

Semi-Organic Growth

+ website

Tactics and Strategies Behind **Google's** Success

George T. Geis

WILEY

Table of Contents

[Title Page](#)

[Copyright](#)

[Dedication](#)

[Preface](#)

[Acknowledgments](#)

[Chapter 1: M&A Success and Failure](#)

[M&A Activities](#)

[Evaluating Performance](#)

[Reasons for M&A Failure](#)

[Semi-Organic Growth: Beginnings](#)

[Notes](#)

[Chapter 2: Imprinting Semi-Organic Growth](#)

[Applied Semantics Deal](#)

[What Distinguishes Semi-Organic Growth](#)

[Semi-Organic Acceleration](#)

[Notes](#)

[Chapter 3: Google versus Apple: M&A Paths Diverge, then Converge](#)

[Historical Perspective in M&A Activity](#)

[Dyadic Cascading](#)

[M&A Strategy Changes](#)

[Notes](#)

[Chapter 4: M&A Market Modeling](#)

[An MIT Market Model for Google](#)

[Key Steps in Market Modeling](#)

[Using Marketing Modeling](#)

[Broad Appeal of Market Modeling](#)

[Notes](#)

[Chapter 5: Google Media Deals](#)

[Media Deal Categories](#)

[Google's Media Schizophrenia](#)

[Notes](#)

[Chapter 6: Google Internet Deals](#)

[Internet Services/Software Market Model](#)

[Post-Closure Deal Analysis](#)

[Notes](#)

[Chapter 7: Google Technology Platform Deals](#)

[Smartphones](#)

[The Smart Home](#)

[Robotics and Artificial Intelligence](#)

[Technology Platform Scope and Endgame](#)

[Notes](#)

[Chapter 8: Failed or Shuttered Deals](#)

[Success Metrics](#)

[Goodwill Write-Downs and Deal Failure](#)

[Failure and the Spirit of Experimentation](#)

[Some Shuttered Transactions](#)

[An Acquisition and Rapid Exit](#)

[Overall Assessment of the Motorola Deal](#)

[Notes](#)

[Chapter 9: Disclosure versus Secrecy](#)

[SEC Guidelines for Disclosure](#)

[Company Secrecy/Disclosure Motives](#)

[Disclosing Value and Terms](#)

[Materiality Revisited](#)

[Notes](#)

[Chapter 10: Forms of Consideration](#)

[Stock versus Cash as Consideration](#)

[Motivations for Using Cash or Stock](#)

[Consideration Beyond the Close](#)

[Notes](#)

[Chapter 11: Contingent Consideration](#)

[The Earn-out](#)

[Retention Bonuses](#)

[Moving Away from Earn-outs](#)

[Notes](#)

[Chapter 12: Dimensions of M&A Integration and Semi-Organic Growth](#)

[Typologies for M&A Integration](#)

[Google's Integration Styles](#)

[Microanalysis Necessary](#)

[Notes](#)

[Chapter 13: Acqui-Hires Enhancing Google Offerings](#)

[Why Products to Reach Customers Should Drive M&A Activity](#)

[Forms of Acqui-Hiring](#)

[Google M&A Alumni](#)

[Notes](#)

[Chapter 14: Competitive Deal Constellations and Ecosystem Synergy](#)

[Competitive Constellations: Google versus Amazon](#)

[Ecosystem Synergy](#)

[Ecosystem Synergy and Semi-Organic Growth](#)

[Notes](#)

[References](#)

[About the Website](#)

[About the Author](#)

[Index](#)

[End User License Agreement](#)

List of Illustrations

Chapter 1: M&A Success and Failure

[Figure 1.1 Google acquires Applied Semantics](#)

Chapter 2: Imprinting Semi-Organic Growth

[Figure 2.1 DeepMind and Robotics Acquisitions](#)

Chapter 3: Google versus Apple: M&A Paths Diverge, then Converge

[Figure 3.1 Google's acquisitions in 2010](#)

[Figure 3.2 Apple's acquisitions in 2010](#)

[Figure 3.3 Apple/Google dyadic M&A cascading in 2010](#)

[Figure 3.4 Select Apple acquisition in 2013](#)

Chapter 4: M&A Market Modeling

[Figure 4.1 High-level category tree](#)

