

## AMI SMB Perspective

### Google vs. Microsoft: where is the key battlefield?

by Dr. Vu-Thanh Nguyen, Research Analyst

[TNguyen@ami-partners.com](mailto:TNguyen@ami-partners.com)

9 July 2009

#### News

8:27am, 28 May 2009, Microsoft CEO Steve Ballmer announced their long-anticipated and much leaked new search engine – Bing – in front of C-levels and business executives attending The Wall Street Journal's 'D: All Things Digital' conference at Four Seasons Resort Aviara, Carlsbad. About half an hour later and 500 miles away in San Francisco, a group of Google engineers presented their highly secretive new communications platform – Google Wave – in front of around 4,000 cheering attendees at the Google I/O developer conference. The crowd cheered even louder when Google presented a free Android phone to every participant at the end of the presentation.

Bing, with an advertising budget of US\$80 to \$100 million, is Microsoft's attempt to be the talk of the town. In the eyes of many observers, however, Google Wave had stolen its thunder. Now, more than one month after their soft launch, Google Wave is still receiving more attention from bloggers compared with Microsoft Bing, according to Nielsen's *BlogPulse*. To some, Bing is perceived to be "just another search engine" despite Microsoft's efforts to market it as a "decision engine." Meanwhile, Google Wave promises a new, open platform for users to communicate and collaborate more effectively. In a sense, observers view Microsoft as talking about the present (or even the past), while Google, the future.

Less than ten days later, on 9 June 2009, Google introduced its *Google Apps Sync for Microsoft Outlook* to let Outlook users connect to Google Apps for email, contact management, and calendaring. By allowing users to continue using their familiar email client, what is behind the scenes – be it Microsoft Exchange Server or Google Apps – becomes less relevant. With this, Google hope to make its penetration into the institutional and enterprise market, currently dominated by Microsoft Exchange, easier.

On 17 June 2009, just eight days later, Microsoft engineers threw the next salvo by announcing that Google Apps Sync has "a serious bug/flaw," which prevents Windows Desktop Search from indexing Outlook data. Microsoft claims that its users cannot search their Outlook email using Windows Desktop Search. Around the same time, the New York Post reported that Google co-founder Sergey Brin is leading a team of top engineers to delve into how Bing works, and how to further improve the Google search engine.

The latest development, on 7 July 2009, saw Google announcing Google Chrome Operating System (OS) for netbooks and PCs. By promising an OS with "speed, simplicity, and security" that can start up within a few seconds, Google is going flat out to attack the widely perceived problems of the Windows OS, striking at the heart of the Microsoft empire.

The battle is getting more intense.

