



# The Business Dynamics of Social Networking Sites

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But how sustainable is an SNS like Facebook? To answer this question this paper looks at 3 issues: (1) how Facebook rose to its present dominant position and why others fell short; (2) what are the business models behind SNS; (3) and how sustainable are they?

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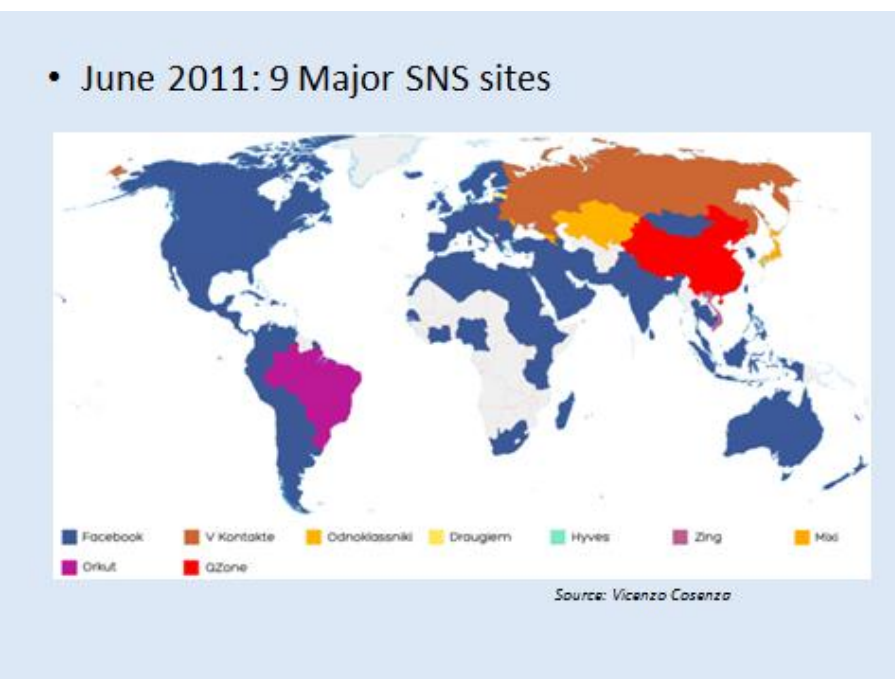
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## A: Introduction

Social networking has become global based as it is on the Internet. Less certain has been its transformation into sustainable businesses models. Most social networking sites (SNS) have either disappeared or their market share has been absorbed by one of a very few global SNS, notably by Facebook (FB) by 2011. Diagrams 1a and 1b show just how dominant FB has become (but it should be noted that not all SNS are represented, for example Twitter is missing).

Diagrams 1a & 1b

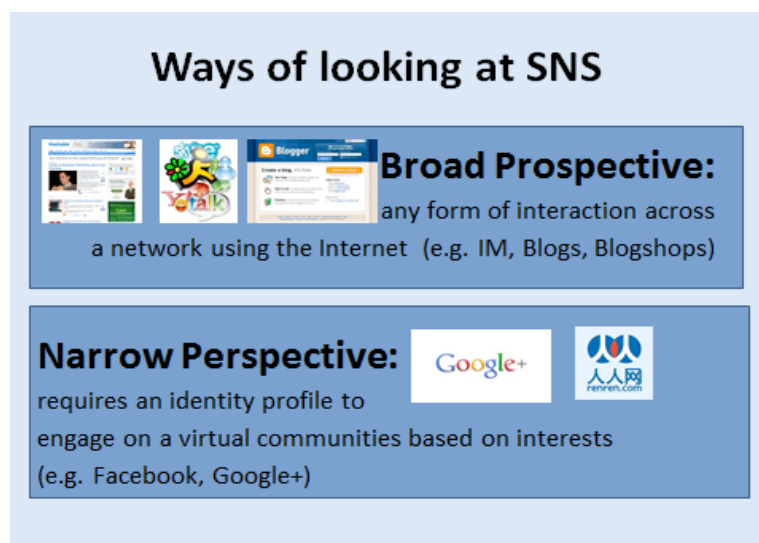


But how sustainable is an SNS like FB? To answer this question this paper looks at 3 issues: (1) how FB rose to its present dominant position and why others fell short; (2) what are the business models behind SNS; (3) and how sustainable are they?

To start the discussion, we first look at how we can best delineate an SNS. We use the word 'delineate' because the word 'define' is not very helpful, apart maybe for purely academic reasons,<sup>1</sup> when examining the commercial implications of SNS.<sup>2</sup> This is because as SNS evolve they increasingly overlap in their functions, accessibility and usability with websites that may not be strictly defined as SNS. For example, a user can access the New York Times (NYT) website from their FB account which encourages more users of, and traffic to, FB as well as the NYT, yet media-only sites are not SNS as usually defined.

A broad delineation of SNS would include blogs and instant messaging sites, whereas a narrow delineation would limit SNS to sites that require an individual identity profile. In this paper we take the broader perspective to embrace social media that is being incorporated into SNS either directly or through mutual links.

Diagram 2



Then we move to looking at the evolution of SNS in terms of functionality and business models. And finally we examine the issue of sustainability.

<sup>1</sup> See <http://encyclopedia.thefreedictionary.com/Social+network> (visited 11<sup>th</sup> October 2011) for references to some of the early social networking studies.

<sup>2</sup> As of October 2011, Wikipedia listed more than 200 sites described as social networking.



## B: Delineating SNS

Our opening proposition is simple: that Internet communications have created a digital society which is not different in principal from the society of which it is a sub-sector. Society according to classical philosophy and political economy has two overlapping arena: civil society and political society, where the former includes household and commercial economic activity and related social and cultural activities, and the latter consists of the exercise of political power and the role of the state. The nature of their interaction is a defining characteristic of society.

### ***Transformational Effects***

Add a digital dimension to society and what is most likely to change are the dynamics of society, assuming the state does not intervene to prevent that from happening.<sup>3</sup> In 1995 Nicolas Negroponte famously entitled his book *Being Digital* to introduce to a wider audience the implications of digital technology and its impact upon society. Had the book been about the *process* of social transformation it might have been entitled *Going Digital*, because even transformations take their time. But one characteristic of the digital age is the foreshortening of the time it takes from invention to diffusion and adoption of digital products and services, resulting in major shifts within society. A common and useful historical precedent for social media in general is the case of the machine printing press.

