

# KNOWLEDGE AT WHARTON

A business journal from the Wharton School of the University of Pennsylvania

## Knowledge at Wharton Podcast

# MySpace, Facebook and Other Social Networking Sites: Hot Today, Gone Tomorrow?

May 3, 2006 • 11 min listen

Popular social network sites, including MySpace and Facebook, are changing the human fabric of the Internet and have the potential to pay off big for investors, but -- given their youthful user base -- they are unusually vulnerable to the next new fad. As quickly as users flock to one trendy Internet site, they can just as quickly move on to another with no advance warning, according to Wharton faculty and Internet analysts, who offer some ideas on how these new sites can both increase user loyalty and generate revenues.



TECHNOLOGY

## SUBSCRIBE NOW

Featured Faculty

Written By

Eric Clemons , Leonard Lodish , Peter Fader Knowledge at Wharton Staff

Popular social networking sites, including MySpace and Facebook, are changing the human fabric of the Internet and have the potential to pay off big for investors, but — given their youthful user base — they are unusually vulnerable to the next ‘new new’ thing. As quickly as users flock to one trendy Internet site, they can just as quickly move on to another, with no advance warning, according to Wharton faculty and Internet analysts.

MySpace, with 70 million visitors, has become the digital equivalent of hanging out at the mall for today's teens, who load the site with photos, news about music groups and detailed profiles of their likes and dislikes. Other social network sites include Facebook, geared to college students, LinkedIn, aimed at professionals, and Xanga, a blog-based community site. In all, an estimated 300 sites, including smaller ones such as StudyBreakers for high schoolers and Photobucket, a site for posting images, make up the social network universe.

Wharton marketing professor David Bell says the long-term success of these sites will depend on their ability to retain the interest of their members. "There is a fad or a fashion component to all these networks. Some will come and go," says Bell. The classic example, he suggests, is Friendster, which burst onto the Internet in 2003 and soon had 20 million visitors. Late last year, it slipped below a million after MySpace and other sites with better music and video capability lured Friendster users away. "A lot of the [success] is serendipitous. These things can have exponential growth. Then, if another community shows up that has better functionality in some way, there can be a mass migration."

Wharton marketing professor Peter Fader agrees that social network sites are powerful, but mercurial, particularly since most are aimed at teenagers and young adults. "It's a complete crap shoot. Look how many of these have come along and how many were touted as the next big thing. How many have disappeared completely or find themselves in some strange little unexplainable niche?"

He points to Orkut, an invitation-only service introduced by Google in 2004 that is little known in the United States, but wildly popular in Brazil, where more than 70% of its users are based. Indeed, Orkut has made Portuguese a second language in its interface. "In Brazil it's gold, but in the U.S., where the service is domiciled, nobody's even heard of Orkut. And there's no good reason why."

While MySpace and Facebook currently rule the popular crowd on the Internet social scene, Fader says the forces that make a hot site are difficult to quantify; any site could become the next outcast. "There is no reason to believe that these, or future ones that are emerging on the radar screen, will be any different. I don't think anyone can come up with a genuine reason why they have become so popular, outside of 20-20 hindsight." Echoing that point, an article in the April 30 New York Times reports that AOL

plans to launch a social networking site to be called AIM Pages as a competitor to MySpace, Yahoo360 and other such services.

One way for investors to benefit from the rise of social networks would be develop a highly diverse portfolio, Fader adds. "I have no problem with betting on a crapshoot, but you want to hedge your bets carefully and accept the downside in exchange for what could be an incredible upside. You can't control your destiny with these nearly as much as any other web site or portal."

#### **Next Target: Cell Phones**

For the moment, MySpace and Facebook are hot. News Corp. paid \$580 million last year for MySpace as part of a \$1.3 billion Internet acquisition spree. Facebook just received an additional \$25 million in venture capital.

Both companies are planning to extend their reach beyond the computer screen to cell phones. Cingular Wireless, Sprint Nextel and Verizon Wireless are starting a service that will allow users to post messages on Facebook's home

pages or search for other users' phone numbers and email addresses from a cell phone. MySpace has a pact with Helio, a wireless joint venture between SK Telecom and Earthlink, that will allow users to send photos and update their blogs or profiles by cell phone.

According to ComScore Media Metrix, MySpace, with its 70 million users, ranks second behind Yahoo in pages viewed and time spent on the site. Facebook, founded by a 21-year-old student on leave from Harvard and backed by Silicon Valley venture capitalists, has 7.3 million registered users.

Chris Hughes, a spokesperson for Facebook, says the company thinks of itself more as a directory grounded in real life rather than a social network creating connections between strangers. "We model people's real lives at their individual schools in a virtual space that enables them to exchange information about themselves. We are not focused on meeting new people, dating or anything like that. Instead, we want to manage information efficiently so that we can provide our users the information that matters most to them."

Social networking sites in general rely mainly on a simple advertising model — selling banner and text ads (although they ban uncool pop up ads). Facebook also permits sponsored groups in which a marketer can build communities within the site. BusinessWeek recently reported that Facebook had rejected a \$750 million buyout offer and was holding out for \$2 billion. “That number is nothing but rumor,” Hughes says.

When it comes to placing a valuation on the social network sites, Wharton marketing professor Leonard Lodish says traditional tools, such as the discounted present value of the profit stream, apply to these new Internet networks as much as they do to any other business. He recalls an argument he had with marketing students during the Internet boom of 2000 about Internet music seller CDNow. Lodish said the firm would never be able to justify costs of \$70 to attain each customer. The following year the firm declared bankruptcy.