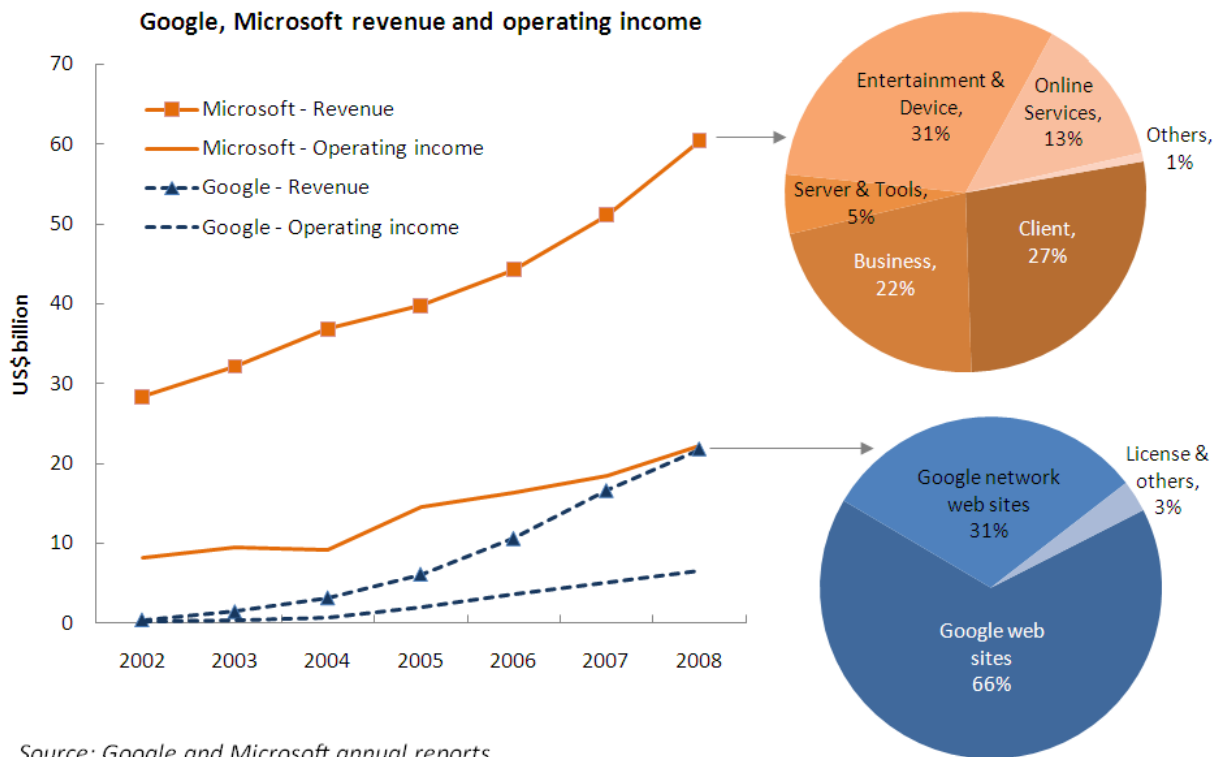
#### Perspective

Founded in 1975, Microsoft is now the biggest software and computer services vendor and the sixth largest company in the world in terms of market value (US\$163.3 billion, according to Financial Times). In its financial year 2008, which ended 30 June, Microsoft made record revenues of US\$60.4 billion and \$22.3 billion in operating income – the highest in its 33-year history.

Most of Microsoft operating income comes from its Client division, which sells the Windows operating systems, and the Business division, which sells Office suites, Dynamics, and other communication products. Each division contributed more than US\$12 billion in 2008 (out of revenues of \$16.5 billion and \$18.9 billion, respectively). Microsoft's third largest division, Server and Tools, brings in an operating income of \$4.2 billion (\$13 billion revenue).

Following these is the Entertainment and Devices Division, which mainly sells consumer hardware, Windows mobile and embedded operating systems, with \$267 million operating income out of \$8.1 billion revenue. The weakest department is Online Services Business, which had an operating loss of \$1.3 billion and revenue of \$3.2 billion (5% of Microsoft's total revenue) in the same year. Although Microsoft got \$11.3 billion revenue from these two divisions, the total income is negative.

Internet and mobile, arguably Microsoft's weak points, are areas of significant importance to many ICT vendors in terms of growth and potential revenue. Of course, Google – to Microsoft's chagrin – is currently the undisputed king of the Internet advertising market and seems likely to grow very quickly in the mobile market.



Source: Google and Microsoft annual reports  
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Founded in September 1998, Google quickly became the world's best search engine and the world's largest search engine in June 2000. Google self-service ad program – AdWords – was launched in 2000, and its text ads were so unobtrusive that after two years many observers were still puzzled as to how Google made money from advertising. At the end of 2001, however, Google had already made 77% of its revenue from advertising and only 23% from licensing and other businesses. Its revenues grew exponentially from \$86 million in 2001 to \$16.6 billion in 2007, and then \$21.8 billion in 2008. Meanwhile, its operating income increased from US\$186 million in 2002, to \$640 million in 2004, \$3.6 billion in 2006, and \$6.6 billion in 2008. Within merely ten years from its founding, Google has become the fourth largest software and computer services vendor, and the 39<sup>th</sup> largest company in the world with a market value of \$83.6 billion.