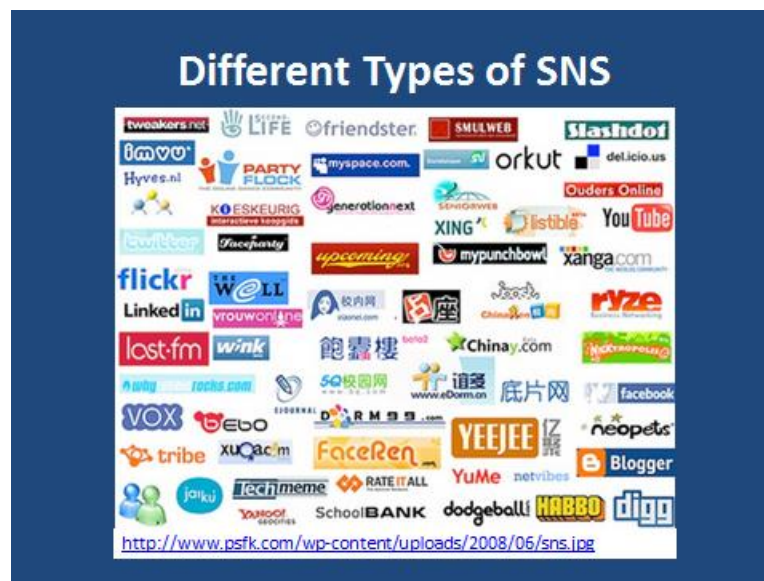
The invention of the printing press by Johannes Gutenberg in 1440, which superceded manual screw presses, was a transformative technology opening society to a democratization of access to the written word. The ‘penny papers’ of the early nineteenth century – in many ways the precursors of, and even more scandalous than, today’s tabloid press – were one of many downstream outcomes. SNS take that process one step beyond. They allow users to create and disseminate their own content. Although the business end of SNS is hierarchical and therefore traditional, the activity they open the door to is non-hierarchical. They are bottom-up self-generated networked communities of interest; far less bounded than earlier telecoms communities of interest – immediate family, friends, and associates – because they open up degrees of separation across the globe. Through privacy settings, individual users can restrict or invite participation limited only by the number of network users and by cultural constraints such as language barriers.

It is not just individuals who create SNS pages. Interest groups, political and religious groups, educational and research institutions, enterprises and even governments can do so. And sites differ in the services they provide, some more specialized than others.

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<sup>3</sup> It took several centuries before the full impact of the Gutenberg printing machine was felt through the circulation of popular mass newspapers.

Diagram 3



Therefore, either as a community or as a business, SNS provide a multiplicity of services based upon Internet communications.

This is summarized in the description of SNS, for example, in *thefreedictionary*.<sup>4</sup>

A **social network service** is an online service, platform, or site that focuses on building and reflecting of social networks or social relations among people, e.g., who share interests and/or activities. A social network service essentially consists of a representation of each user (often a profile), his/her social links, and a variety of additional services. Most social network services are web based and provide means for users to interact over the internet, such as e-mail and instant messaging, although online community services are sometimes considered as a social network service. In a broader sense, social network service usually means an individual-centered service whereas online community services are group-centered. Social networking sites allow users to share ideas, activities, events, and interests within their individual networks.

It is the 'service' – or *range* of services – that is the 'value-added' in SNS, that makes users want to join (access) and to use,<sup>5</sup> although how that service is paid for varies. Mostly it is through advertising of one sort or another, and also by other means such as e-commerce commissions, revenue-sharing arrangements with apps and content providers, and the sale

<sup>4</sup> <http://encyclopedia.thefreedictionary.com/social+networking+sites> (visited 11<sup>th</sup> October 2011)

<sup>5</sup> The distinction is important. Not all subscribers are active users and the network effects stop short.

of game items or virtual money credits. Business models and their sustainability are discussed in more detail below.

What is most significant about the growth of SNS services is the shift from single-purpose sites, for example for messaging or sharing photographs, to fully-fledged SNS sites that link these activities.

Diagram 4a

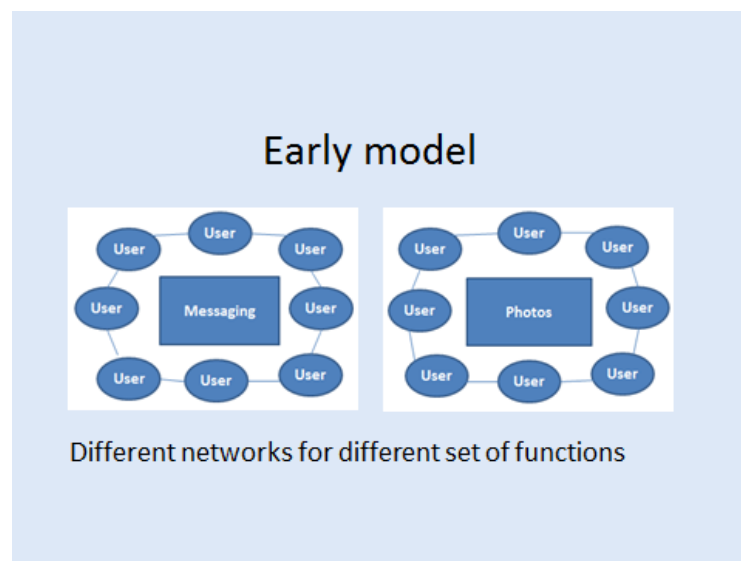
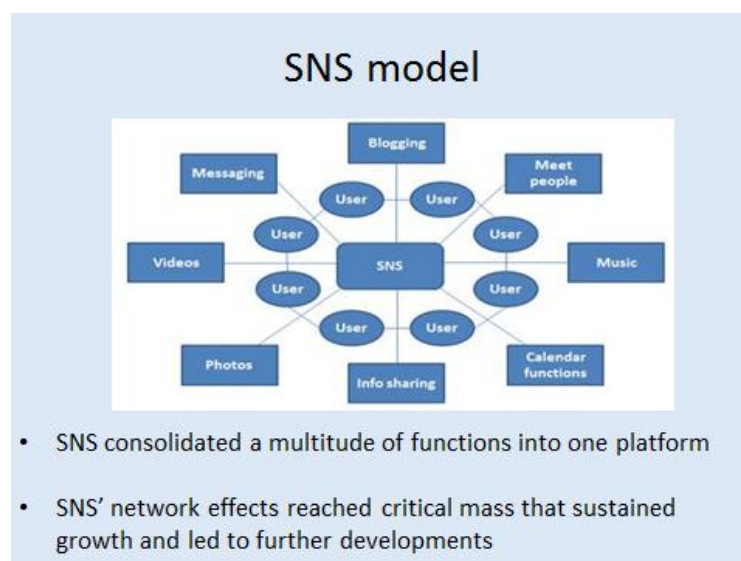


