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## MySpace and the Social Networking Business Model

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**SUMMARY:** Social networks have gotten a great deal of attention lately. While MySpace continues to dominate in terms of traffic, questions abound over how it will monetize that traffic. Such speculation was partly quieted this week by the announcement of a multiyear US\$900 million deal that lets Google distribute ads across MySpace and other Fox Interactive Media properties. Other social networks have also entered the market to address demographics not served by MySpace. Specifically, OurStory and Eons have launched in the past few months to serve older demographics and psychographics (one of Eons' main features is a nationwide database of obituaries). MySpace, meanwhile, has slowly begun to appeal to thirtysomethings interested in meeting people and sharing music. ComScore reported last month that MySpace has seen declines in its audiences in the 12-to-17, 12-to-24 and 12-to-34 age ranges, while the 21-to-34, 25-to-34, and 35-to-54 groups have increased. All in all, the influx of entrants to the space has many wondering if we are in a social networking bubble. More important are questions regarding the sustainability of social network business models, even that of the high-flying MySpace.

### MySpace's Mandate

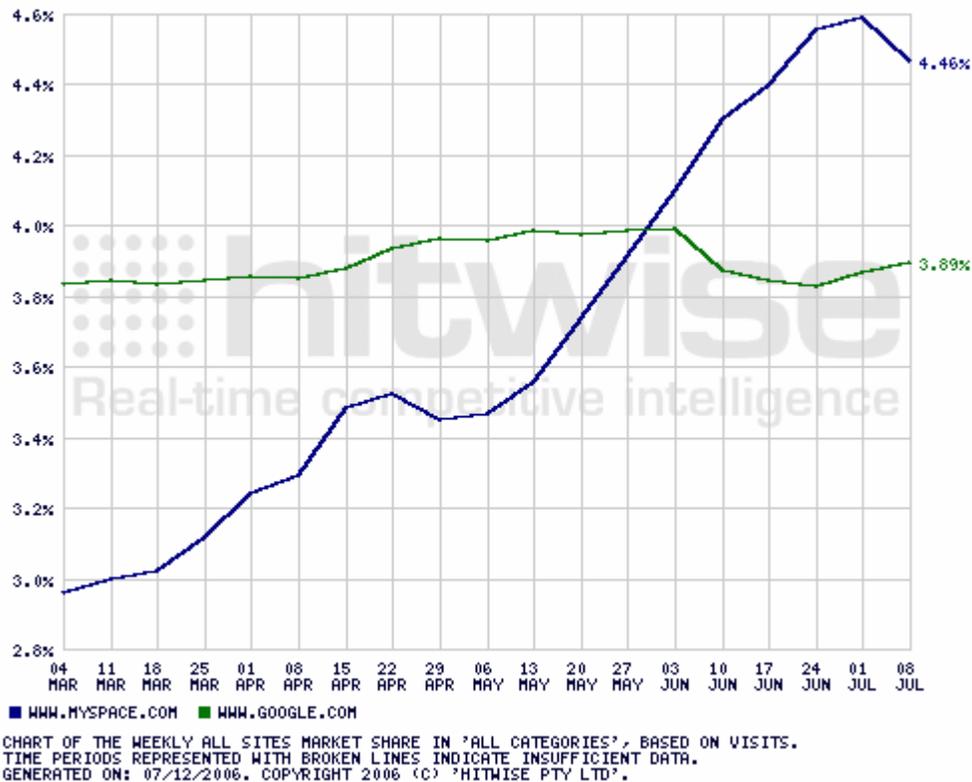
Back in February, during News Corp.'s fourth-quarter earnings call, Rupert Murdoch stressed the value of the company's Internet properties, which fall under the banner of Fox Interactive Media. The latest addition to this family had been MySpace, acquired for US\$580 million in July 2005. The real value of FIM, however, had yet to be shown in reported financials, Murdoch asserted. To read into this, the value of MySpace's 100 million users hadn't been monetized anywhere near its potential.

"Our mandate now is clear: to monetize this vast audience with targeted advertising made possible by the wealth of information we have from our engaged, passionate users," said Murdoch. "The revenue and profit potential from monetizing this audience, even a fraction of it, is significant."

