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IPOs

How I Did It: Google's CEO on the Enduring Lessons of a Quirky IPO

by Eric Schmidt

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It happened six years ago, but I still remember every detail of our journey to becoming a public company. It was a uniquely "Googley" experience that to this day says a lot about who we are.

An IPO can change a company. Many in the media seemed certain that if we went public, the Google ethos wouldn't survive. A public offering would be "one of the worst things that could happen to Google," said Danny Sullivan, editor of the *Search Engine Watch* newsletter and a well-regarded industry commentator. People predicted that we would suddenly be divided into haves and have-nots on the basis of how many shares of Google stock each of us held. The talent would cash out and quit. A new focus on pleasing Wall Street would cause us to lose our prized objectivity and independence. Developing the infrastructure to become a public company would dull our edge.

Ultimately, people feared that as Google transitioned from a bright young start-up to a mature public company, it would lose the quirky spirit that had made it so innovative.

Google Stock Since the IPO $85 August 19, 2004$581 March 11, 2010

Click here for a larger image of the graphic.

None of that happened. And I firmly believe that at our core we are the same company we were then—just a lot bigger. Although it is dangerous to read too much into a single event, I think one of the reasons we have held on to our values is that we chose an unconventional path to going public. Larry Page and Sergey Brin, Google's founders, began their "Letter from the Founders," which was included in our IPO prospectus, by saying, "Google is not a conventional company. We do not intend to become one." They went on to warn potential investors that we would invest in risky projects that might result in home runs—or might never pay off. Choosing a new path to follow doesn't always produce the best results, and the road can be bumpy. Google's road to that IPO was anything but smooth.

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The company was founded back in 1998. I came on board three years later. Although we were growing rapidly, in both employees and revenues, we were in no hurry to go public. But given our size—and, more particularly, the fact that we wanted our employees to have equity in our growing enterprise—in early 2004 we found ourselves in the position of having to release our financial results to comply with U.S. securities laws. At the time, those laws required Google to become a publicly reporting company once it had 500 shareholders, and to file the associated financial statements within 120 days of the end of the year in which we crossed that mark.

We had until late April 2004 to file the necessary registration statement with the Securities and Exchange Commission. But the securities laws did not require us to have an IPO in the traditional sense. In fact, we could have simply become a publicly reporting company without selling any shares to the public.

We faced three choices: We could restructure to get back below 500 shareholders (meaning, essentially, find a way to buy back shares from our employees); we could continue to be a private company but at the same time live with having to report our financial results like any public company; or we could go public. Not surprisingly, we explored some unconventional alternatives, such as trying to develop an internal market for our employees' Google shares. In the end we opted to take the usual path for a venture-backed technology company and make an initial public offering of our common stock. However, we wanted to structure our IPO in a way that was anything but usual.

The Dutch Auction

We pride ourselves on trying to do things right, and we viewed this process of going public as a giant IQ test. How should we sell shares? At what price? Whom should we bring in to help us? What was the proper way—the Google way—to do this?

In debating those questions, we reviewed as much data about prior IPOs as we could get our hands on and agreed on a few things we did not like about the typical process. We didn't like the "pop" often experienced by successful technology companies when they went public. The difference between the IPO price and the price of a company's stock at the end of the first day or week of trading seemed to us to be money that should properly be in the hands of the company. But ordinarily, large institutions with connections to the underwriting syndicate are the only group allowed to buy those shares at the IPO price, and they flip them a few days later for a healthy profit. Somehow that didn't feel right for Google. We wanted something much more transparent and open—and we wanted our users to have a chance to take part.

As we were reviewing our alternatives, we were drawn to an approach championed by WR Hambrecht, an investment bank based in San Francisco, which argued that auctions were a better way to raise capital than the traditional underwritten IPO. In what is known as a Dutch auction, a company would collect bids from all interested investors and then group them by how much each investor was willing to pay. The company (and its bankers) would then move down from the top bid until it reached the highest price at which it could sell all the shares it wanted to offer. The company could choose that price (or, for a variety of reasons, a lower one) and then sell all the shares that were bid on at the chosen price or higher as soon as the stock was traded on its exchange.