Diagram 4b

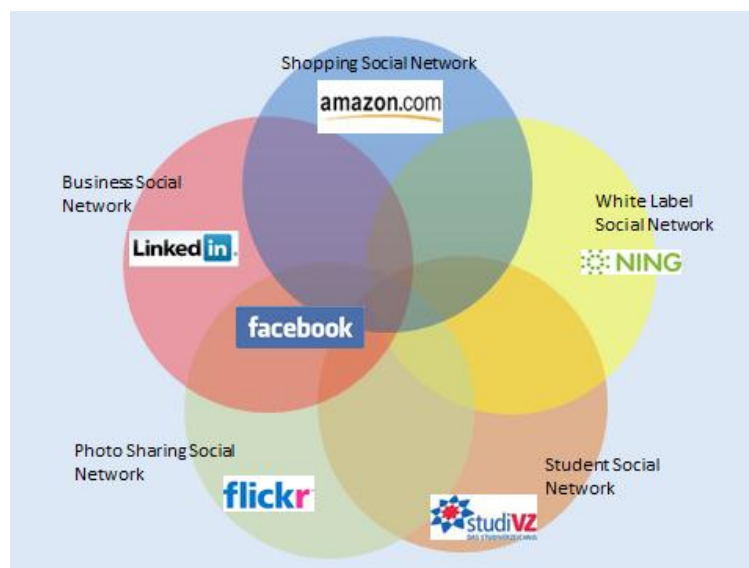


## Network Effects

The network effects of SNS are cumulative when sites link together, when they interoperate with each other and generate both more users and traffic for each other. These sites are complementary. What we have witnessed over the past decade is two developments: first, more and more sites are inter-linking and allowing access via just one account, and second, complementary services are being built into the most successful sites as they widen their scope or range. The diagram below illustrates this overlapping process.

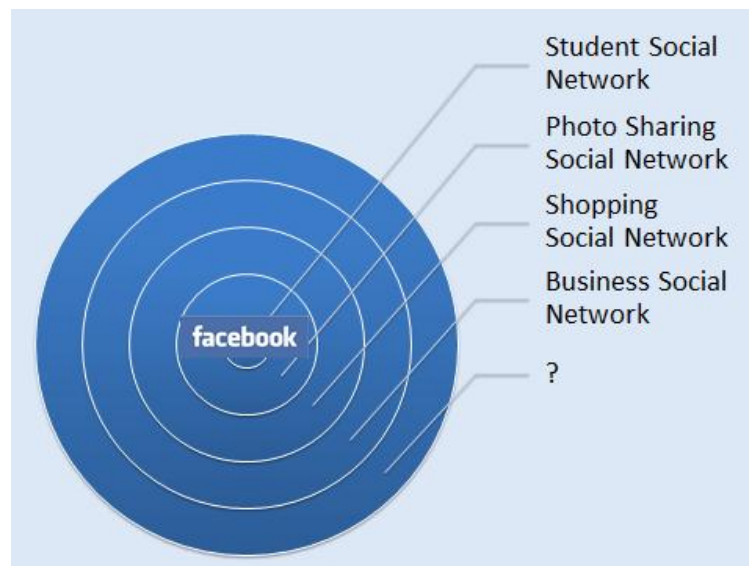
A recent example of widening the scope of services is the move by FB to provide a FB app for download to mobile phones, one for Apple's App Store and another for Android-based handsets which will link to FB's own Mobile App Showcase and on which FB, not Apple, will collect 30% of the downloading fee.

Diagram 5



Previously, connecting to FB by mobile phone was through the phone's web browser, but now developers are being encouraged to develop new mobile apps for FB. The success of FB and its network effects is clearly the product of being able to widen the range of services and functions it can offer as diagram 6 suggests.

Diagram 6

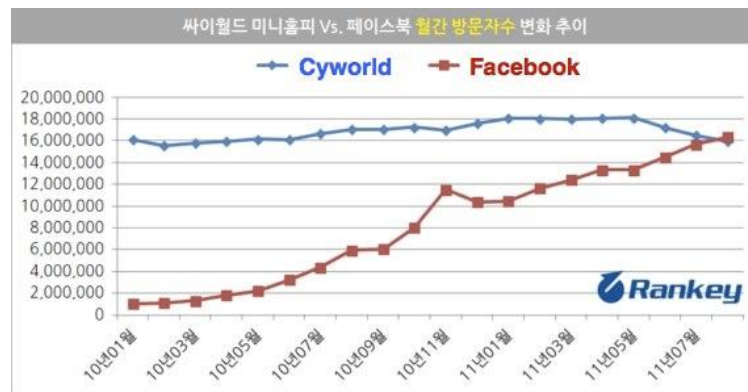


Of course, if the network effects are strong enough they become by definition a self-fulfilling prophecy, but can they be strong enough when the barriers to entry of new SNS are so low? Can SNS sites have unique and non-replicable features that ensure their sustainability? Network effects can be a zero-sum game for unsuccessful sites, when additional users to one site represent fewer users for another, where a site becomes a substitute for another, replacing it in popularity. A crucial question for the business model is what determines the popularity of one site over another. For example, the sites FB has replaced or overtaken, such as SK Telecom's Cyworld in Korea, often looked highly successful in their own markets. Cyworld has led the South Korean market for the past decade, but was overtaken by FB in terms of site visitors for the first time in August 2011. According to the *Korea Times* (7<sup>th</sup> Oct 2011) this is partly due to negative network effects: "those who defected to Facebook say they are following their friends."<sup>6</sup> This issue is addressed below.

<sup>6</sup> [http://www.koreatimes.co.kr/www/news/biz/2011/10/123\\_96267.html](http://www.koreatimes.co.kr/www/news/biz/2011/10/123_96267.html) (visited 13th October 2011)



Diagram 7



### Regulatory and Security Issues

On the understanding that Internet society is a sub-set of wider society and not a ‘special case’ of any sort, it follows that existing laws and regulations rather than new ones aimed specifically at the Internet and social media should apply, either as they stand or with revision. This is not to argue that these are not issues that are special to digital society, because clearly there are. For example, legal problems arise with cross-border communications such as cross-border data traffic between jurisdictions that have different privacy protection laws, and problems arise around how to assign liability for content or for taxation when websites and servers are hosted beyond borders. But these types of problems are not unprecedented: international telecommunications has been around for a long time.

What has really changed is the potential for socially damaging use of digitally-empowered social media, ranging from terrorism and organized cybercrime to hateful and predatory behaviour, etc.<sup>7</sup> Cybercrime and industrial espionage has now reached an industrial scale globally, and SNS has become a treasure trove of personal and company information. This poses problems at different levels and requires responses based upon proportionality or the degree of risk involved. At the international security level, nation states are investing considerable resources in national cyber security centres. For example, the USA has established its National Security Agency and US Cyber Command in the state of Maryland, and Singapore will host Interpol’s global operations centre when phase 3 of the National Cyber Security Centre is completed, due 2013. At the system level, one of the founding fathers of the Internet, Vint Cerf, has gone on record as supporting the idea of starting over

<sup>7</sup> We use the term ‘socially damaging’ rather than illegal because not all social damaging use may be illegal, and not everything illegal may be considered socially damaging.

with an Internet 2: “I would have a stronger focus on authenticity or authentication – where did this email come from, what device am I talking to ...”<sup>8</sup>

At industry level there is a massive effort underway to ensure greater security at all levels, from private to independent data centres, from data in the cloud to data stored on machines, and for traffic across all types of networks, fixed and wireless. At the personal level part of the answer will be the learning curve that everyone has to climb as people get use to the norms of the new society and adjust their behaviour accordingly.