This monetization challenge indeed represents FIM's biggest opportunity. Its online darling MySpace is, in essence, sitting on a goldmine of traffic. Last month, Hitwise reported that MySpace was the No. 1 Web site in terms of overall traffic, displacing Yahoo! Mail and Google search. For the week ended July 8, it accounted for 4.46 percent of all U.S. Internet visits. According to Hitwise, MySpace also held an 80 percent share of visits to online social networking sites in June, up from 76 percent in April (the closest competitor was Facebook at 7.6 percent). The site adds an average of 250,000 users daily. Interestingly, 90 percent of its traffic comes from the U.S., suggesting there is substantial growth opportunity internationally as well.

MySpace's strategy in monetizing this content has so far consisted mostly of selling space to large companies that want an ad to appear on every MySpace.com page. It also allows advertisers to choose particular sections of MySpace to display their ads.

## MySpace Traffic Growth Surpasses Google



Source: Hitwise (2006)

### Enter Google

This week, FIM announced a partnership with Google to distribute contextual text ads through some of its sites. The agreement will last three years and nine months and will award Fox US\$900 million if certain traffic levels are achieved. In return, Google becomes the exclusive search and text-based ad partner for FIM properties. The deal also gives Google a place on MySpace's toolbar (under development) and the right to place ads on every page of MySpace, IGN.com, Scout.com, RottenTomatoes.com, and assorted TV and news Web sites.

Google is the No. 1 exit point for MySpace users, and therefore an integrated search experience is an important unifying feature. In future iterations of Google's ad engine, advertisers will be able to target broadly (like search today) or home in on MySpace specifically through a variety of options. Demographic targeting could eventually come into the picture, although such plans haven't been disclosed. Given a fragmented audience, Google's mobile targeting initiatives and other monetization projects, a targeting option that includes demographics is extremely likely, however.

Fox will continue to sell graphical ads through its own sales force, but Google is entitled to all remnant ad inventory (which was previously served by 17 providers). Google has a stated goal to grow its graphical advertisements overall, but text ads will likely occupy these positions. To date, video ads have not been mentioned as part of the deal. However, we expect conversations to develop between the two companies about video ads over the course of the agreement.

According to Fox, this deal represents a 70 percent premium over the MySpace purchase price and pays for about two-thirds of FIM initiatives.

"All the money from the deal is net revenue," according to News Corp. President Peter Chernin. "We're playing with the house chips. Whoever said that we couldn't monetize this, they've probably changed their mind."

Incidentally, U.S. companies are expected to spend an estimated US\$1.8 billion at MySpace.com and competing social networking sites by 2010, up from US\$280 million this year, research firm eMarketer reported last month. The firm also projected that MySpace's revenues will hit US\$180 million this year (other sources put this figure as high as US\$350 million), taking the biggest chunk of ad revenues among online social networks. However, social network ad spending overall will only account for 1.7 percent of the US\$16.7 billion U.S. online advertising market this year, according to eMarketer. The firm predicts this number will rise to 6.3 percent by 2010.

### **That's the Good News, But ...**

MySpace has faced some challenges in its strategy to win over large national advertisers, given the sometimes racy and unpredictable content that peppers the network. Many advertisers aren't interested in social networks simply because they can't control the user-generated content with which their brand will be associated. Another challenge has been recent public sentiment that MySpace provides a place for sexual predators to gather information about young people.

In fact, a bill to ban social networking sites like MySpace from schools, libraries and other federally funded venues moved to the Senate this week after the House passed it in an overwhelming vote of 410 to 15. Known as the Deleting Online Predators Act, the bill is expected to pass the Senate and be signed into law by President Bush within the next month. It was authored by U.S. Rep. Michael Fitzpatrick, R-Pa., and contains broad language that would direct the Federal Communications Commission to publish a list of banned commercial Web sites with personal profiles and journals and direct communication between users.

Meanwhile, conjecture in the blogosphere indicates social networks have always had limited shelf lives, dating back to the days of GeoCities and Friendster. In the case of MySpace, its meteoric success is based on the loyalty of teenagers, which is a double-edged sword.

The teenage demographic that makes up most of its user base (the average age is 18) has fueled the site's exploding traffic with viral marketing and a kind of fad-driven growth. However, this somewhat fickle demographic can easily stray if it sniffs out a hidden strategy to slap corporate marketing in front of it. As business writer Nicholas Carr, in his Rough Type blog, wrote recently: "The young are capricious, particularly when it comes to the places where they hang out. Trying to hold them in one spot is like trying to hold water in your hands."