### Analysis

Google generates most of its revenue from online advertising. In 2008, 97% of Google's US\$21.8 billion revenue was from Google-owned websites (66%) and its network web sites (31%). Essentially, Google's revenue comes from its AdWords program where advertisers can create ads, choose keywords, and bid to display their ads next to relevant search results or content on Google or its network websites. The underlying thinking behind is that when users are reading or searching for something, they are interested in such content and would be likely to click on relevant ads to find out, and hopefully, to buy the advertised products or services. Hence, the more users who click on Google ads, the happier advertisers will be, and the higher revenue Google achieves.

While Google advertisers currently pay for each ad click ("pay-per-click" model), what they really want is to pay for successful sales, or at least, for more direct sales-related user activities like email subscription or form filling ("pay-per-action" model). Of course, advertisers will not be very happy if clicks are fraudulent or purposely generated from non-interested parties or automated programs to earn money. They will also not be happy if legitimate users click the ads but buy nothing eventually. These are key issues that Microsoft tries to attack when competitively positioning themselves.

For search, Microsoft has yet to prove an exceptional competitive quality when compared with Google. As of June 2009, Google is still the number one search engine with 74% volume of searches, far above Yahoo's 16% and Bing's 5%, according to *Hitwise*. For web site exposures, Google.com is also the most popular site, visited by an average of 31% of global Internet users over the last 3 months, followed by Yahoo.com, YouTube.com, and Facebook.com. In the same period, less than 18% of global Internet users visit Microsoft's websites like live.com and msn.com, and the number are decreasing by more than 5% during the last 3 months, according to *Alexa*.

Since neither search quality nor web site exposure is Microsoft's strength, it has decided to compete with Google by using a different online advertising model and through its significantly larger war chest. First, by selling ads under the "pay-per-action" model, Microsoft – similar to eBay – promises advertisers higher returns on investment compared with Google. This model, as evidenced in eBay's case, works well for e-commerce activities. Second, by integrating technologies from Jellyfish (acquired in October 2007) and Farecast (acquired in April 2008) into Bing Shopping and Travel, Microsoft allows customers to compare prices of products from different online stores, predict price movements (currently for air tickets, and potentially for other products and services in future). If they choose to purchase through Bing referrals, customers could receive cashback, which normally comes from the advertising payment Microsoft receives from stores. With this strong cash incentive, Microsoft is willing to accept less profit or even loss in order to attract more customers. The more customers use Bing to purchase, the higher revenue for online stores, which will in turn attract more of them to join Bing's program. Since advertising often follows where the money goes, Microsoft hopes not only to increase its online advertising revenue, but most importantly, to seriously stem the only lifeblood of Google.

Google is fully aware of its vulnerability. The company has been trying to diversify into different revenue sources, but has not succeeded. One example is Google Video, which aims to sell digital copies of broadcast TV shows and games. It was not well received among media publishers and was replaced by YouTube, acquired by Google in 2006 with \$1.65 billion. To date, YouTube is still burning money with its enormous bandwidth consumption and has not brought in sustainable profit to Google, despite being the third most popular website in the world. Another example, Google Book – aiming to digitalize all published books for mass Internet search, read, and buy – has received hostile reception and even lawsuits from publishers and authors. If proved successful, however, Google Book will allow publishers to sell e-books directly to consumers, who could read their books on various devices and thus glean better benefits than what Amazon currently offers through Kindle.

Above all, Google Apps Premier continues to receive attention from Google as it poses a significant threat to Microsoft. Google Apps – comprising of Gmail, Calendar, Talk, Video, Sites, Docs, Spreadsheets, and Presentations – is supported by ads and free for individuals. Google, however, is offering educational institutions and non-profit organizations ad-free Google Apps services without any charge. If Google Apps is widely adopted by these large organizations, Google could persuade other enterprises to purchase its Google Apps Premier – the ad-free, larger-storage, higher-security version of Google Apps – and challenge the dominant position of Microsoft. However, Microsoft Business Division, which gets about 80% of its revenue from sales to businesses, will fiercely protect its share, and Google will surely face great challenges in penetrating this market.