[Figure 4.2 Using a category tree to display acquisitions in social networking](#)

[Figure 4.3 Deals using stock as consideration](#)

[Figure 4.4 Apple's M&A activity in mapping](#)

[Figure 4.5 Acquisitions by Apple, Facebook, or Google in Israel](#)

[Figure 4.6 Google deals in response to key competitors](#)

[Figure 4.7 Description and classification of sample target](#)

[Figure 4.8 Apple/Google mapping-related acquisitions](#)

Chapter 5: Google Media Deals

[Figure 5.1 Media \(overview\) + Advertising segmentation](#)

[Figure 5.2 YouTube and some YouTube-related acquisitions](#)

[Figure 5.3 DoubleClick and DoubleClick-related M&A deals](#)

[Figure 5.4 Advertising deals in additional formats](#)

[Figure 5.5 Sample media content-related acquisitions](#)

Chapter 6: Google Internet Deals

[Figure 6.1 Internet services/software market model](#)

[Figure 6.2 Blogging-related M&A activity](#)

[Figure 6.3 Google's M&A activity in Internet retailing](#)

[Figure 6.4 Google's M&A activity in mobile apps](#)

[Figure 6.5 Select Google M&A's in social networking](#)

Chapter 7: Google Technology Platform Deals

[Figure 7.1 Technology platform market model](#)

[Figure 7.2 Android and related acquisitions](#)

[Figure 7.3 Google's smart home-related acquisitions](#)

[Figure 7.4 Robotics, AI, and driverless car-related acquisitions](#)

Chapter 8: Failed or Shuttered Deals

[Figure 8.1 Some Google acquisition failures](#)

[Figure 8.2 Google buys Motorola Mobility](#)

Chapter 9: Disclosure versus Secrecy

[Figure 9.1 Acquisitions for which Google has disclosed purchase price/terms](#)

[Figure 9.2 Acquisitions for which Apple has disclosed purchase price/terms](#)

Chapter 10: Forms of Consideration

[Figure 10.1 Google's use of stock in acquisitions](#)

[Figure 10.2 Apple's use of stock in acquisitions](#)

[Figure 10.3 Facebook's use of stock in prominent acquisitions](#)

Chapter 11: Contingent Consideration

[Figure 11.1 Sample deals involving earn-outs](#)

[Figure 11.2 Sample deals involving retention bonuses](#)

Chapter 12: Dimensions of M&A Integration and Semi-Organic Growth

[Figure 12.1 Four possible integration strategies](#)

[Figure 12.2 Examples of symbiotic integration during 2014](#)

[Figure 12.3 Starting point and movement with an integration](#)

Chapter 13: Acqui-Hires Enhancing Google Offerings

[Figure 13.1 Mapping segments against products](#)

[Figure 13.2 Google product and service category tree](#)

[Figure 13.3 Google acquisitions in support of cloud services](#)

[Figure 13.4 Acquisitions in support of Google X](#)

[Figure 13.5 Acquisitions in support of Google Play](#)

[Figure 13.6 Form I *acqui-Hires*](#)

[Figure 13.7 Form II *Acqui-hires*](#)

[Figure 13.8 Form III *ACQUI-HIRES*](#)

[Figure 13.9 Form IV *acqui-HIRES*](#)

[Figure 13.10 Google M&A alumni](#)

Chapter 14: Competitive Deal Constellations and Ecosystem Synergy

[Figure 14.1 Amazon M&A positioning constellation against Google](#)

[Figure 14.2 Google M&A positioning constellation against Amazon](#)

[Figure 14.3 M&A ecosystem synergy in advertising](#)

List of Tables

Chapter 1: M&A Success and Failure

[Table 1.1 Deal Activities](#)

Chapter 3: Google versus Apple: M&A Paths Diverge, then Converge

[Table 3.1 Documented M&A Transactions for Apple and Google \(2001-2013\)](#)

Semi-Organic Growth

***Tactics and Strategies behind
Google's Success***

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To George S. Geis, Terri L. Geis, and Anne L. Geis—three ongoing sources of semi-organic growth

Preface

Around 1995, I became intrigued with developing a methodology and related visualization technology to systematically analyze company acquisitions, minority equity investments, alliances, and other corporate development activities. At the time, I was concentrating on companies that included Microsoft, Intel, and Cisco.

