

Market Snapshot

THE BUSINESS OF SOCIAL NETWORKING

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“If you are not on MySpace, you don’t exist.”



16-year old Skyler Sierra quoted by Danah Boyd (www.danah.org) at a 2007 presentation at the Berkman Center for Internet and Society, Harvard Law School¹ .

The accuracy of this statement may be questionable, but the above quote effectively captures the staggering global popularity and growing ubiquity of online social networking sites^{2,3}. Closer to home, in spring 2007, Toronto was crowned “The Social Media Capital of North America” and “the Facebook Capital of the World”, though the Facebook crown passed from Toronto to London by fall 2007^{4,5,6}. While popular social networking sites enable individual users to connect and share interests and information, it is also the case that technology and product developers and marketers increasingly view these portals as attractive platforms for conducting business and showcasing their wares - often to a targeted audience. Despite this growing popularity of social networking trends, it is not uncommon for new market entrants to find themselves grappling with questions such as: ***Just how big is the online social networking market? And what exactly does it take to build a successful commercial venture around online social networks?*** Our goal in preparing this document has been to provide Ontario-based entrepreneurs with a primer on this very dynamic market.

In compiling the information for this document, we have utilized licensed market research resources as well as other secondary research resources with these specific objectives in mind: 1) to present current market data and trends related to online social networking*; 2) to provide an overview of business models employed in monetizing online social networks; and 3) to provide technology entrepreneurs and start-ups with an update on strategies and recommendations for launching and/or operating successful companies in the social networking space.

*A **social network**, as noted by IDC, “consists of nodes and links connecting the nodes, where the nodes represent individuals or organizations, and the links represent varying degrees of social relations and interactions between these individuals or organizations. It is therefore a sociological term, even though it is used as shorthand for **‘social networking services’**. A social networking service is an Internet service the primary purpose of which is to facilitate building and maintaining a social network”.

Definitions and Market Segmentation

Although definitions of social networking sites often vary contextually, here the term will be used to refer to web portals such as MySpace, Facebook, Bebo and LinkedIn that enable online social networking, and have changed the Internet from a medium providing access to static content to a medium where connectivity, dialogue and user-generated content dominate⁷. As defined by IDC, a social networking application is “a commercial software, often delivered as a service, to create and maintain social networks. Functionality typically includes configurable member management, participant profiles, profile linking, and communication tools that can vary from online discussion threads and blogs to unified communication services that enable email, chat, video and voice interaction”⁸.

IDC divides the overall social networking applications market into three emerging segments: 1) self-service applications providing a self-service, consumer-like model and having integrated advertising platforms that enable creation, deployment and management of social media communities; 2) brand applications focusing on customer engagement and driving interaction; and 3) enterprise applications providing more effective ways of working with customers, partners and other external parties⁹. This document, however, does not address the final segment: enterprise applications of social networking technologies for collaborative and networking purposes. Instead, we define social networking applications as software applications that constitute the **core** of social networking sites as well as applications that **enrich** user-experience on social networking sites by offering additional functionalities.

Market Size

In a recent article, the Canadian publication *IT World Canada* summarizes the size of the social networking market: “if the population of the Web’s social networking sites were a country it would be the third-most populous nation on the planet”¹⁰. Tables 1, 2 and 3 provide an overview of the membership- and revenue-data, respectively, as well as the market-growth projections for online social networking sites¹¹.

Table 1. Memberships on online social networking sites

Geography	2007 (Estimated)	2012 (Estimated)	CAGR % (2007 - 2012)
Global	229.6 million	565.0 million	19.7
North America	56.6 million	126.9 million	18.0
Canada	5.4 million	11.6 million	17.0