Beyond these issues are others which capture much attention, such as copyright and other IPRs such as patent issues, the right to privacy, personal data protection and data retention regulations, and where liability lies in cases of infringement, such as the posting of content deemed to be illegal or unacceptable. For example, is an SNS liable for hosting materials considered illegal in one jurisdiction but maybe not another, and can they seek a ‘safe harbour’ from prosecution as long as they compile in reasonable time to take down the offending content?

Compliance, security and public goodwill are all involved in these questions, and all affect the public reputation of SNS. There is an inevitable tension between providing an open social media platform, even with the best will in the world to “do no evil” and running a successful business driven by the need to continually grow in terms of users, traffic, content, services, connections and ultimately revenues. Google fell foul in several jurisdictions when it apparently inadvertently collected personal data as its vans went driving around the streets connecting to Wi-Fi networks and photographing buildings for Google Earth and maps. FB has fallen foul of privacy advocates on numerous occasions, sometimes pulling back, sometimes explaining the personal privacy settings to an audience not fully aware of them.

The big question is whether there are foreseeably any major regulatory or security roadblocks ahead. There are clearly some. If national economies start to impose taxation on e-commerce that would certainly have an impact, but it would not be terminal for SNS in general. If states impose restrictions on content, or worse on access, that is likely to be more detrimental. Cyber security could yet be a major roadblock at least to the development of social commercial where SNS link up with online payments systems. There have been several incidences of what are thought to be politically-motivated cyber-attacks, including during the Arab Spring uprisings in 2011 when there were cases of the entire Internet being closed down to silence SNS, but these are always temporary and non-

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<sup>8</sup> <http://www.financialexpress.com/news/time-to-hit-reset-says-one-of-internets-founding-fathers/859279/>  
(visited 13<sup>th</sup> Oct 2011)

sustainable measures unlike selective restricted access or no-access, for example as the authorities in China impose upon Google and FB respectively.

In a very real sense, SNS are expanding their influence from pure social networking to becoming a part of the digital economy in terms of online commerce, as a marketplace for content and apps developers, and as a marketing medium for companies big and small. These developments are for the most part still nascent; for example, the convergence of SNS and mobile apps is opening the way for m-commerce on an enlarged scale. Under these circumstances the mostly widely held view in policy circles still seems to be that regulation should be kept to a minimum in order to encourage this growth in the digital economy.

## C: Business Models and SNS

Typically early dot.com companies were start-ups based upon imagination, talent and enthusiasm, backed by friends and family, 'angel' capital and in some cases venture capital funds. In the 1990s few started with seriously worked-out business plans or tried-and-tested business models: this was uncharted territory. Indeed business failures were widely seen in Silicon Valley as a badge of experience, a point of view nicely captured in Gary Trudeau's *Doonesbury* cartoons.

### Doonesbury's view of the dot.com world



Many of the few that survived the dot.com crash in 2000 have since become household names, but the creations of others sometimes survived by being absorbed. Among the early social media web sites was Geocities, launched in 1994 to allow users to create their own websites, but in 1997 Sixdegrees.com was the first site to allow for personal profile creation and friend listing and for this reason is often considered to be the original SNS. E-commerce sites such as Amazon.com promoted elements of social media by inviting readers to give their comments on books and other products. In 1996 the ICQ instant messaging service was launched and acquired by AOL in 1997. This was followed by Yahoo! Pager (later Yahoo! Messenger) in 1998. Although a search-engine and not an SNS at its core, Google also introduced social networking, including an unsuccessful service called Buzz to emulate Twitter. In 2004 its Gmail service was launched, which like all email services is a *de facto* social networking service, and orkut, named after its creator and Google staffer Orkut Büyükkökten as an SNS service and it retains popularity outside the US, for example in Brazil and India. In 2006 Google bought one-year old YouTube for nearly USD1.8 billion.

In 2011 Google launched SNS Google+ based upon by the categorizing of communities-of-interest into groups of friends, family, acquaintances, business contacts, countries, etc. In recognition of imitation being the sincerest form of flattery, every SNS site, like all *commercial* social media sites, will quickly follow the innovations of their competitors whenever they appear to be a success, so the underlying problem of such sites is that differentiation cannot be easily maintained. New ideas, new services, new formats are easily replicated. There seem to be three ways in which an SNS can maintain its leadership:

- Scale (network effects) and scope (diversification) of operations
- Exclusive content and partnership agreements to deny the competition
- Closed garden access to the underlying development and delivery platform, for example Apple's App Store – this is the product of the previous two points

It may be thought that company-specific intellectual property can also give a protection to a competitive advantage, and indeed Amazon did patent a 'Social networking system' in 2010 based on the now defunct 'PlanetAll', a social networking site used by academic institutions founded in 1996;<sup>9</sup> and Friendster patented a 'System, method and apparatus for connecting users in an online computer system based on their relationships within social networks' in 2006.<sup>10</sup> While these patents prevent direct replication of the systems involved they clearly do not stop the alternatives.

The irony here is that it was once the telecom companies who tried to operate the closed garden approach, for example with 3G networks, but they overlooked the fact that Internet access enabled subscribers to by-pass the 3G gatekeepers by using open websites and over-the-top (OTT) downloads directly to the PC or wireless device. By failing to 'own the customer' – as opposed to serving the customer – the telecom companies failed also to tie-in the content and apps developers on the scale required to operate a sustainable closed garden model.<sup>11</sup> Apple's competitive advantage was forged by creating attractively designed devices which customers flocked to that enabled Apple to attract small content and apps developers on a grand scale and to cut some innovative revenue-sharing deals with the larger content owners of music: the successful execution of a two-sided market approach.<sup>12</sup>

### **Broadband and Apps**

<sup>9</sup> <http://patft.uspto.gov/netacgi/nph-Parser?Sect1=PTO1&Sect2=HITOFF&d=PALL&p=1&u=/netahtml/PTO/srchnum.htm&r=1&f=G&l=50&s1=7,739,139.PN.&OS=PN/7,739,139&RS=PN/7,739,139>

<sup>10</sup> <http://patft.uspto.gov/netacgi/nph-Parser?Sect1=PTO1&Sect2=HITOFF&d=PALL&p=1&u=/netahtml/PTO/srchnum.htm&r=1&f=G&l=50&s1=7069308.PN.&OS=PN/7069308&RS=PN/7069308>

<sup>11</sup> No 'closed garden' is sustainable forever.