Then along came Google. Starting with the early days of Google, acquisitions appeared to play a particularly important role in the strategic unfolding of this iconic company. Google was becoming an experimental lab, not only for products and services but also in utilizing M&A to further its purposes.

I wanted to understand in depth why Google was engaging in what was an unprecedented level and type of M&A activity.

As of 2015, Google had acquired some 200 companies. But there's much more to the story than numbers. The major thesis of this book is that early in the company's existence, a playbook for M&A activity (which I dub *semi-organic growth*) was established, and that this pattern became a core element of Google's success.

Semi-Organic Growth presents a unique analysis of Google's distinctive expertise in the area of mergers and acquisitions. The book provides insights derived from the many Google acquisitions completed over the company's brief history. While organizational revenue growth has traditionally been characterized as organic (internally generated) or inorganic (from acquisition), this book features Google's use of a blended, semi-organic strategy to accelerate product and service revenue.

Google's extensive use of M&A during its period of rapid growth has been in sharp contrast to rivals such as Apple. In addition, Google's overall success in M&A further contrasts with the failures of many other companies in this area of corporate business development. All readers will gain distinctive insights from the M&A expertise and practices of this iconic company.

Semi-Organic Growth illustrates how Google's M&A moves can be explained through a unique sector/subsector classification scheme that dynamically maps the media, Internet, and technology platform markets. Market modeling dynamics are illustrated with some 50 infographics to help understand important categorical M&A dimensions and visualize deal constellations. These market-modeling techniques are applicable to any company.

The book examines Google's practices in disclosing M&A deal structure (such as valuation and form of consideration) and in using contingent consideration in the form of earn-outs and stay bonuses.

But perhaps most importantly, we examine how Google has integrated its acquisitions, thereby accelerating the growth of its array of products and services.

[Chapter 1](#) describes the challenges of building a successful M&A program in domains that include strategy, economic valuation, organizational design, and deal dynamics. This chapter discusses each of these activities, emphasizing approaches linked to positive outcomes.

[Chapter 2](#) features Google's acquisition of Applied Semantics, a watershed transaction in that it imprinted on Google a methodology for revenue acceleration through semi-organic growth. This chapter provides a history of the Applied Semantics deal and how the acquisition led to the

creation of AdSense, which grew into a highly significant service within Google.

[Chapter 3](#) contrasts Apple and Google, two companies that have had dramatically different corporate philosophies with respect to the role of M&A in strategy. Until 2012, Apple engaged in M&A only sparingly, believing that innovation should essentially originate from within. In contrast, Google was acquiring companies at a rapid clip and using technology and talent from the purchases as a major part of its innovation efforts.

[Chapter 4](#) introduces marketing modeling, which involves connecting knowledge chunks comprised of three elements: market segments, companies, and deals. The chapter illustrates market modeling by developing a sample model for Google in the MIT (media, Internet, and technology infrastructure) spaces.

[Chapter 5](#) highlights advertising as Google's core business. The chapter develops a market model for media and then analyzes Google's acquisitions in sectors such as online content and advertising.

[Chapter 6](#) analyzes numerous acquisitions that Google has made to strengthen its position in Internet search, as well as accelerate its move into a range of additional Internet products and services. This chapter develops a market model to explain Google's Internet-related purchases.

[Chapter 7](#) explains how acquisitions have played a key role in extending Google beyond its core search/advertising business to an ever-expanding technology platform for new products and services. The chapter explores acquisitions that relate to subsectors of this platform, including smartphone, smart home, robotics, and artificial intelligence.

[Chapter 8](#) illustrates that although Google is regarded as having developed the most successful technology M&A program in history, certainly not all of its deals have done well. This chapter examines some of Google's abortive transactions and suggests reasons for these failures. We also provide an analysis of gains and losses associated with the purchase of Motorola Mobility.

[Chapter 9](#) examines when a publicly traded company such as Google announces an acquisition. When must the company disclose deal valuation and other key terms? This chapter focuses on the M&A disclosure practices of Google and Apple and explores possible motives for deal disclosure or secrecy.

