's browser. Our Google News service is never available; Google Images is accessible only half the time. At Google we work hard to create a great experience for our users, and the level of service we've been able to provide in China is not something we're

[8] *http://www.google.com/corporate/history.html, accessed August 2006.*
[9] *http://news.bbc.co.uk/2/hi/technology/4647398.stm, accessed August 2006.*

> proud of. This problem could only be resolved by creating a local presence, and this week we did so, by launching our website for the People's Republic of China.[10]

Google.cn

The launch of the new website and search engine, Google.cn, enabled the company to create a greater presence in the growing Chinese market and offered a customized region-specific tool with features (such as Chinese-language character inputs) that made the Chinese user experience much simpler. It also sparked the greatest controversy in the company's history. In order to gain the Chinese government's approval and acceptance, it agreed to self-censor and purge any search results of which the government disapproved. Otherwise, the new website risked being blocked in the same way the previous Google.com was blocked by the Chinese authorities. Google conceded. Type in "Falun Gong" or "Tiananmen Square" on Google.com and thousands of search results will appear; however, when typed into Google.cn all the links will have disappeared. Google will have censored them completely. Google's decision did not go over well in the United States. In February 2006, company executives were called into Congressional hearings and compared to Nazi collaborators. The company's stock fell, and protesters waved placards outside the company's headquarters in Mountain View, California.

Google's Defense

Google defended its position, insisting that while the decision was a difficult one, it served the greater advantage to the greatest number of people.

> We know that many people are upset about this decision, and frankly, we understand their point of view. This wasn't an easy choice, but in the end, we believe the course of action we've chosen will prove to be the right one.
>
> Launching a Google domain that restricts information in any way isn't a step we took lightly. For several years, we've debated whether entering the Chinese market at this point in history could be consistent with our mission and values. Our executives have spent a lot of time in recent months talking with many people, ranging from those who applaud the Chinese government for its embrace of a market economy and its lifting of 400 million people out of poverty to those who disagree with many of the Chinese government's policies, but who wish the best for China and its people. We ultimately reached our decision by asking ourselves which course would most effectively further Google's mission to organize the world's information and make it universally useful and accessible. Or, put simply: how can we provide the greatest access to information to the greatest number of people?
>
> Filtering our search results clearly compromises our mission. Failing to offer Google search at all to a fifth of the world's population, however, does so far more severely. Whether our critics agree with our decision or not, due to the severe quality problems faced by users trying to access Google.com from within China, this is precisely the choice we believe we faced. By launching Google.cn and making a major ongoing investment in people and infrastructure within China, we intend to change that.

[10] *http://googleblog.blogspot.com/2006/01/google-in-china.html, accessed August 2006.*

> No, we're not going to offer some Google products, such as Gmail or Blogger, on Google.cn until we're comfortable that we can do so in a manner that respects our users' interests in the privacy of their personal communications. And yes, Chinese regulations will require us to remove some sensitive information from our search results. When we do so, we'll disclose this to users, just as we already do in those rare instances where we alter results in order to comply with local laws in France, Germany and the U.S.
>
> Obviously, the situation in China is far different than it is in those other countries; while China has made great strides in the past decades, it remains in many ways closed. We aren't happy about what we had to do this week, and we hope that over time everyone in the world will come to enjoy full access to information. But how is that full access most likely to be achieved? We are convinced that the Internet, and its continued development through the efforts of companies like Google, will effectively contribute to openness and prosperity in the world. Our continued engagement with China is the best (perhaps only) way for Google to help bring the tremendous benefits of universal information access to all our users there.
>
> We're in this for the long haul. In the years to come, we'll be making significant and growing investments in China. Our launch of Google.cn, though filtered, is a necessary first step toward achieving a productive presence in a rapidly changing country that will be one of the world's most important and dynamic for decades to come. To some people, a hard compromise may not feel as satisfying as a withdrawal on principle, but we believe it's the best way to work toward the results we all desire.[11]

Dr. Lee, a Chinese citizen, also defended Google's decision to censor the search results for Google.cn, stating that the Chinese students he meets and employs "do not hunger for democracy." He claims that,

> People are actually quite free to talk about the subject (of democracy and human rights in China). I don't think they care that much. I think people would say: "Hey, U.S. democracy, that's a good form of government. Chinese government, good and stable, that's a good form of government. Whatever, as long as I get to go to my favorite web site, see my friends, live happily." Certainly, the idea of personal expression, of speaking out publicly, had become vastly more popular among young Chinese as the Internet had grown and as blogging and online chat had become widespread. But I don't think of this as a political statement at all. I think it's more people finding that they can express themselves and be heard, and they love to keep doing that.[12]

Google's management team, although publicly supporting their decision, were disturbed nonetheless by the growing anti-censorship campaign targeting Google. Led by groups such as the "Students for a Free Tibet" and Amnesty International, mass public rallies and demonstrations were staged outside Google offices, more than 50,000 letters were sent to Google CEO Eric Schmidt demanding the removal of search filters, and the company received intense negative publicity in the media.[13]

> The web is a great tool for sharing ideas and freedom of expression. However, efforts to try and control the Internet are growing. People are persecuted and imprisoned simply for

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[11] *http://googleblog.blogspot.com/2006/01/google-in-china.html, accessed August 2006.*
[12] *Google – New York Times, http://www.nytimes.com/2006/04/23/magazine/23google.html?ei=5090&en=972002761056363f&ex=1303444800.&adxnnl=1&adxnnlx=1156925160-KvHRNCAA/InAFCXMUlz/+g, accessed August 2006.*
[13] *http://politics.slashdot.org/politics/06/02/20/0238233.shtml, accessed August 2006.*

> criticizing their government, calling for democracy and greater press freedom, or exposing human rights abuses, online.
>
> But Internet repression is not just about governments. IT companies have helped build the systems that enable surveillance and censorship to take place. Yahoo! has supplied email users' private data to the Chinese authorities, helping to facilitate cases of wrongful imprisonment. Microsoft and Google have both complied with government demands to actively censor Chinese users of their services.
>
> Freedom of expression is a fundamental human right. It is one of the most precious of all rights. We should fight to protect it.[14]

As the debate continued, Google executives realized that statements such as "We actually did an evil scale and decided that not to serve at all was worse evil"[15] made by Schmidt were not resonating with the public. It wondered what the immediate and longer-term implications of their action would be, and whether they really were staying true to their motto "Don't Be Evil."