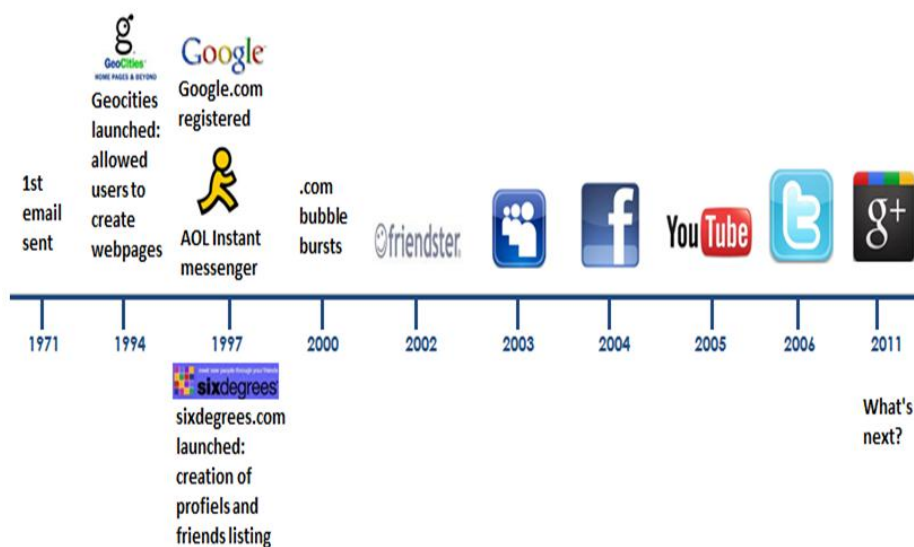
<sup>12</sup> [http://en.wikipedia.org/wiki/Two-sided\\_market](http://en.wikipedia.org/wiki/Two-sided_market)



Although the dot.com crash was typified by the implosion of thousands of dot.com companies as they simply ran out of cash – their revenues were just insufficient – the demand for social media activities, such as sharing photographs, exchanging chat, posting travel experiences, using dating services, etc., grew as ‘communities of interest’ because these activities were simply social activities continued over into digital space. For example, Friendster (for contacting friends) and Flickr (for sharing photographs) were both post dot.com startups. Global economic recovery was happening in 2004 when Facebook was launched, followed in 2005 by YouTube which was later bought by Google, and in 2006 by Twitter.

Diagram 8

### Origins of SNS

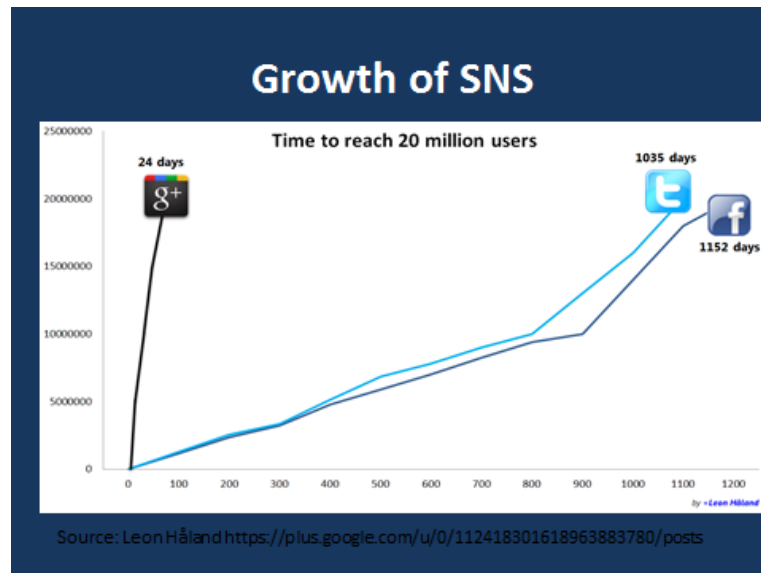


Reliable networks offering fast speeds and easy and affordable access are essential for the success of Internet businesses, and the 2000s has been the era of broadband in which megabit speeds in fixed line and wireless networks are becoming commonplace, at least in urban areas. Given this level of broadband, the mass consumer market has been driven by a raft of smart devices, notably smartphones, designed specifically for online access to apps and content. In addition to Internet cafes, in developing or ‘emerging’ markets mobile phones are the way most people first access the Internet.

Given this much more favourable operating environment, the rate of growth of SNS users has accelerated within and across economies. For example, it took over 1,000 days for

Twitter and Facebook to reach their first 20 million users compared with 28 days for Google's G+ launched in 2011.<sup>13</sup>

Diagram 9



That begs the question: when does the rate of growth slow up? Where is the saturation point in the market? For example, although G+ grew rapidly, by end-2011 it remains very much at the early adopter stage and according to a report by *Chitika* its traffic volume growth which had been rising to mid-September 2011 then experienced a dramatic 60% drop.<sup>14</sup> Apple's Ping also seems to have struggled to gain traction, and even the growth of Facebook's active user base has shown signs of slowing down.<sup>15</sup>

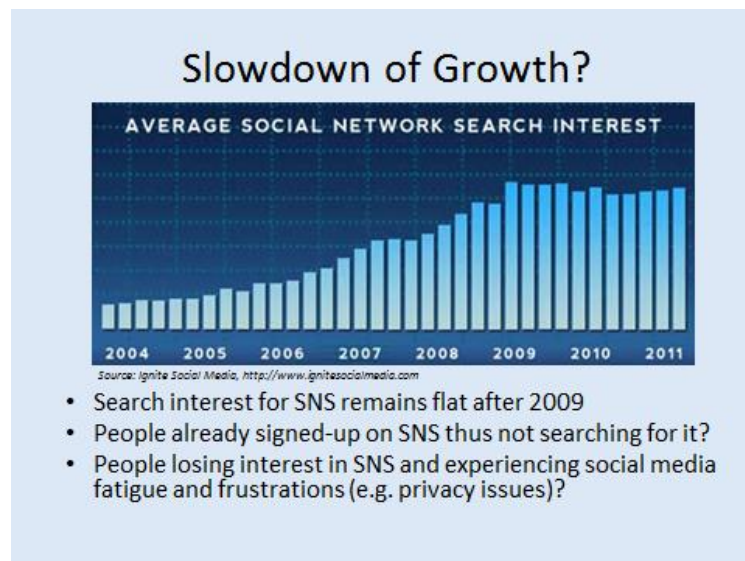
<sup>13</sup> Of course, Google could migrate existing Gmail customers, but the speed of uptake is qualitatively different from the mid-2000s.