[Chapter 10](#) describes how an acquirer can pay for a target using accumulated free cash flow, using cash raised from a new debt or stock offering, exchanging shares of its stock for shares of the target, or combining these forms of payment. How often has Google used stock in purchasing a company? What are the motives for using stock as opposed to cash? How does Google's consideration choices in its M&A transactions compare to those of other major technology companies such as Apple or Facebook?

[Chapter 11](#) highlights that for some M&A transactions, not all consideration is paid out by an acquirer at the close of the transaction. Earn-out consideration contingent on the target meeting performance metrics can be used. Or retention bonus consideration (in cash or in stock) can be provided to motivate target employees to stay on with the acquirer for a period of time. We'll explore how these forms of contingent consideration have been used by Google and other leading technology and media companies.

[Chapter 12](#) stresses that successfully integrating an acquisition is vital if M&A value is to be captured. This chapter explores some classic strategic dimensions that

provide a high-level framework for M&A integration. We examine how Google's semi-organic form of acquisitions fits into this scheme and how Google has learned to be more effective in executing a challenging integration strategy. We also describe some notable Google failures in M&A integration.

[Chapter 13](#) highlights that a substantial amount of M&A activity is undertaken to support specific products or services that can reach customers. This chapter uses Google as an example to illustrate a market model that maps a company's products and services and how a particular acquisition might enhance these offerings. We also identify four major types of acqui-hires, talent/technology purchases designed to accelerate sales of both existing and new products and services. Finally, we explore career moves by a number of Google M&A alumni, company founders who sold organizations to Google, worked to add value to a Google offering, and subsequently made significant career changes.

[Chapter 14](#) examines how competitive contests such as the Amazon/Google struggle for market control in e-commerce and advertising can be understood by developing M&A deal constellations. We next illustrate the concept of ecosystem synergy and demonstrate how this type of synergy can strengthen competitive positioning and add value to a company. We show how a number of Google's acquisitions have achieved this higher order of synergy.

I hope you enjoy and benefit from this journey through the land of Google's semi-organic M&A!

Watch the Videos

This book is accompanied by a companion website that includes a short introductory video, together with 14 additional online videos, each about 10 minutes in length. The content of each video is designed to add to your understanding of key concepts found in a given chapter. You'll find these videos referenced at the end of each chapter.

For the URL and access code for your online videos, please refer to the instructions at the end of this book.

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I have greatly benefited from the insights and support of many colleagues, friends and students in writing this book.

Debbie Foster, Olaf Westheider, and Steven O'Toole provided inspiration and outstanding technical support in the development of the concept of market modeling.

Sean Carr, Executive Director of the Batten Institute at the Darden School of Business, University of Virginia, suggested that I give a talk while on campus as a visiting professor. The talk, which involved Google's acquisition strategy, was uploaded to YouTube and subsequently viewed by Bill Falloon, Executive Editor of Finance and Investment at Wiley. Bill encouraged me to write a book expanding upon the talk. Thus the origin of *Semi-Organic Growth*.

My special thanks to Bill Falloon and Meg Freeborn, Development Editor at Wiley, for their encouragement throughout this project. I also appreciate the assistance of the entire Wiley team for their support in completing this effort.

I regard the M&A writings of Bob Bruner, Dean of the Darden School, as foundational to a number of ideas that appear in this book. I've benefited from my ongoing conversations with Bob.

I am indebted to many students and research collaborators for insight and assistance. These include James Biskey, Debadutta Bhattacharyya, Neelima Clark, Tom Crow, Zubin Davar, John Dearing, Reggie Hall, Kevin Hopkins, Ahreum Hong, Kyle Jansen, Joey Lei, K. Burns McNamee, Alisa Sommer, Emily Scadden, Renu Senjalia, Joshua Schachter,

Jacqueline Sutro, and Miao Wang. Please forgive any omissions.

I am not writing this book as a Google insider. However, I have benefited from interviews with numerous present and past Google employees, conducted as reality checks. I am extremely grateful for the insights provided.

I deeply appreciate the entire UCLA Anderson environment for decades of support. Special thanks to Al Osborne, Elaine Hagan, Martin Lieberman, and George Ingersoll.

Finally, I'd like to thank my wife, Penny, who graciously postponed getting our new Springer Spaniel until the first draft of this book was completed. Now it's time for many more long walks along the Cambria ocean bluffs.