In the case of MySpace and Facebook, Lodish points out, the cost of gaining new customers is practically nothing because users join voluntarily and provide their own content through their profiles. In addition, the cost of

running the sites' web servers is relatively low. If a classic advertising or subscription revenue model is used, he says, low-cost social network sites could be highly profitable.

Yahoo must buy or develop content for its site to attract advertisers and Google has to invest in its search capabilities, Lodish notes. "Yahoo makes a lot of money selling ads on its sites. Why can't Facebook and MySpace do the same thing?"

Nitin Gupta, an analyst with The Yankee Group in Boston, says MySpace is rooted in linking emerging bands to new fans, which makes it a logical partner for a media company, such as News Corp. The company can use the site to test or build buzz around its products. "These have become almost living systems, as the social network has begun to expand beyond a place for people with certain musical tastes and become popular for dating and all sorts of things."

While the MySpace population has grown, the site's roots remain in media, Gupta adds. "Today, it continues to be used to identify individuals interested in, not just music, but television and radio as well." Before News Corp. bought MySpace, NBC used it to show clips of "The Office" before

the show was aired on the network. While media companies may be a more logical fit with a social networking site, other businesses might mesh too, according to Gupta. "It's a little more difficult to build a community around a Norelco razor, but it's possible."

Meanwhile, Gupta says, social networks have power beyond ad revenue to act as a customer relationship management (CRM) tool for companies selling products or services. "There's a lot of focus on advertising and banner ads and the amount of traffic. But it's important to look beyond traditional forms of web advertising to see the real potential — which is leveraging the connectivity of the sites and using them to form communities around products, media or services to really be in contact with your users."

Still, he acknowledges, it will not be easy to convert those relationships to new revenue sources. "The future is in finding ways to monetize the online community beyond just traditional web advertising, although it's going to be difficult for online communities, even those behemoths like MySpace."

According to Wharton professor of operations and information management Eric K. Clemons, connectivity is nice, but the Internet bust of 2000 showed that revenue is what matters. "As we learned from the first dot-com silliness, value is not in click-through or eyeballs. Value comes from revenues .... Can you sell subscriptions to your data or your service? Can you charge for referrals or for purchases that result from referrals? Can you sell stuff? If not, your revenue is zero and your market value is zero."

### **Safety and Privacy Concerns**

As MySpace and other social networking sites have grown, so, too, have concerns about Internet safety and privacy. The Center for Missing and Exploited Children reported more than 2,600 incidents of adults using the web to target children online in order to engage in sexual activity. In March, federal prosecutors in Connecticut charged two men with using MySpace to contact youths with whom they later had sexual contact. Following Congressional hearings about online sexual predators, MySpace hired a safety czar to improve the site's protections for young users.

The popularity of social networking sites may also have unexpected consequences for users. A gay student attending a Christian college was expelled after administration officials viewed photos of the student in drag on Facebook. Twenty middle school students in California were suspended after participating in a MySpace group where one student allegedly threatened to kill another and made anti-Semitic remarks. In Kansas, authorities arrested five teenagers after one of the suspects used MySpace to outline plans for a Columbine-like attack on the boys' school.

Gary Arlen, president of Arlen Communications, a Bethesda, Md., research and consulting firm, says MySpace users may also begin to shy away as they grasp the long-term consequences of putting up photos of wild parties or tales of sexual bravado. "This stuff may come back to haunt you 20 years from now. MySpace runs the risk of a social reaction, but that is part of being the pioneer."

Despite those obstacles, he is enthusiastic about social networks' promise, although he says the sites' ultimate value is less clear-cut than other Internet successes, such as eBay and Amazon. "It may be that this is a very slow play because the existing sites, Friendster and now MySpace and Facebook, are building a habit among young users. It will become a part of how they operate in their 20s and 30s. This service will be part of the landscape."

According to Bell, there are strategies that social network sites can use to avoid becoming tomorrow's abandoned property. One way to retain a site's aura is to limit membership. For example, Bell notes that when Diesel jeans faced the problem of losing marketing cachet by becoming too popular, the brand cut back on the number of outlets it would sell to. Facebook tries to limit itself to college students. Social networks seem to operate best when they strike a balance between heterogeneity, which provides large numbers of members, and selectivity, which keeps the hordes focused and engaged in the site, he says, adding that social networking sites also must keep pace with technology and provide new features — for example, fast downloads. "To create stickiness you must have functional value and also community value. If either of those becomes diluted, you give people a reason to start looking elsewhere."

As a web-based business, social networks do have some advantages over traditional companies in tracking user behavior in order to detect problems early. "If you are sophisticated, you can measure and monitor the rate at which users join and you can detect early warning signs, such as a drop off in the number of people interacting," says Bell. "There would be metrics to monitor if you are headed in the wrong direction."

Bell also cautions that sites will need to remain subtle in their approach to marketing if they are to build on their current success. While they provide banner and text ads, even more valuable word-of-mouth promotion lurks in the buzz within user profile pages. "Part of the popularity of these things is that they are more credible and not explicitly commercial," he says. "If somebody on the Mac fanatic site tells me about iPod, it's more credible than Mac advertising. If people feel the networks are too corporate, that's a turnoff."

Still, no matter how their future takes shape, Bell says these types of networks are ingrained in Internet society. "They're here to stay. Like eBay, they are embedded now. The idea of joining online communities and being able to participate in them is not going to disappear."

© Knowledge at Wharton. All rights reserved. Knowledge at Wharton is an affiliate of the Wharton School of the University of Pennsylvania.