There is some degree of hyperbole in Carr's statement, and it's hard to point to empirical evidence for this cultural phenomenon. However, this is something MySpace and other social networks must keep in mind while undergoing a commercial evolution. Delicacy will be required in altering an online setting most users have erstwhile viewed as being free of parents, teachers and corporate sponsorship.

This suggests a need to diversify its demographic appeal, something MySpace has already begun to do. The site is forming the foundation for a model that is more of an information and entertainment portal than a pure social network — a step toward

long-term sustainability. This was the strategy behind its recent partnership with SimplyHired to create a MySpace career section. Diversifying its audience will broaden MySpace's appeal and allow it to tap into new forms of advertising afforded by video, jobs and other verticals. It will also soften the blow of the exodus of teen users that may occur when MySpace integrates more advertising and user interface changes.

The site has also drawn a great deal of criticism for its cluttered and awkward design. This hasn't impeded MySpace's growth, as its core user base doesn't appear to care. However, it might have to improve the site's design and interface if it is to evolve into a media portal and appeal to broader demographic ranges.

### **YouTube: Me Too**

One way MySpace can diversify is to build in the capability for a media portal or video-sharing site — a strategy that has worked well for YouTube. According to Alexa data, YouTube has taken the lead in terms of global Internet visits with a 3.9 percent share, compared with MySpace's 3.35 percent.

YouTube in fact has grown from the same viral marketing (and similar demographic) as MySpace. Its American user base grew 297 percent in the first half of 2006, according to Nielsen/NetRatings, and its reach (number of users per million that visit the site) increased 155 percent over the past three months. (MySpace increased 9 percent during the same period.) The average YouTube visitor spends 28 minutes on the site.

YouTube has more universal appeal as a media and entertainment portal, which is why socially driven video distribution is an area in which MySpace and other such networks could thrive. MySpace in particular has the advantage of existing traffic on which to leverage a video distribution model (YouTube had to start from scratch).

MySpace already seems to be moving in this direction. The video portion of the site had 10.4 million visitors during the week ended July 23, up from 2.9 million the previous week. The new figure places it ahead of MSN's online video site and brings it closer to YouTube's leading 15.8 million unique users for the same period (up from 12.8 million the week before). While MySpace and YouTube video sites have grown in users, Google Video, MSN and others have stayed fairly flat over the past few months.