Chapter 1

M&A Success and Failure

Konrad Lorenz's classic experiment with graylag geese captures the attention of many college freshman enrolled in an introductory psychology class. Lorenz found that geese would *imprint* on the first movable object within a *critical period* occurring 13 to 16 hours after hatching. It didn't matter whether the "parent" object was Lorenz's boots or a box placed on a toy train moving around a circular track.

Imprinting involves phase-sensitive learning whereby an animal or person establishes a pattern of attachment to another animate or inanimate object. Business ventures can also experience imprinting events during the early stages of development.

The notion that a corporation's early experiences can have lasting impact on future development has long been noted.¹ A firm commonly experiences an inertial impulse very early in its history that persists for a significant duration.² This initial organizational experience can involve corporate development activity. For example, Milanov and Fernhaber presented evidence that the initial alliance experiences of a venture affect future alliance formation patterns.³

Similarly, the acquisition of Applied Semantics early in Google's history (before going public in 2004) imprinted upon the company not only a proclivity to do mergers and acquisitions (M&A), but also to favor a certain style of *M&A activity*. Indeed, over its relatively brief corporate history, Google has acquired some 200 companies. In addition, Google has enjoyed an unusual degree of achievement in its dominant style of M&A activity, in 2012 asserting success

in two-thirds of purchases,⁴ significantly higher than commonly cited acquisition statistics.

However, before we examine strategies and tactics that Google has employed in its transactions, let's examine how M&A performance has traditionally been measured, as well as some of the most common reasons for M&A failure and success.

M&A Activities

Developing a successful M&A program is a major challenge for any organization, arguably significantly more difficult than operational functions. Nevertheless, the pace and volume at which technology firms have been buying is staggering. For example, according to Thomson Reuters, the total spent on technology M&A worldwide during the first quarter of 2014 was \$65.2 billion. This represented the largest dollar volume for any equivalent period since 2000.

Consider the breadth of activities that must be considered in doing a deal ([Table 1.1](#)).

Table 1.1 Deal Activities

Strategy	Economics	Organization	Deal Dynamics
Responding to opportunity or threat	Doing valuation/NPV analysis	Establishing best practices for integration	Designing the deal, including tax strategy
Determining attractiveness of industry position	Determining synergies	Building acquisition teams	Engaging in negotiation and bidding
Establishing strategic deal system	Estimating revenues, costs and cash flows	Merging corporate cultures, as necessary	Handling legal concerns
Determining optimal type of transaction	Determining effects of deal financing		Engaging in negotiation and bidding

Strategy

First of all, a compelling strategic rationale for a transaction must be developed. This may involve responding to an opportunity or shock in a market. Or it may be based on a creative vision whereby the company desires to establish new positioning in a market or even attempts to create a new market. For example, Google's cluster of eight robotics acquisitions in 2013 clearly signaled that the company saw significant market opportunity in areas that could range from robotic manufacturing to android-assisted home health care. Although to be successful such strategic thinking necessarily must involve senior executives, a company such as Google also has strategy leads engaging in analysis to

support the growth of each major business division, including areas such as search, social, mobile, and YouTube.

Strategy also involves establishing a systematic approach to M&A activity. Organizations have established systems for virtually every activity of the firm—from HR management to supply chain management—but typically lag in thinking systematically about M&A and other corporate business development activities. There are some notable exceptions, such as GE Power Systems (later renamed GE Energy), as documented by Robert Bruner.⁵ We'll later examine Google's systematic approach to M&A.

In addition, deal strategy involves determining the optimal type of transaction. This includes knowing when not to acquire a company, but instead designing an alternative form of partnership relationship. For example, in 2003, as Apple was in the process of launching its iTunes platform, the *Los Angeles Times* reported that Apple was considering the purchase of Universal Music (a global player in recorded music) owned at the time by Vivendi.⁶ Apple correctly decided against the purchase. Doing so, among other things, would have created supply-channel conflict with other music providers that it needed to launch iTunes into a platform with a broad music library. Instead, Apple licensed music from Universal (and other music companies) in order to build an extensive collection for users to download using iTunes. (In 2014, Apple was facing different challenges as it attempted to maintain a leadership position in digital music and, as we'll see in [Chapter 3](#), decided to engage in a major M&A activity to do so.)