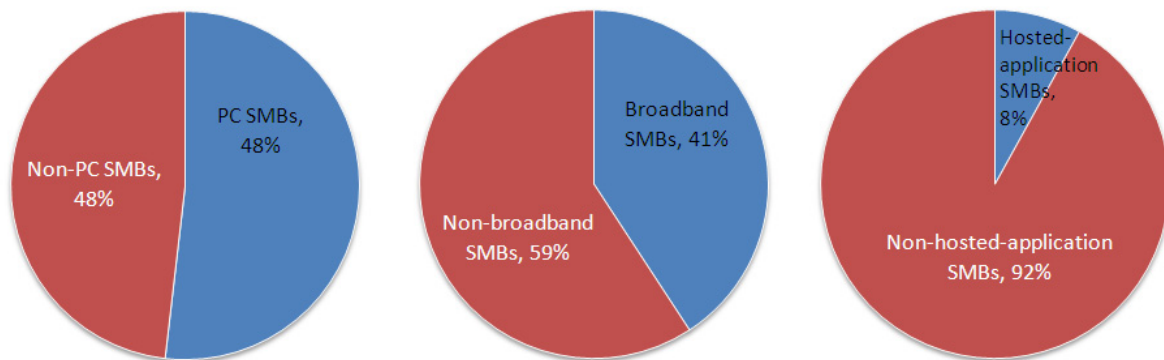
Meanwhile, Google's free operating systems, Android for mobile and Google Chrome OS for PCs, looks set to encroach on Microsoft's operating system business boundaries. Announced in November 2007 as the first open platform for mobile devices, Android is quickly gaining ground, with Android G1 launched in October 2008, Android myTouch 3G launched in July 2009, and at least 18 new-generation Android phones to be released in 2009. According to *Forward Concepts*, Windows Mobile only had 14% share of the smart phone market after eight years in market, while Linux/Android had captured 11% market share by the end of 2008.

At the same time, Google is expanding to the rapidly growing netbook market with Android Acer netbooks in 2009, and Chrome OS netbooks via various vendors from 2010. Since about 80% of Microsoft's Windows operating systems are sold through original equipment manufacturers (OEMs) like Acer, Dell, HP, HTC, and Lenovo, their warm reception towards Google's OSs could threaten one of Microsoft's core revenue sources. Granted, Google may not directly receive revenue from its free operating systems, but it can force Microsoft to reduce its OS prices and thus, lower its revenues and profits. In addition, the Google OSs could serve as starting points for other Google application products, bringing them physically closer to consumers and small-and-medium businesses (SMBs).

Getting closer to SMBs could be an essential strategy in the war between Google and Microsoft. While Google is busy attacking Microsoft in the enterprise space and Microsoft is equally keen to squeeze Google in its Internet consumer stronghold, both seem to be missing the key battlefield – the SMB market.

Since SMBs or companies with less than 1,000 employees have a smaller budget and are less visible than large enterprises, some vendors and sales executives may think that it is better to focus on the big names and not waste efforts on SMBs. In fact, the number of SMBs and their related spending on information and communication technologies (ICT) are overwhelmingly larger than the large enterprise market. According to AMI's research, about 71 million SMBs spent about US\$809 billion on ICT in 2008. In 2013, this will grow to 74 million SMBs spending over US\$1 trillion on ICT. Therefore, it is difficult to perceive an ICT vendor that could afford to ignore this significant and fast growing market.