<sup>14</sup> 'Failure to Launch: Google+ Growth Spurt Short Lived' Chitika, 7 October 2011 (visited 18 October 2011) <http://insights.chitika.com/2011/failure-to-launch-google-growth-spurt-short-lived/>

<sup>15</sup> "[a]ccording to data from *Inside Facebook*, Facebook's growth in April and May 2011 slowed considerably. It gained 11.8 million new users in May, and 13.9 million in April — compared to a typical month in the last year when it grew by at least 20 million users." 'Facebook's Growth Slows' Stan Schroeder, 13 June 2011 *Mashable Social Media* (visited 20 October 2011) <http://mashable.com/2011/06/13/facebook-loses-users/>

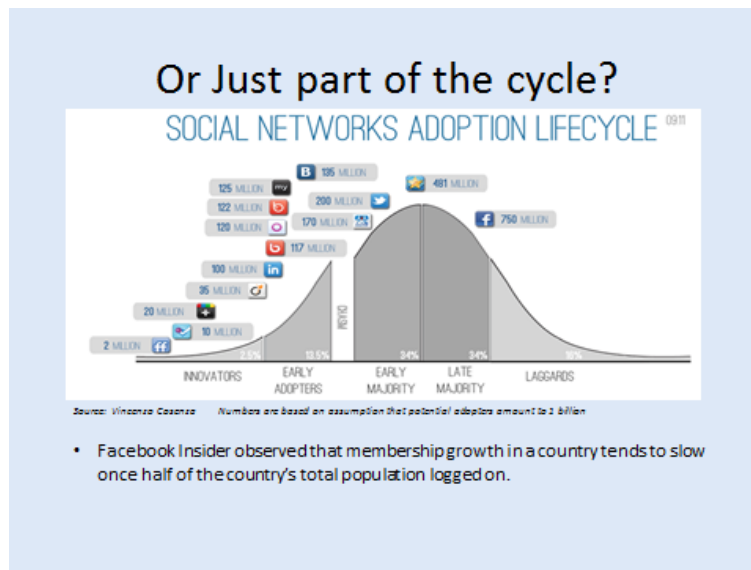
Of course the key statistic is *Users x Usage* so both metrics will be important going forward. Also, data may show a hiatus at times prior to new markets such as Africa opening up, and new services, but according to Google statistics, search data for SNS sites shows a marked leveling off from 2009 onwards. The vertical axis in the diagram runs up to 100 showing the proportion of traffic for a given query, so higher volumes of query traffic are closer to 100.<sup>16</sup> This could indicate that most people who want to join are already members.

Diagram 10



<sup>16</sup> <http://www.ignitesocialmedia.com/social-media-stats/2011-social-network-analysis-report/> (visited 16 October 2011) cited by Brian Chappell <http://www.ignitesocialmedia.com/social-networks/social-networks-2011-winners-and-losers-as-shown-via-search-volume/>

Diagram 11



The familiar S-curve or logistics diagram maps out one possible scenario in terms of up to one billion users worldwide constitutes the 'late majority' phase of the market. However with the world's population threatening to break through 7 billion and possibly continue well beyond that number it seems unlikely that 1 billion is already the 'late majority', especially in the absence of most of Africa.

### **Numbers Matter?**

Judging the long-term commercial strength of an SNS will depend on more than numbers of account holders. First, much will depend upon how many accounts are active, what are the demographics of users and what is their online behaviour in terms of e-commerce such as purchasing virtual money or accessories for games, joining group-buying plans, clicking on ads and purchasing from the vendors, and so on.

Measuring Growth of SNS: Metrics	
Users	Total number of users; growth rate of users; percentage of users compared to online population
Demographics	Age groups; sex; ethnicity; language; etc.
Time	Average time spent on SNS
Geography	Areas where SNS is accessed
Usage	Active or passive; what SNS is used for; how do people access SNS
Business	Membership size; brand mentions in SNS; conversions (of click-throughs)
Market Research	Nielsen, Kantar, Burson-Marsteller, Ignite Social Media, eMarketer, etc. provide data regarding SNS

An example of less useful metrics would be the statistic that Twitter had 175 million registered users in March 2011, but according to calculations by *Business Insider*, “a little subtraction shows us that there are 56 million Twitter accounts following zero other accounts, and 90 million Twitter accounts with zero followers.”<sup>17</sup> As nineteenth century British PM Benjamin Disraeli is reported to have exclaimed – according to Mark Twain – there are ‘lies, damn lies and statistics’ and in any media setting, including online social media, ‘metrics’ consist of a mixed bag of calibrations and measurements. Probably the most meaningful metrics are those insisted upon by the advertising agencies as they have the most immediate commercial-interests. SNS use various ad models, for example, Facebook Ads and Google’s AdWords allow both pay-per-click (PPC) and cost-per-mile (CPM) or the cost per one thousand views for banner ads.

Second, if an SNS can develop a core service that is difficult to replicate and that core service proves popular then a more sustainable foundation exists. Google for example has search as its difficult-to-replicate core service and its social networking is an add-on development. Facebook by contrast has not yet established such a service, but it seems to be developing a ‘passport’ strategy that will allow a user’s FB personal identity easier access to numerous other sites and services. Insofar as these have to be negotiated between FB and those other sites replication may be difficult. Of course, FB may also develop or adopt through a partner a search engine to consolidate its loyal customer base.

In terms of numbers, none are yet available for Africa, but longer term as network access spreads and costs fall the continent of Africa will be a big market for growth. On the other hand, China is about the only market of substantial size that systematically restricts or denies access to global brands such as Google and FB. China also restricts or denies access to many foreign bricks and mortar companies wanting to enter China’s domestic market so in that sense there is something of a synergy, but the restrictions on the digital social networking are less to do with tilting the commercial balance in favour of home-grown companies – that seems to be a secondary albeit a concomitant consideration – than on the need of the authorities to set boundaries on *who* can access *what* information and who can *disseminate* what information and *express* an opinion. As Deng Xiaoping said about the Open Door policy of 1979, the door to information would be the last door to open.

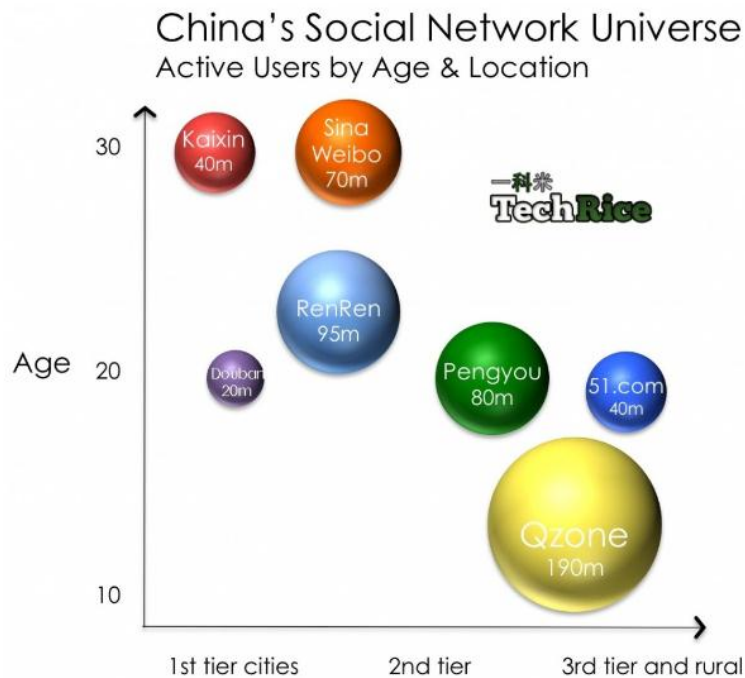
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<sup>17</sup> Chart of the Day: How Many Users Does Twitter REALLY Have? Nicholas Carlson, *Business Insider*, 31 March 2011 (visited 20<sup>th</sup> October 2011) <http://www.businessinsider.com/chart-of-the-day-how-many-users-does-twitter-really-have-2011-3>



Diagram 12

China's SNS universe for the top 7 sites.