Deal Economics

Second, deal economics must be evaluated. This involves conducting a valuation analysis that is appropriate for a given M&A transaction. This may require obtaining a constellation of values using methodologies such as discounted cash flow analysis, revenue, or earnings-related multiples using public company comparables, multiples from past M&A transactions, or multiples of *something-or-other* in early-stage ventures. There is rarely one North Star valuation metric. The constellation approach is intended to provide an acquirer with perspective regarding an appropriate range of value.

Jaw-dropping valuations have not been uncommon for deals in technology markets, including some Google transactions. Although not as staggering as the estimated \$350 million/employee multiple that Facebook paid in its \$19 billion acquisition of WhatsApp in 2014, Google has spent \$1 billion or more for newly minted companies such as YouTube, Waze, and Nest.

Such valuations subject a company to critics who characterize the purchase as an irrational spending spree, but a deal might be later dubbed as brilliant if the target's platform proves out as a core asset in the acquirer's growth.

Synergy analysis is an essential ingredient in valuation, although *synergy* is perhaps one the most misused terms in corporate strategy. The word *synergy* has a most interesting origin as part of business jargon, according to the following account.

Professor J. Fred Weston was a giant in the field of M&A.⁷ He arrived at UCLA from the University of Chicago in 1949 and over his career wrote 32 books and 147 journal articles, many of which dealt with M&A. He mentored many outstanding graduate students, including Nobel Laureate Bill Sharpe. I worked with Fred, taking over as

faculty director for UCLA Anderson's *Executive Program on Mergers & Acquisitions* from him in 2005. Fred continued to speak in the program. When I introduced him as the “John Wooden of M&A” (referring to UCLA's legendary basketball coach), it was scarcely an overstatement.

Fred told the story about how the term *synergy* came to be used in corporate deal making. The year was 1950, and Fred was at lunch in Westwood, California, with executives from a nascent industry that would later become aerospace. Fred saw a drink menu on the table that promoted *Irish coffee, The Perfect Synergy* (Irish coffee blends coffee and Irish whiskey). Not knowing what synergy meant, Fred looked up the term after he returned to his office at UCLA and saw that *synergy* equals the interaction of two or more agents so that their combined effect is greater than the sum of their individual effects. “Now that's what an M&A is supposed to do,” thought Fred. He began using *synergy* in his writings to characterize successful deals, and the term became a cornerstone of academic and professional thinking.

Many of Google's deals involve estimating *revenue synergy* that is believed will occur sometime in the future. Only rarely does a Google M&A transaction center on cost savings resulting from the combination of Google and the target company. Much of this anticipated revenue synergy involves creating or accelerating new products or services—rather risky synergy goals, but we'll see how Google considers and attempts to manage such risk.

Organizational Design

Third, organizational design plays a crucial role in M&A activity. For example, it's widely understood that unless deal integration efforts succeed, the premium or even the basic consideration paid for a target can evaporate. Some

executives feel that this implies that integration efforts must necessarily be concluded rapidly, certainly within a year. After all, cash flows associated with an acquisition have *time value*, so the sooner positive flows are realized, the more valuable they will be.

Although rapid assimilation is the correct path for some deals, we'll see that one size doesn't fit all with M&A integration. In fact, there are numerous styles for successful integration, some of which require that targets be left alone for a considerable period of time after the deal closes.

Google has come to understand that there is not a holy-grail path to integration and utilizes numerous styles for its acquisitions in attempting to make a deal work. For example, consider Google's 2012 acquisition of Wildfire Interactive. Wildfire's technology enabled advertisers to serve campaigns on social websites such as Facebook, Google+, Twitter, Pinterest, YouTube, and LinkedIn. When Google acquired Wildfire, Jason Miller, a Google product manager, made this blog posting: "With Wildfire, we're looking forward to creating new opportunities for our clients to engage with people across all social services... social presence can complement all marketing campaigns—search, display, video, mobile, offline ads and more."