Table 2. Revenues from online social networking sites

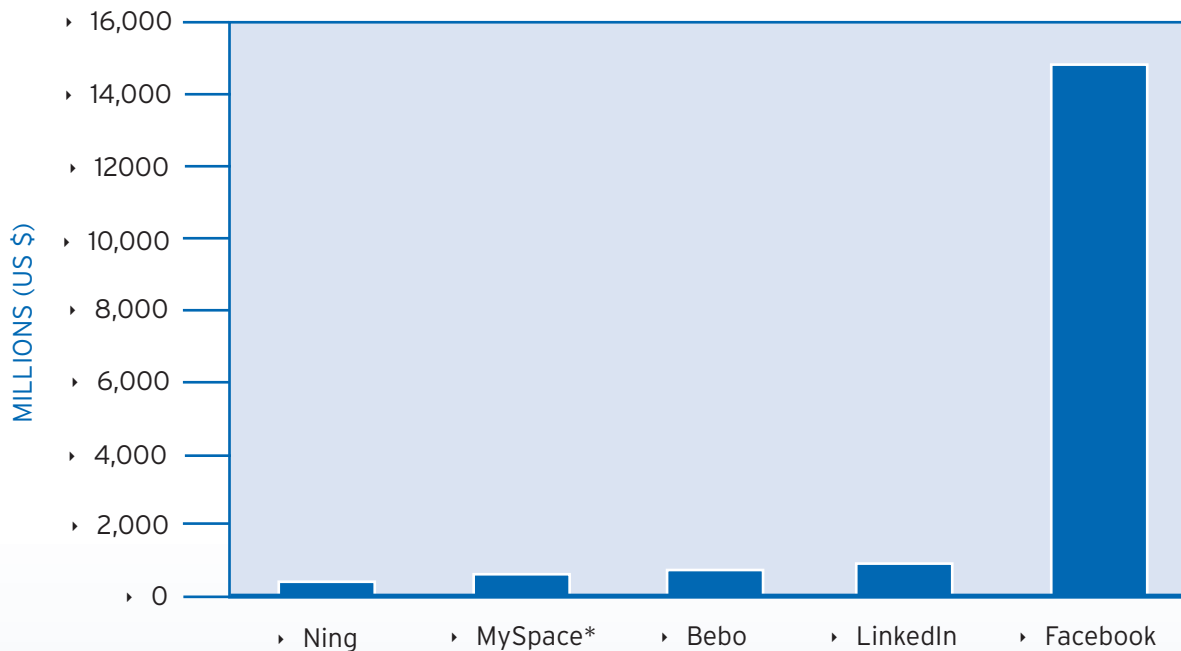
Geography	2007 (Estimated)	2012 (Estimated)	CAGR % (2007 - 2012)
Global	\$965.9 million	\$2,423.5 million	20.2
North America	\$496.9 million	\$1,115.5 million	18.0
Canada	\$32.1 million	\$69.0 million	17.0

Table 3: Some stats on the top two social networking sites

	MySpace Launched Jan. 2004	Facebook Founded Feb. 2004
Number of active users	110 million ¹²	70 million ¹³
Average number of new registrations per day (since Jan. 2007)	300,000 ¹⁴	250,000 ¹⁵
Total number of applications launched on the platform (2008)	955 ¹⁶	>13,000 ^{17, 18}
Revenues (estimated for 2008, US\$)	\$800 million ¹⁹	\$300-350 million ²⁰

Both IDC and Datamonitor predict that global social networking will continue to grow, only flattening in 2012^{21, 22}. For Canada, both memberships and revenues from social networking are expected to reveal a growth pattern similar to that expected globally - growing steadily until 2010 and then reaching a plateau around 2011²³.

Table 4. Recent Valuations of Social Networks



▸ *MySpace's valuation of \$570M equals the sum paid by News Corp in 2005; Facebook's valuation of \$15B is based on the pricing of Microsoft's 1.6% share acquired in 2007. All other valuations are from 2008.**

As in the case of the overall social networking market, the social networking application market also appears to be poised for growth that is followed by a plateau. The size of the U.S. social networking application market was estimated at approximately US\$47 million in 2006, growing to approximately US\$428 million by 2009 and is forecast to slow down after 2011 (CAGR, 2006 - 2012: 55%). Market analysis by IDC suggests that this trend will be primarily driven by the slow adoption - over a longer period of time - of social networking solutions and applications by small- and medium-sized businesses²⁵.