Source: 'China's Top 15 Social Networks' Kai Lukoff 03/08/2011 <http://techrice.com/2011/03/08/chinas-top-15-social-networks>

Nevertheless, social media – including highly popular micro-blogging – is playing a role of growing importance in China, often highlighting stories and events before they are taken up by the official media, and also contributing to a new wave of consumer-led e-commerce. Among the most popular forms is group-buying or Tuángòu. According to Wikipedia there are more than 800 tuangou websites in China, and according to the China Daily, yoka.com's group-buying application on SNS kaixin001.com attracted 180,000 netizens in a few days with around 5,000 buying on a daily basis. The same report mentions SNS are turning to online payment systems.

## D: Sustainability and SNS

In moving from ads to online payments, SNS have an advantage over traditional e-commerce and shopping sites because they already have a mass base of 'netizens'. In 1964 one of the most insightful scholars of the media, Marshall McLuhan, published *Understanding Media: The Extensions of Man*, coining the phrase 'the medium is the message' – he also originated the term the 'global village'. His central thesis was that great innovations in media act to *extend* the capabilities of people to do what they desire to do. Such innovations do not change behaviour in terms of its goals but in terms of ways to accomplish those goals. Communication is among the basic of human needs (to survive) and desires (to enjoy life). If SNS can offer e-commerce as an *extension* of what users/netizens already desire to do, be it play games using virtual money to buy game accessories or be it shopping around for discounts through group-buying, then they can capitalize on their consumer base.

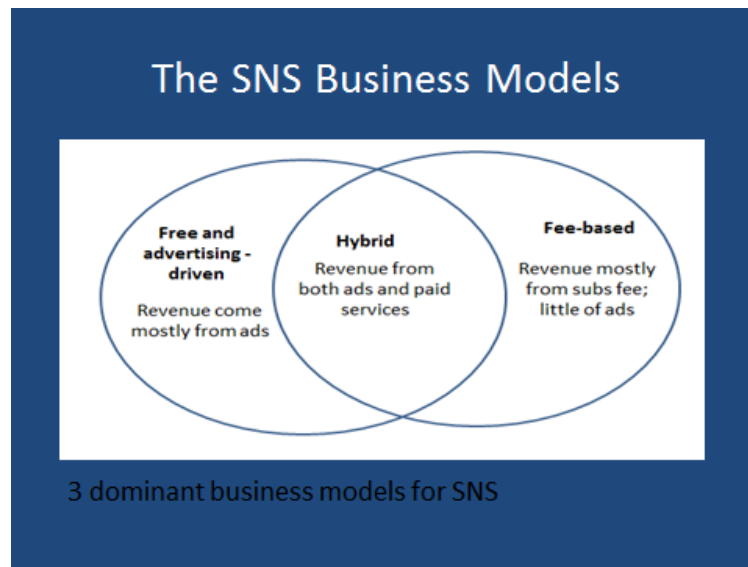
In other words, SNS as part of digital social life can more closely replicate the norms of non-digital society and thereby become an *embedded* part of the new reality. Or in marketing terms, SNS will emerge as a permanent new channel. But this is not yet guaranteed, certainly not for any particular SNS, and there may be yet other important forms of digital social media to emerge in which case the key business issue for SNS is whether they can adapt to and ride that change when it comes.

In the short-to-medium term, i.e., any period to be covered by an IPO for example, an SNS like FB needs to 'monetize' its user base to the maximum. This will be an incremental process with the danger that moving too quickly will alienate users, for example, too many intrusive advertisements or the sharing of user's contact lists when signing up for an app without the consent of the contacts which seems to be the current direction. At the basic level, business models fall into three categories: ad-driven, fees-driven or most commonly a hybrid model.<sup>18</sup>

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<sup>18</sup> In 2006 Fred Stuzman suggested I his blog 5 overall revenue sources: (i) Advertising, (ii) Product affiliation groups, (iii) Partnership opportunities, (iv) Micropayments, (v) Subscriptions/premium features <http://chimprawk.blogspot.com/2006/10/selling-social-networks.html> (visited 20 October 2011)

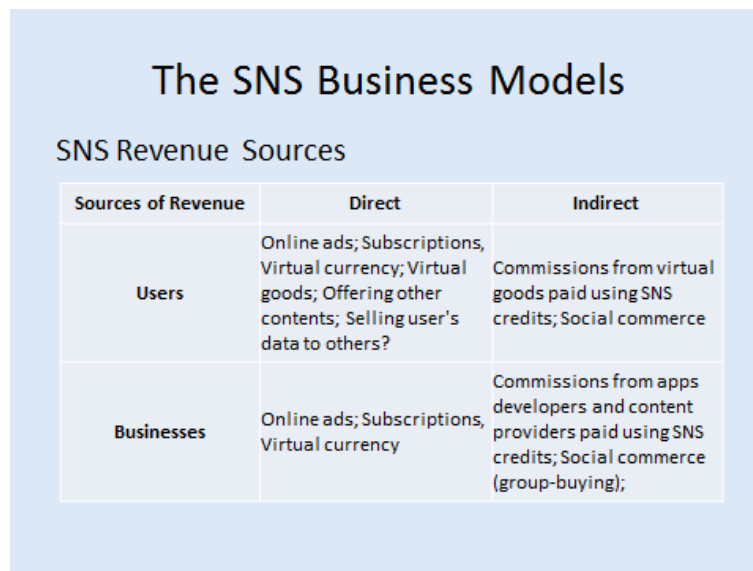
Diagram 13



Sources of revenues can be further segmented in terms of user-generated and business-generated and whether the source of fees is directly from either or from third parties. Examples would include the following:

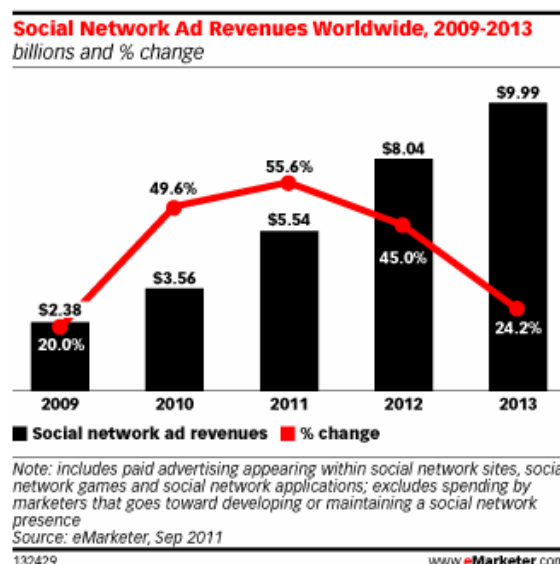
Revenues generated by users, business and 3 <sup>rd</sup> parties	
Online ads	<ul style="list-style-type: none"> <li>o SNS post targeted online ads on its API, based on information from users</li> <li>o Facebook filters the ads based on users' info such as location and also based on the topics posted.</li> </ul>
Subscriptions	<ul style="list-style-type: none"> <li>o LinkedIn offers paid subscription services such as job postings and viewing of more profiles among others</li> </ul>
Virtual goods	<ul style="list-style-type: none"> <li>o Tencent's QQ and Japanese and Korean SNS have a range of virtual goods that can be collected or given to other users</li> </ul>
Virtual currency	<ul style="list-style-type: none"> <li>o Facebook credits: user can use the virtual currency to purchase games and other contents. Facebook earns commissions from the purchases</li> </ul>
Social commerce	<ul style="list-style-type: none"> <li>o GroupOn, LivingSocial and others posts deals from various merchants and get commissions from the purchase of the deals.</li> </ul>

Diagram 14



There is plenty of data showing the gradual growth of revenues from all of these sources and far more data will be on display if and when as FB and others offer an IPO as planned. A forecast from *eMarketer* for social network ad revenues by end-2011 is USD5.5 billion, of which half comes from the US. By 2013 the forecast is USD10 billion.<sup>19</sup> But as their chart

Diagram 15



<sup>19</sup> 'Social Network Ad Revenues to Reach \$10 Billion Worldwide in 2013' *eMarketer* 5 October 2011 (visited 20 October 2011) <http://www.emarketer.com/Article.aspx?R=1008625>

shows this suggests a *fall* in growth rate. No explanation is offered for this trend, although the threat of another global economic recession may have affected their forecasts.

Nevertheless, their figures do suggest that a growing proportion of total ad spending will go to social networking sites. Needless to say, FB is expected to benefit the most. A report from *Reuters* suggests FB doubled its total revenues in 2H 2011 to USD1.6 billion.<sup>20</sup> *The Financial Times* reported that FB's ad prices had been raised by more than 74% over the year in four of its largest markets.<sup>21</sup> If these figures are on target and FB captures 50% of the ad revenues, it could mean FB boosting its revenues up to USD4 billion by 2013 making an IPO an attractive proposition. In 2011 at least two US funds have been set dedicated to investing in private social networking, GSV Capital (USD50 million) and Keating Capital (USD86 million).<sup>22</sup> As *The Economist* reminds us, entrepreneurs in Silicon Valley refer to the URL strategy: Ubiquity first, Revenue Later.<sup>23</sup> FB may have reached that point already.

### ***Putting in Perspective***

This paper has argued that the key business model issue for SNS is sustainability: will SNS be the dominant form of social media for social commerce in the future, or will other digital media developments overtake SNS; will SNS be able to adapt to new media developments; and which SNS will survive up to the medium term. One way to place this in perspective is to compare the key features of the business models of telecoms, Google, Facebook and Apple.

The core activity is the line of business that is fundamental to the company: broadband nowadays in case of telecoms companies, search remains the bread and butter business of Google, SNS for FB and i-devices for Apple. Each has also a diversified range of services which are leveraged off the core service. The strength of each company hinges either upon it offering a utility service as in the case of telecoms and Google, or upon its network effect as with FB and/or its closed garden as with Apple.

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<sup>20</sup> 'Facebook doubles first half revenues' Alexei Oreskovic, *Reuters* 7 September 2011 (visited 20 October 2011) <http://www.reuters.com/article/2011/09/07/us-facebook-idUSTRE7863YW20110907>

<sup>21</sup> 'Facebook as prices soar more than 74%' Tim Bradshaw, 19 July 2011, *The Financial Times*

<sup>22</sup> 'Second fund targets tech groups in echo of the dotcom bubble' Telis Demos, *Financial Times* 14 July 2011

<sup>23</sup> 'Social networks have a better chance of making money than their critics think' *The Economist* 28 January 2010



Diagram 15

SNS Sustainability: Comparison with other models				
	Telecomm	Google	Facebook	Apple
Core Activity	Broadband	Search	SNS	Access Devices
Diversified	Value Added Services	SNS	Social Commerce	App Store; Music and digital media
Business Model	Utility	Utility	Network Effects	Closed-Garden
Replicability (Indicates sustainability)	Difficult - high barriers to entry (capital-intensive)	Difficult to replicate the effectiveness of its search algorithm	Medium-term? Facebook built on the ideas of its predecessors and improved upon them	Long-Term? The unified platform offers virtualization across devices + many App Store tie-ins
Access/Usage	Access/Usage	Access/Usage	Usage/Access	Usage/Access

The key question is how easy is it for competitors to enter the market and replicate the core activities that support and sustain the value added activities. In other words, it is insufficient to measure the success of value-added revenue generation without examining the long term sustainability of the business core activity, *even where the core activity may not be the major revenue generator*.

The most vulnerable business model in the table would appear to be the FB model in terms of market entry and possible replication. Naturally FB will take its own steps to bolster its position by taking out 'options' on investments in complementary businesses, possibly including search and/or access devices. The final row highlights the fact that the core business activity is first and foremost about access in the case of utilities, a staple commodity in demand. In the case of FB and Apple it is about usage. Mass usage generates mass revenues, but the long term question is always, who will be the service providers receiving those revenues.

## ***Conclusion***

Two issues arise from this. First, investment risk must be based upon an assessment of the medium-to-long term sustainability of the business model in question and the adaptability of the company threatened by new entry and innovation from others. It is argued here that sustainability requires a stable core business even if most of the revenues do not come directly from that core.

Second, if the growth path (the numbers) is to be sustained, SNS will need to anchor their services in reliable data networks to maintain quality of service, and to do deals with access network providers and/or access device vendors in addition to the deals being cut with apps and content providers and other social media sites. In other words, SNS will need to move into infrastructure, either directly as the owners of networks or virtually through leasing and partnership arrangements. Google and Facebook have already taken steps in that direction.