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NEWS ANALYSIS

By Steve Rosenbush

Socializing for Dollars

Sites that link up users in affinity groups are wildly popular. Even better, they seem to have figured out how to make money

Last year, News Corp. (NWS) drew a lot of attention for paying \$580 million to acquire Internet sensation MySpace (see BW Online, 11/15/05, "Users Crowd Into MySpace"). The price generated a fair amount of controversy.

Skeptics said the social-networking site, where mostly teen and young adult users trade messages on home pages loaded with photos, blogs, and music, was a risky bet. They argued that younger audiences are fickle and that MySpace would be in trouble if the cool kids skipped off to the next hot site. Others said the acquisition by a large corporate entity would ruin the appeal of MySpace.

LOOKIN' GOOD. The objections seemed reasonable enough. The only problem with the gloomy scenario is that, so far, it hasn't come to pass.

MySpace -- which was said last year to be making profits in the millions of dollars -- has become larger, and according to News Corp., more profitable. And LinkedIn, a subscription-based social-networking site for professionals, has turned cash-flow positive after about three years of operation, co-founder Konstantin Guericke says (see BW Online, 4/10/06, "How LinkedIn Broke Through"). There may be a financial basis for social networking, after all.

The dire ending for MySpace still could come to pass -- But that scenario loses plausibility with each passing month.

Other social-networking sites are growing at an astonishing rate, too. Facebook, a site for students, is now the seventh-busiest spot on the Web. (see BW Online, 03/28/06, "Facebook's On The Block").

The site's owners, who started Facebook just two years ago when they were sophomores at Harvard, would want as much as \$2 billion to sell the company, a senior media executive told BusinessWeek Online.

TREND FOLLOWERS. Such success is forcing traditional media companies and advertisers to consider the possibility that social-networking sites are here to stay. If that's the case, they may have to develop a strategy of their own, buying or building their way into the market.

Media giant Viacom (VIA) has hired social-networking experts of its own and has even been in talks about a possible acquisition of or investment in Facebook.

That's not to say that the sites don't present plenty of business challenges. User-created content on the Web can be unpredictable, creating risks for companies that don't want their brand associated with racy or edgy material. Parents, politicians, and police have become concerned that criminals could be taking advantage of MySpace (see BW Online, 03/06/06, "Making MySpace Safe for Kids").

There are other challenges. The fact that a Web site has lots of users doesn't necessarily mean that users pay attention to ads, let alone respond to them. "User does not equal audience," says Troy Young, executive vice-president of Organic, an online advertising and consulting agency.

The companies have attracted major investors. LinkedIn has received venture capital from Greylock and Sequoia Capital, which helped launch companies like Google (GOOG), Yahoo!, Cisco (CSCO) and Apple Computer (AAPL). Facebook raised \$12.7 million in venture money from Accel Partners, a backer of Internet music and video player RealNetworks (RNWK).

Are the business models viable over the long-term, though? Some experts say the answer is yes. The Internet in general is becoming a more legitimate medium for advertising. "Online rates continue to climb. The cost rose 20% last year," said Jeff Lanctot, general manager of online advertising firm Avenue A/Razorfish.

FLOCK OF ADVERTISERS. Social-networking sites are attracting a rising number of major advertisers. Most of them come from the entertainment sector, although consumer products companies are active, too (see BW Online, 6/13/05, "Hey, Come To This Site Often?"). Target (TGT), NBC (GE), and Procter & Gamble (PG) have run ad campaigns on MySpace. Interscope Geffen A&M Records (V) has launched new albums from Beck and other artists there.

Social-networking sites have some natural advantages for advertisers, too. Even if the environment can be a bit wild, it creates an opportunity to develop powerful affinity groups and to collect a mother lode of demographic data about its members.

That can be used to create carefully targeted promotions that go way beyond the common text and display ads found on the Web. "It's a challenging environment to get your message across, because there is a lot going on, like in a teenager's bedroom," says Organic's Young. "But there's an upside, because people reveal a lot about themselves when they use social-networking sites. That can allow you to target messages in pretty sophisticated ways."

Procter & Gamble used MySpace to launch Secret Sparkle, a deodorant for 16-to-24-year-old girls and women. It linked the product to the home pages of musicians that used MySpace and appealed to the same demographic.

When users listened to new songs by The Donnas and Bonnie McKey, they were exposed to ads for Secret Sparkle and offered a chance to participate in a Secret Sparkle sweepstakes (see BW Online, 04/04/05, "Broadband Ads' Speedy Progress").

HIGHER END. Advertising isn't the only approach to making money in social-networking. Some sites are having some luck with getting users to pay.

That's a difficult thing to do on the Web, where information tends to be free. But LinkedIn uses a combination of free access and tiered levels of service that range from \$60 to \$2,000 a year.

The higher-end plans allow professionals like headhunters to search for job candidates. A headhunter can make \$30,000 or more by placing one job candidate, so an investment in a high-end LinkedIn plan can easily be justified, LinkedIn's Guericke says.

Other sites are hoping to maintain their viability by focusing on niche markets. That's true to some extent at MySpace, which caters to hundreds of thousands of musicians and millions of their fans. PEERtrainer.com is a social-networking site that creates a buddy system for people who want to lose weight.

Mobile social-networking holds a lot of promise, too. AirG is geared toward cell phone users. That makes good business sense, according to co-founder Frederick Ghahramani.

While content on the Web tends to be free, that's rarely the case with mobile data. Cell phone operations charge a range of prices for AirG service, Ghahramani says. The privately held company is making millions of dollars in profit, he says.

The business models for the social-networking market are still evolving. No doubt, plenty of them will fail, providing fodder for jokes that compare them to Pets.com or Friendster, a social-networking pioneer that lost its lead.

But the current leaders already have much greater scale than such flameouts. In fact, it would be unusual for a site the size of Facebook or MySpace to fold. When Internet giants like AOL (TWX) run into trouble, they tend to get fixed (see BW Online, 06/16/05, "Parsons to AOL: 'You've Got Cash'").

The rise of social networking has created plenty of comparisons to the Internet bubble of the '90s. For sure, that era had more than its share of losers.

But it also created Yahoo, Google, eBay (EBAY), and Amazon (AMZN). It could well be that a few of the next major Internet companies will come from the ranks of social networking.

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