We liked this approach. It was consistent with the auction-based business model we used to sell our ads, so we felt we understood the underlying dynamics, and it had a strong intuitive appeal for us. We also liked the idea of opening up our auction to everyone—retail investors as well as traditional institutional buyers. We hoped that an auction would do a better job than the traditional approach of setting a price for our shares—and would allow our share price to remain stable after we went public.

I know this may sound like baloney, but we settled decisively on the Dutch auction after we got a letter from a little old lady—or at least someone who claimed to be a little old lady. She wrote something along the lines of "I don't understand why I can't make money from your IPO the way the stockbrokers will."

We thought she had a point about the basic fairness of the system. So we decided to go with our version of the Hambrecht model, even though it would add considerable complexity to our IPO. No company the size of Google had ever done such a thing. Our auction would be on a significantly larger scale than other auction-based IPOs. We would have to build systems to support that increased scale. And those systems would need to be reviewed by the SEC. Wall Street viewed our decision as arrogant. The analyst Henry Blodget wrote in *Slate*, "Participating in the Google IPO auction is gambling, not investing, and the most likely outcome is a waste of money and time."

Undaunted, we worked through how to structure our IPO, and we stopped communicating with the press. The SEC's "quiet period" requirements prevented us from talking about our business in the run-up to a possible initial public offering. Under those rules, companies are encouraged to make sure that in all material respects, only the prospectus speaks for the company. Because Google was in the media spotlight during this period, people came out in droves to criticize our business, our management, our culture, our IPO—almost every aspect of who we were. And because we had to remain silent, we weren't able to defend ourselves, correct misinformation, or try to reassure the public.

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"Don't bother to bid on this shot-in-the-dark IPO," a *BusinessWeek* columnist concluded—a not-uncommon sentiment. But there wasn't much we could do about it. Yet as we kept silent, we realized that people didn't really know what Google had become. There was a gap between what was written about us and reality. Ultimately, we published our financials, but until then many people thought of us as a bunch of idiots with lava lamps (and perhaps they still do). The fact is, we had really started to take off.

A Sort of Limbo

As the filing deadline approached, we were still scrambling to get things in order. Just a week before the due date, for example, we realized that we were three board members short of the number of independent directors required to meet the listing standards of either the Nasdaq or the New York Stock Exchange. So we quickly added three heavy hitters. We also drew criticism because of the way we opted to structure our dual-class common stock.

The world had figured out our expected filing date, so the media focus on Google in late April was intense. Constant news stories, TV-station vans on the campus, unrelenting calls to our muzzled communications team, rampant employee speculation—it was quite a time. We were legally required to present our financials by 2:00 PM on April 29. But we pulled a fast one: We announced to the world at 11:00 AM that we were going public. It caught everyone by surprise.

The Road to Google's Unconventional IPO in 2004

Click here for a larger image of the graphic.

The IPO process and our business then entered a sort of limbo as we waited for, and then responded to, the SEC's comments on our registration statement. This is a standard part of the process, although it took longer for us than for most other companies because the SEC also had to get comfortable with how we had designed our auction. In the end our legal and management teams worked from May through early August to address the SEC's concerns. Our decision to include a letter from our founders in the prospectus didn't exactly help us from a timing perspective. Larry and Sergey's letter described the values by which we planned to run our business. The job of the SEC is to evaluate the completeness and accuracy of qualitative and quantitative statements made in a prospectus. It really isn't in a good position to evaluate and comment on values. The commission made it clear that it wanted us to remove the letter from the prospectus, out of concern that it would confuse potential investors. We held our ground. I encourage anyone to go back and read that letter. I am struck by the fact that most of the values it set forth are, six years later, still the values that drive our company.

By this point the press coverage had become so negative that we stopped reading it—although I still have all the clippings. "Google is putting a nail in the coffin for technology IPOs," one analyst concluded. I've always thought that the bad press actually helped our business, because it raised awareness. Our revenue depends on traffic, and our traffic exploded during this period. I feel certain there's a correlation.

