# Stanford eCorner

## Taking Your Company to a New Level: The IPO

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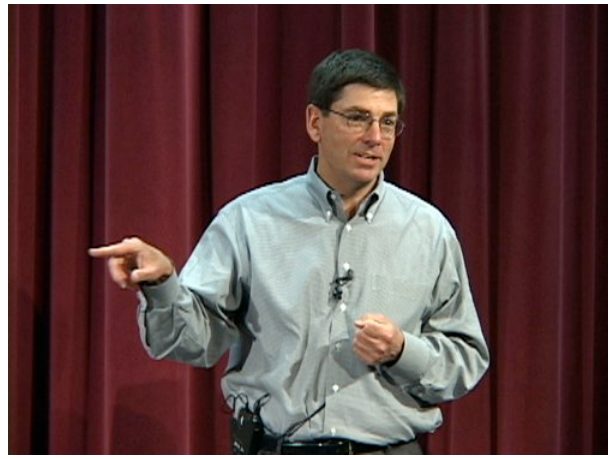
**Video URL:** http://ecorner.stanford.edu/videos/886/Taking-Your-Company-to-a-New-Level-The-IPO

Google has decided to IPO though the Dutch auction method, which has never been done for such a large-scale offering. In the Dutch auction method, each buyer makes a blind bid for what they are willing to pay. The seller then finds a clearing price for how many shares they want to sell, and the people with bids above that price are awarded stock. The method is designed to avoid the tremendous first day stock price volatility experienced by newly-public companies.



**Transcript**

I thought I would just finish the formal part of my talk by outlining some of the things that are unique about the public offering. You have no doubt read about it, but I can help explain some aspects of it if you like. Google is in every way an unconventional company. They set out to solve a big problem and did it, and they are convinced that they can solve all big problems if they put their mind to it. One problem is how to preserve editorial integrity. And to do this, Google has followed in the path of many companies in the communications or publishing world like The Washington Post and have created two classes of stock, one for the existing shareholders, the founders, the employees, the venture capitalists. Those shares have 10 votes per share and the new shares that will be sold to the public will have one vote per share. Otherwise, they are economically equal. But the purpose of this is to prolong the period during which the insiders will have control of the company so that some of the basic principles under which the company was established can't be compromised. Kind of the editorial integrity of the internet.

And one of the other things that's unconventional about Google is it's not managed by a single CEO. It's managed by the two founders, who are 30 years old probably now, and Eric Schmidt, who's a seasoned technology company executive, as a triumvirate and they get together and they make joint decisions. And it seems to work. They believe it. If you take a look at the IPO, there's this unusual shareholders manual. Their shareholders manual is a six-page letter to the prospective investors in Google that is following a pattern established by Warren Buffett for his company, Berkshire Hathaway, but the content is largely original thinking and they simply--the founders of Google explain their thinking here and they think that better decisions are made by consensus of the three and that it's an effective way to run the company. Not conventional, but effective. And then, of course, one of the very, very interesting things is that this IPO, which is enormous by any standards, will be sold through the Dutch auction method which was pioneered for public offering by Bill Hambrecht of the WR Hambrecht Investment Banking firm. But it's only been done for relatively small public offerings to date. Nothing of the scale of Google.

And does everybody understand how a Dutch auction works? It's kind of the reverse. In a normal auction, the bidders in the audience are bidding up to a price and then the highest bidder wins. In the Dutch auction, you all put in blind bids and you bid whatever you're willing to pay. And then the company takes a look and looks for the clearing price and says, "OK, I can sell all the stock I want to sell by lowering my price to..." let's say, $10 a share even though some people bid $30 a share and some bid $20, some bid $10, some bid $8. If I want to sell a million shares, let's say, I'll bring it down until I see the price that clears the market for a million shares. And anybody who bid that or higher gets their allocation of shares. And so this method is designed to solve a problem that existed in the bubble where IPOs would go public at, say, $10, and then shoot up on the first day to $30, $40, $50 a share because of super heated demand, and then gradually come down. And obviously there wasn't good price discovery. People didn't really understand what the market value of the stock was. Maybe the company priced it too low, some people paid too much, and then some people lost money.

So the idea here is, let's do an auction, find out where the real market for our stock is, and then try to sell it accordingly and try to avoid the spike and just kind of have a price that is pretty much what the trading price of the stock will be. It's a good question whether it can be pulled off. We'll see. The other very unconventional thing in this shareholders letter is that the founders make it clear--it's a very personal letter, it's in the First Person, it's a very interesting letter to read--that they are going to make business decisions that are designed to be investments for the long term. One of the challenges of being a public company is that they are under the scrutiny of the trading markets, which basically require quarter-to-quarter, if not day-to-day, financial results that are consistent with investor expectations. And so there's a huge pressure on companies to increase profits every quarter in some methodically increasing way and with double-digit growth, maybe 10%, 20% over the same quarter a year ago. Maybe 30% to get a high P/E multiple. And sometimes it's not the right business decision to try to maximize sales that quarter. Maybe you want to focus engineering resources and building a better product for a year from now but you can't afford to because it would increase your expense load or your profit for this quarter or the market will be disappointed. The Google founders have said in their letter, "We're not going to make decisions on a quarter-to-quarter basis.

We're going to make them for the long term. So buckle your seatbelts. Trust us and hang on because we're going to achieve shareholder value, but we're not going to do it necessarily by making quarter-to-quarter decisions." And then finally, they say, "We're not going to compromise the principles under which we founded the company. We are going to do no evil." And one of the ways that translates is that basically information on the internet wants to be free. Although there is an economic model for Google to be sure, it's not the banner ad model that's--it's not paid search. When somebody pays to have priority under search results, that's in a separate column, so you know who paid for that position. But if you want the unadulterated, what does our algorithm tell us is the most accurate match for what you're looking for, that's just listed according to accuracy, if you will, of their engine. And then people who pay are identified separately. So you're not going to confuse the user of the search engine about which are paid for and which are essentially free listings the way some of the other search engines do. And so it's a very laudable goal, very interesting approach, very novel in every way.

And we're all waiting with bated breath to see what happens.