As part of the deal terms, Google established a significant retention bonus in order to motivate Wildfire co-founders Victoria Ransom and Alain Chuard to continue leading the company's 400-employee team. Wildfire was left alone in an attempt to pursue key enterprise social marketing metrics that Google felt could be better achieved without immediate tight integration into a Google product group. There certainly was no guarantee that this integration approach would yield desired results, but Google

apparently believed it would maximize the chances that it would.

In contrast, other acquisitions have been immediately associated with product groups within Google. For example, in 2011, Google purchased Green Parrot Pictures, a developer of tools for the manipulation of digital video and images. Almost immediately, Green Parrot's technology and team was attached to the YouTube group with the goal of helping users make flicker-free videos, particularly for videos taken with mobile phones.

Still other acquisitions become part of a collection with the goal of introducing a series of new product introductions. Consider the cluster of robotics acquisitions mentioned earlier. Google initially placed these acquisitions and its robotics initiative under Silicon Valley veteran Andy Rubin to explore greenfield opportunities based on the collective technologies from these deals.

There is much more subtlety in Google's approach to integration. Many of these efforts have been successful, but there are also notable failures. We'll devote [Chapter 12](#) to exploring acquisition integration in detail.

Deal Dynamics

Finally, consider the deal dynamics dimension of M&A. This dimension includes designing the terms and structure of the deal. Will the consideration of the transaction involve cash, stock, or some combination? Will there be contingent consideration, payable to the target only if certain milestones are met? How about retention or stay bonuses for key talent? Will the employees of the acquired company need to relocate, or can they stay in place?

Consider some dynamics issues relating to Google deals. When Google purchased Waze, an Israeli crowd-sourced

mapping and navigation company, the consideration was \$966 million in cash. (Retention bonuses could increase this amount.) Google would use the technology to enhance its Google Maps with Waze's real-time traffic information. In closing this deal, Google allowed Waze personnel to remain in Israel. This concession was reportedly an important factor in Waze's decision to agree to the acquisition.

Google rarely uses its stock in making acquisitions, although it has done so in certain key purchases (such as Applied Semantics AdMob, and YouTube). However, going forward, Google might use stock more often in M&A transactions. After a stock split in 2014, the company has nonvoting stock to use as a potential acquisition currency.

Taking all four of these major activities (strategy, economics, organization, and deal dynamics) into consideration, the bottom line is that successful M&A activity is an intricate challenge. It is no small undertaking for a company such as Google to succeed in building an acquisition program that becomes a core strategic capability.

Evaluating Performance

M&A success rates for corporations are generally considered poor, although just how poor has been the subject of some disagreement. Some studies report the rate at which acquisitions fail to create value range to be 40 to 60 percent, while others assert a failure rate within an even higher range of 70 to 90 percent.⁸

Abstracting from a wide range of studies, Robert Bruner concluded: "The buyer in M&A transactions must prepare to be disappointed. The distribution of announcement returns is wide and the mean close to zero. There is no free

lunch.”⁹ (Announcement returns involve *event studies* that examine abnormal returns to shareholders in the period of time surrounding transactions.) Bruner went on to further assert that negative performance post-merger is troubling, but suggested that more rigorous testing is necessary to draw firm conclusions about the returns after an acquisition is completed.

M&A activity performance has been studied extensively, with various schools of thought emerging.¹⁰ First, the *financial economic* school measures value creation and stock market returns around the time of a transaction. These studies are prominent in academic thinking, but are of limited use when the acquirer is private or when the acquirer engages in a small transaction (or series of small transactions) relative to its market capitalization. And such small acquisitions have long dominated for Google and other leading technology companies, as reflected in the practice known as *acqui-hiring*. Acqui-hiring, in general, involves the process of acquiring a company to recruit its talent, with or without being interested in the target's technology, products, and services. We'll examine various forms of the acqui-hiring phenomenon in [Chapter 13](#).

A second school of thought involves evaluating the effects of *strategic relatedness* on M&A performance. Traditionally, this line of thought has argued that acquisitions enjoyed a higher likelihood of success if they were in some way related to the acquirer's current products or markets. Significant evidence has been presented that acquisitions involving unrelated diversification commonly result in lower financial returns than nondiversifying deals.¹¹ Peter Lynch, well known as a mutual fund investor, went so far as to coin the term *diworsification*, implying that an organization that diversifies too widely risks destroying its original business,