Market Trends

An interplay of several market forces is expected to shape the online social networking / social networking applications landscape. Trends that act as strong drivers for online social networking and that, in turn, will continue to make these sites attractive platforms for marketing applications and products include^{26, 27, 28}:

- Increased access to and time spent using the Internet and mobile communication devices
- Increased broadband penetration
- Internationalization of popular social networking sites
- Evolution of do-it-yourself social networks estimated at approximately US\$47M

The release of Google's OpenSocial Initiative may influence the development and marketing of future social networking applications. OpenSocial, released in November 2007, refers to a "set of common application programming interfaces (API) for web-based social network applications." In principle, applications implementing the OpenSocial APIs are intended to be inter-operable with any host social network system that supports them. However, thus far, the overall uptake of the OpenSocial platform has been limited due to technical challenges with implementing the framework across different social networks and due to security issues^{29, 30, 31}. One rapidly emerging segment within the online social networking market is mobile social networking. The advent of social network channel extenders such as Intercasting, Trilibis Mobile and Mobestar has enabled social network services, vendors and publishers to extend their content and functionality to the mobile channel. Further, location-based applications like Gypsii and Clicmobile facilitate GPS-based pinpointing, thus equipping mobile social networks with additional functionalities such as establishing the geographic relation between users, as well as between users and certain locations³². However, according to a recent IDC analysis, U.S. penetration of mobile social networking is at a very modest 1.1%. Further, it might take up to 2012 for mobile social networking providers to attain penetration rates of 10% and hundreds of millions in annual revenue³³.

On the flip side, user concerns over privacy and security of personal information are critical issues that must be addressed by businesses to ensure success and longevity for online social networking/social networking applications³⁴. The strong backlash to Facebook's introduction of behavioral targeting through its advertising service "Beacon" illustrates users' privacy concerns, and their need for explicit communication on how the data on their profiles and activities will be used^{35, 36, 37}.

Additionally, to succeed in the mobile social network services market, providers will need to address issues such as: (a) high cost, (b) low consumer interest, (c) limited high-end device penetration and (d) content filtering and privacy rights³⁸.

Business Models

Currently, there are three main business models that online social networking sites use:

- Advertising
- Subscription
- E-commerce

A review of membership and revenue data from online social networking (Table 1, 2 and 3) reveals that online membership growth far exceeds the growth in social networking revenue. Based on current estimates, annual revenues from social networking sites average approximately \$3 per member. Further, almost all online social networks primarily depend on advertising for their revenues and, as pointed out by IDC, "for all the traffic, the reality of advertising on social networks is that so far there is little of it." Advertising revenues yielded by some popular social networking sites are documented in Table 5³⁹.

Table 5. Advertising revenues from popular social networking sites.

Social Networking Service	Advertising Rates ⁴⁰ (based on CPM ⁺)	Estimated Advertising Revenues (2007) ⁴¹
MySpace	\$2	\$ 525 million
Facebook	\$ 0.15	\$ 125 million
Other	N/A	\$ 172 million

In a 2006 analysis, Wharton marketing professor Leonard Lodish points out that “in the case of online social networks such as MySpace and Facebook, the cost of gaining new customers is practically nothing because users join voluntarily and provide their own content through their profiles. Also, the cost of running the sites’ web servers is relatively low. If a classic advertising or subscription revenue model is used, low-cost social network sites could be highly profitable”⁴². According to an eMarketer report global ad spending in the online social networking market in 2008 is expected to increase 75% year over year, amounting to a total of \$2.1 billion^{43, 44}. Despite these advantages, monetizing online social networking continues to be one of the biggest challenges confronting this market, indicating that companies need to identify profitable business models*, and to continually review their business and operating strategies, some of which are presented in the following section.

One example is provided by social networking platform Ning (www.ning.com), which enables anyone to build her own social network based on Ning’s technology. While the basic service is free, customers who create their own social network can choose to pay monthly fees for services like increased storage and bandwidth, removing Ning’s promotion links, getting your own domain name, controlling the ad space (In the basic free version, Ning will control and sell the ad space on your network for their own revenue). As of April 2008, 230,000 networks had been created on Ning’s platform, with more than a 1,000 networks being added each day⁴⁵.