[14] *http://irrepressible.info/about, accessed August 2006.*
[15] *http://www.rfa.org/english/news/technology/2006/02/01/china_google, accessed August 2006.*

Exhibit 1

Google Inc.

CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share amounts)

	Year Ended December 31,		
	2003	2004	2005
Revenues	$1,465,934	$3,189,223	$6,138,560
Costs and expenses:			
Cost of revenues	625,854	1,457,653	2,571,509
Research and development	91,228	225,632	483,978
Sales and marketing	120,328	246,300	439,741
General and administrative	56,699	139,700	335,345
Stock-based compensation (1)	229,361	278,746	200,709
Contribution to Google Foundation	—	—	90,000
Non-recurring portion of settlement of disputes with Yahoo	—	201,000	—
Total costs and expenses	1,123,470	2,549,031	4,121,282
Income from operations	342,464	640,192	2,017,278
Interest income and other, net	4,190	10,042	124,399
Income before income taxes	346,654	650,234	2,141,677
Provision for income taxes	241,006	251,115	676,280
Net income	$ 105,648	$ 399,119	$1,465,397
Net income per share:			
Basic	$ 0.77	$ 2.07	$ 5.31
Diluted	$ 0.41	$ 1.46	$ 5.02
Number of shares used in per share calculations:			
Basic	137,697	193,176	275,844
Diluted	256,638	272,781	291,874

(1) Stock-based compensation is allocated as follows (see Note 1):

	Year Ended December 31,		
	2003	2004	2005
Cost of revenues	$ 8,557	$ 11,314	$ 5,579
Research and development	138,377	169,532	115,532
Sales and marketing	44,607	49,449	28,411
General and administrative	37,820	48,451	51,187
	$229,361	$278,746	$200,709

Source: Google Inc. Annual Report 2005

Exhibit 2

Google Inc.

CONSOLIDATED BALANCE SHEETS
(In thousands, except par value)

	December 31, 2004	December 31, 2005
Assets		
Current assets:		
Cash and cash equivalents	$ 426,873	$ 3,877,174
Marketable securities	1,705,424	4,157,073
Accounts receivable, net of allowances of $3,962 and $14,852	311,836	687,976
Income taxes receivable	70,509	—
Deferred income taxes, net	19,463	49,341
Prepaid revenue share, expenses and other assets	159,360	229,507
Total current assets	2,693,465	9,001,071
Property and equipment, net	378,916	961,749
Goodwill	122,818	194,900
Intangible assets, net	71,069	82,783
Deferred income taxes, net, non-current	11,590	—
Prepaid revenue share, expenses and other assets, non-current	35,493	31,310
Total assets	$3,313,351	$10,271,813
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 32,672	$ 115,575
Accrued compensation and benefits	82,631	198,788
Accrued expenses and other current liabilities	64,111	114,377
Accrued revenue share	122,544	215,771
Deferred revenue	36,508	73,099
Income taxes payable	—	27,774
Current portion of equipment leases	1,902	—
Total current liabilities	340,368	745,384
Deferred revenue, long-term	7,443	10,468
Liability for stock options exercised early, long-term	5,982	2,083
Deferred income taxes, net	—	35,419
Other long-term liabilities	30,502	59,502
Commitments and contingencies		
Stockholders' equity:		
Class A and Class B common stock, $0.001 par value: 9,000,000 shares authorized at December 31, 2004 and December 31, 2005, 266,917, and 293,027 shares issued and outstanding, excluding 7,605, and 3,303 shares subject to repurchase (see Note 10) at December 31, 2004 and December 31, 2005	267	293
Additional paid-in capital	2,582,352	7,477,792
Deferred stock-based compensation	(249,470)	(119,015)
Accumulated other comprehensive income	5,436	4,019
Retained earnings	590,471	2,055,868
Total stockholders' equity	2,929,056	9,418,957
Total liabilities and stockholders' equity	$3,313,351	$10,271,813

Source: Google Inc. Annual Report 2005

Exhibit 3

SELECTED GOOGLE PRODUCTS

Alerts
- a service which provides emails of news and search results for a particular topic area

Answers
- a service where users can post queries for which they are willing to pay others to do research; the user sets the price they are willing to pay

Blogs
- Google's own blog site is "blogger"
- They also provide a blog search utility

Book & catalog search
- allows users to search the full text of books and to search and browse online catalogs for mail order businesses

Images and Video
- google's sites for searching pictures on the web and videos

Google Earth & Google Maps
- global maps and driving directions
- also includes the capability to search for various businesses etc. within a map and display the results graphically

Google Scholar
- allows users to search academic papers

Google Groups
- a site to allow users to create mailing lists and discussion groups

Google Desktop Search
- uses Google's search technology to track information on the user's PC

GMail
- Google's mail application

For a complete listing of Google products and services, see http://www.google.ca/intl/en/options/index.html