We were now on track to go public in August. We'd known for months that August is a bad time to go public—Wall Street is essentially on vacation then—but it seemed that all our delays were inevitably leading to a late-August IPO. And given that more time seemed to beget more problems, we didn't want to delay until September. So we kept moving and finally started to get everything lined up.

Until...the September issue of *Playboy* hit the newsstands. It turned out that Larry and Sergey had given a long interview to the magazine back in April, and it was published in this issue. It was a very generic interview (without any pictures, I might add), but it almost derailed the whole IPO.

All Hell Broke Loose

The problem was that the interview, which of course touched on business issues, may have violated the "quiet period" rules I mentioned earlier. All hell broke loose, and the SEC considered forcing us to postpone the entire process. A month earlier the commission had delayed Salesforce.com's IPO because Salesforce had been featured in a lengthy profile in the *New York Times* during its quiet period. (Interestingly, it was headlined "It's not Google. It's that other big I.P.O.") That article, along with the subsequent publicity, prompted the SEC to push Salesforce to put a hold on its offering. We were worried that we faced a similar fate.

I sat down with Larry and Sergey to make it clear that it wasn't their fault—that I knew they hadn't realized they were doing anything technically wrong. We had a lot of work to do, but first I wanted to make sure that the two of them felt OK about everything. Then, working with the regulators at the commission, we came up with a solution: We included the *Playboy* interview in our official SEC filing as an appendix—meaning it would be available to any potential investor.

In mid-August the bidding began, based on our published expected IPO price range of $106 to $135 a share. It was a tough environment: Several tech companies had decided the market wasn't right and had pulled IPO plans of their own. In fact, the bidding for our shares didn't go particularly well. We seemed to be in a perfect storm of bad news: The *Playboy* article had been the joy of pundits and talk-show hosts everywhere; we had endured months of media criticism; we were dealing with an SEC investigation into our employee option program; and our financial performance in Q2 was experiencing a modest seasonal "flattening," which led analysts to question whether we could maintain our growth rates. (They soon reaccelerated.)

In addition, Wall Street was angry with us. In keeping with our auction model, we had wanted the information we communicated to our retail investors to be largely consistent with what we communicated to more-sophisticated institutional investors. Institutional investors are used to getting deep under the hood of a potential tech IPO when they meet with executives. They were not happy with the few extra details we were willing to share with them beyond our standard management presentation, which we had made available online to both retail and institutional investors. It didn't help that we had created an admittedly very amateurish video (shot by handheld camera) to introduce our executive team. One meeting in particular, with mutual-fund and hedge-fund investors at New York's Waldorf-Astoria Hotel the day after our pricing announcement, was roundly criticized as not serious enough and thin on details. (That was fair—on both points.)

There weren't a lot of orders, and to be frank, we wondered if we'd made a mistake in choosing an auction-based approach. The offers that did come in were at or below the low end of the range we'd anticipated. When the bidding period ended, it was clear that we weren't going to be able to sell all the shares we had planned to sell in the price range we wanted. I met with the board to discuss whether we should delay our IPO and hope to get a higher price later. Our underwriters believed that we could close the IPO with a price around $80 to $90 a share if we reduced the number of shares for sale—a disappointing outcome. In the end we decided to close the IPO for a number of reasons, the most important being that it was time to put this chapter behind us and get back to running our business. So on August 18 we agreed to price it at $85 a share.

After the Countdown

We flew overnight to New York to watch our shares start trading on the Nasdaq on Thursday, August 19. We showed up in the morning, bleary-eyed. That day the *Wall Street Journal* had run a front-page piece with the headline "How Miscalculation and Hubris Hobbled Celebrated Google IPO," and CNBC commentators were talking us down all morning. I remember thinking as we headed down to the Nasdaq trading floor, *We're screwed*.

We showed up bleary-eyed on August 19. I remember thinking as we headed down to the Nasdaq trading floor, We're screwed.