In a recent press release, LinkedIn announced that it was aiming to generate \$100M in revenue from their 23M user base in 2008⁴⁶. On a per-user basis that amount is approximately \$4.35 per user - somewhat higher than IDC’s of \$3 per user as previously mentioned. With a user base largely made up of professionals, LinkedIn makes money from advertising sales (to recruiters) and premium member services.

However, the aforementioned backlash to Facebook’s “Beacon” service illustrates the difficulties social networking sites are having in translating the high volumes of users and activities into revenue from advertising, particularly compared with a company like Google. Despite the backlash against Beacon, the service still exists and is helping Facebook create advertising products for marketers that are eager to reach social network members. With time it might turn out to be the solution the industry is looking for but, as Facebook knows, it has to tread carefully with regard to their members’ privacy, according to shareholder Roger McNamee.⁴⁷

*CPM: Cost Per Thousand (“Mille”) serving of an ad.

* See <http://chimprawk.blogspot.com/2006/10/selling-social-networks.html> for some alternate models proposed for monetizing online social networking.

Strategies

Both Facebook and MySpace seem to be innovating in order to generate more revenue from advertising:

- In May 2008, MySpace announced a new page layout for its members. While aiming to make it easier for members to track down friends and family members, the primary goal of the de-cluttering was to increase space for advertising on the member pages of MySpace⁴⁸.
- Facebook, in turn, launched a new advertising format dubbed 'engagement ads' in August 2008. As the name suggests, the purpose of this ad format is to allow the members to engage with the brand, either by becoming "fans" of the advertiser's brand, commenting on the ad or giving promotional gifts from the ad⁴⁹.

The challenge for both MySpace and Facebook is that these changes will not be effective unless marketing executives, advertising agencies and media advisors see value for their brands in these new formats on offer. What follows are some general recommendations for Ontario start-ups that either seek to build and host a social network or use existing social networks as marketing platforms:

Recommendations for start-ups promoting their brand on social networks:

In their book "Groundswell"⁵⁰, Charlene Li and Jeff Bernoff suggest that **"the key to success in Social Networks is to help people spread your message and to measure the results"**. Among their recommendations for marketers on social networking sites are:

- Use research to ensure that your target customers are indeed using social networks.
- Only use social networks for marketing if your brand is "loved"; if members in a social network don't like your brand enough to "friend" your brand, the marketing effects will be lost.
- Ensure that the content to be displayed on social networking sites encourages interaction by being engaging, interactive and easy to share online.

Recommendations for online social networking hosts and application developers:

- Any social network (or social network-based application) needs to offer real utility and purpose to earn user participation and loyalty⁵¹.
- To enhance revenues from ad sales, IDC recommends: (a) focusing on demographic targeting using solutions such as 'data mining' and 'verticalization;' and (b) ensuring advertisers' brand safety by implementing peer-review or filtering software to screen out inappropriate or pirated content⁵².
- In the quest to drive advertising revenue, avoid alienating site members. Implementing a transparent policy that protects members' data and privacy is key.

Conclusion

Social networks offer large, untapped audiences that can be monetized. Although many analysts⁵³ are skeptical about the business of social networks, we believe it is too early to conclude that it is not a viable business. However, social networks need to work hard to fulfill the initial promise that their large member bases represent (and their high valuations suggest as per Table 4). The fact that the members of a social network themselves are largely in control of the content and messages in the medium, poses a new set of creative challenges for marketers when compared to the much more controlled environment offered by traditional media, including most other online environments. Social networks are a completely new medium and it is natural that it will take some time for marketers to master it.

Building on the recommendations from Li and Bernoff to marketers above, it is clear that social networking hosts need to work closely to educate marketers and advertising agencies on the particulars of social networks as a space for promotional activities. The challenge most networks will face is that it is hard for marketers to find budget to experiment with in tough economic times. For those social networks that can successfully help marketers master the new medium, the rewards will be great from a business perspective and represent a great opportunity for quick learners with creative talent.

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