Meanwhile, despite much attention on the cloud, it is worthwhile to remember that many SMBs are still very much "on the ground." Globally, in 2009, only 52% of SMBs are using PCs and 41% of SMBs have broadband access globally. Fast-forward to 2013, these numbers are not expected to change much: 53% and 46% respectively. The SMB penetration rates of portable PCs, handheld devices, wireless access, and hosted applications are even smaller. Without computing devices and fast Internet access, working on the cloud is simply impossible. That is exactly why the Google and Acer co-operation is significant. While Acer is famous for its ability to produce low-priced PCs and netbooks, Google is a champion in providing and sponsoring free and open-source software. By working with OEMs to reduce price of the whole hardware/software package, Google may significantly drive the adoption of Android/Chrome devices and Internet access among SMBs, thus paving their way to its cloud.



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AMI defines SMBs as businesses with less than 1,000 employees.

Getting closer is important also because customers – whether they are consumers, SMBs, or large enterprises – want assurance and satisfaction. No cloud-computing vendor can assure 100% uptime, not to mention stable, secure, and high-speed connection from customers to servers. Although Google is working on technologies like HTML5 to allow web-based programs to run off-line, it may not be enough to convince business users. Security and privacy are often the top concerns associated with business users, and for many, having physical servers on their premises could give them the assurance of being in control. The best way to address these security and privacy concerns, from AMI's perspective, is to expound on the cloud's benefits of being "anywhere, anytime, and on any device access", and craft a hybrid solution with small, on-premise cloud servers connected and synchronized with external, and more global clouds.

In this aspect, Microsoft is having an advantage over Google. Microsoft's dominant presence on business premises, coupled with its Azure services platform to be launched in November 2009 with various cloud applications like Office Live, Dynamics, and SharePoint Online, may just click with the end customer. On the other hand, Google has only two on-premise devices, Google Search Appliance and Google Mini, and none provides Google Apps with the ability to compete with similar products from Microsoft. Google Wave, being a new open platform that may potentially unify communication, collaboration, and social networks, has not yet realized its potential until the end of 2009.

In the near term, it will be not easy for Google to capture much market share from Microsoft in the enterprise market. Microsoft, on the other hand, will do its best to dent Google's online advertising revenues. The key battlefield for the mid to long term, however, will be in the SMB marketplace. Google has its "free" advantage and very strong brand, while Microsoft has its massive presence and mature products. If Google can quickly spread its affordable Android/Chrome OS devices to the market and get Google Apps, Voice, and Wave into SMBs' premises, the pie could be significantly expanded and Google will undoubtedly establish a major beachhead in enemy territory. If Microsoft can rethink and fine-tune its SMB go-to-market strategy, with all the associated investment in products, services, resources and time surrounding that move, it could be well positioned to win a few key battles. Only time can tell which company will win, but the intense competition between these two giants will surely spark much more innovation, and ultimately, benefit us all.

### **About Access Markets International (AMI) Partners, Inc. (AMI-Partners)**

AMI-Partners specializes in IT, Internet, telecommunications and business services strategy, venture capital, and actionable market intelligence — with a strong focus on global small and medium business (SMB) enterprises and extending into large enterprises and home-based businesses. The AMI-Partners mission is to empower clients for success with the highest quality data, business strategy perspectives, and “go-to-market” solutions. Led by Andy Bose, the firm has built a world-class management team with deep experience cutting across IT, telecommunications, and business services sectors in established and emerging markets.

AMI-Partners has helped shape the go-to-market SMB strategies of more than 150 leading IT, Internet, telecommunications and business services companies over the last eleven years. The firm is well known for its IT and Internet adoption-based segmentation of the SMB markets, its annual retainership services based on global SMB tracking surveys in more than 25 countries, and its proprietary database of SMBs and SMB channel partners in the Americas, Europe and Asia-Pacific. The firm invests significantly in collecting survey-based information from several thousand SMBs annually, and is considered the premier source for global SMB trends and analysis.

### **For More Information**

For more information about AMI-Partners, or our Global SMB research, please call AMI-Partners at 212-944-5100, email [ask\\_ami@ami-partners.com](mailto:ask_ami@ami-partners.com), or visit the [AMI web site, www.ami-partners.com](http://www.ami-partners.com).