Just before the trading started, there was a countdown on the floor: 5-4-3-2-1. We watched the first trade, but it wasn't at $85—it was at $100, an 18% increase over our IPO price. Someone was making fast money. Despite our efforts, people were buying and flipping within an hour, taking a quick $15-a-share gain. The volume was huge.

All day long the stock price never went down. It closed at $100.30.

We were now public. Thrilled and exhausted, we flew home to California. By the following Monday our stock was trading at $105 to $110. Now there was an unbelievable amount of excitement in the press. Even the *New York Times* had weighed in on its editorial page: “Google still exudes that unabashed Silicon Valley anti-establishment attitude....Nowhere was that more apparent than in the way it sought to dictate to Wall Street the terms of its own sale, as opposed to the other way around. This is a commendable impulse—I.P.O.’s have generally been structured to benefit insiders.”

The IPO had consumed so much of our time and focus that I decided we needed closure before we could get back to business. The Olympic Games were taking place in Athens then, so they were on our minds. I asked Omid Kordestani, a senior executive at Google who has a wonderful voice, to say something appropriately Olympian to our management team to conclude our ordeal. He stood up in the boardroom we use for our executive management meetings and declared: “We now pronounce the end of the Google IPO.”

I told everyone to get back to work. As a management team, we haven’t talked about the IPO since.

So what had we done right? What had we done wrong? The right is easy to point to: Going public is a massive undertaking, and our finance, legal, and management teams had risen to the task, tackling the many obstacles in their path with tenacity, intelligence, and patience. In the end we made it, even if we did stumble somewhat coming out of the gate. As for the wrong: To this day I can't fully explain why our stock price opened so high—causing the pop we had tried to avoid. A lot of complicated factors played a role.

For a CEO, outcomes are what matter most. Although personally I would prefer to run a private company (it's easier), we made the decision to go public, and Google ended up succeeding beyond our most optimistic dreams.

And the naysayers were wrong. We didn't change. Basically, the same people are still running Google, in accordance with the same values we had as a private company. If you have the right people and the right values, and if you stick to your goals, you can go through a process like this and remain coherent as a company.

Crazy as the whole process was, I wouldn't change a thing—except maybe that *Playboy* interview.

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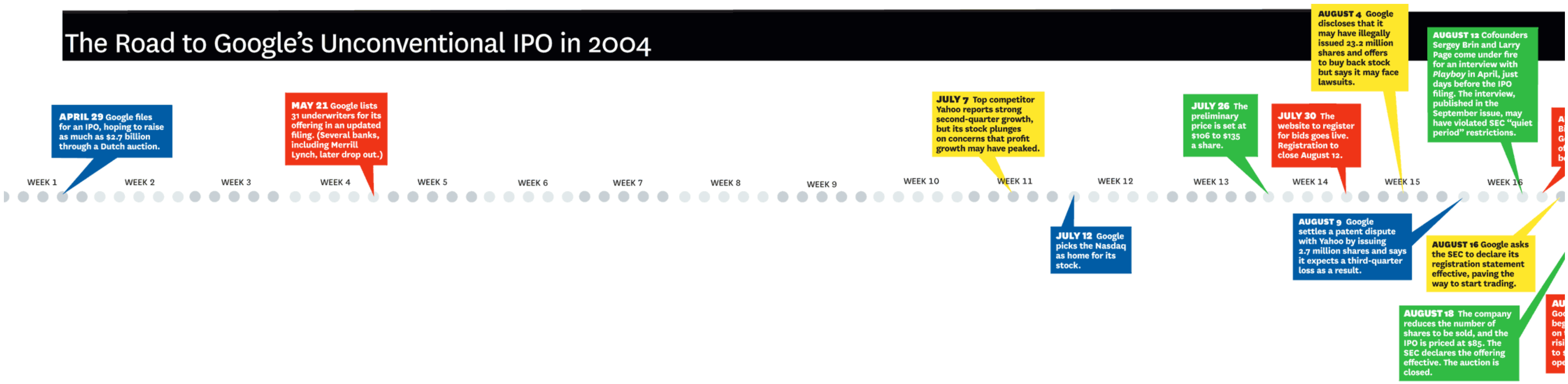

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