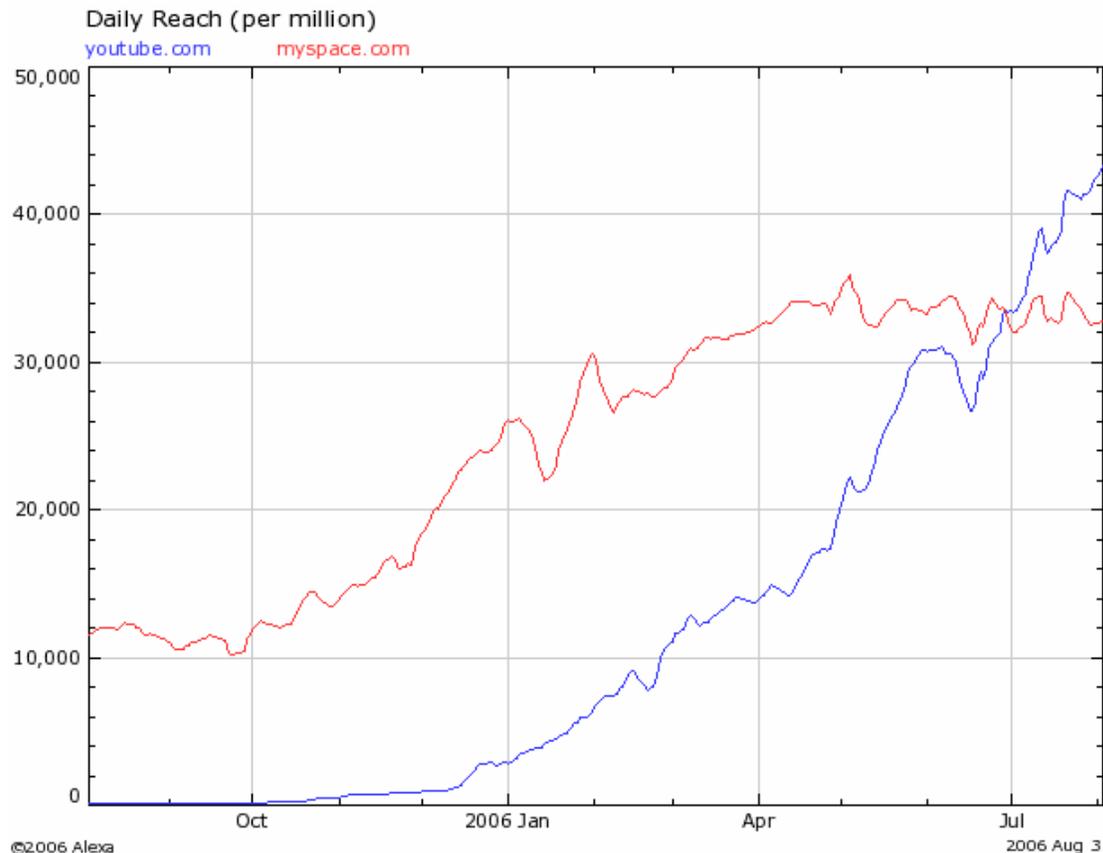
### **What About Local?**

Hollywood studios have begun to experiment with social networks to generate buzz for upcoming releases. Warner Independent Pictures created a MySpace profile in April for the movie "A Scanner Darkly." Sony Pictures Entertainment likewise posted character profiles on MySpace for the movie "Monster House." This allows users to proliferate the buzz for a given movie by viewing and interacting with a character profile in the same way they would a real person's profile. Sony's creation of a profile page for the character "Jill" from the film "When a Stranger Calls" garnered more than 110,000 "friends" on the network. This included a blog and an instant messaging avatar that produced 440,000 sessions and 31 million IMs between "Jill" and consumers as well as 430,000 phone calls to a toll-free number.

An element of this concept has been present since MySpace's inception. The site has been lauded as a medium for bands, comedians and other performers to promote their recorded material or live shows.

Though they don't possess the same "buzz-worthiness" as movie characters or bands, local businesses are the next logical extension of this concept, posting information about themselves and spreading their message throughout the MySpace community. This is allowed and embraced by MySpace, although it expressly prohibits some of the

## YouTube Exceeds Reach of MySpace



Source: Alexa (2006)

methods that have developed to spread promotional messages throughout the network. This includes software that performs data mining of user profiles to pick out certain attributes, which are then targeted to blast out hundreds of requests to join a network of friends.

### Monetization Opportunities

So how are these business listings currently monetized by MySpace? They aren't. However, we believe there is the opportunity for MySpace to use the appeal of social networks to tap into local business advertising.

Part of the appeal of MySpace business profiles is that they are free and can generate a significant amount of exposure or lead generation for SMEs. However, they are currently at a qualitative level of service in line with the lack of a price tag. In other words, opportunities exist to create enhanced services to upsell local and small businesses that wish to make their profiles more media rich, searchable or browsable in certain business categories.

Business profiles are currently thrown together with the rest of the MySpace profiles and aren't browsable by category. There is an opportunity here to bring together the advantages of vertical search and social networking to create a powerful forum for local business advertising.

Take, for example, TripConnect, a social network and user-generated content site in the travel vertical. The interactions between users are more relevant and the contextual advertising opportunities are greater than those of a general experience in which content is much harder to qualify.

Creating vertical experiences can enable a forum — well within the spirit of a social network — in which users directly influence one another's purchasing decisions. If you then bring into the picture the demographic targeting Google could provide, there seem to be many rich targeting possibilities within MySpace's reach. Compare this with the current system of serving banner ads on MySpace pages where users are chatting about the random and extensive gamut of things that interest them.

It is possible for MySpace to maintain the broad appeal of an all-encompassing social network. But within that framework, there are also advantages to segmenting certain verticals, which will enable opportunities for enhanced business profiles and more relevant interactions between users. This higher degree of specificity and relevancy opens up opportunities for better demographic targeting and contextualization in line with MySpace's partnership with Google. It has been proved by Google, and to some degree by vertical content aggregators such as Topix.net, that highly targeted ads aren't seen as intrusive but rather as value-added content — something that could help alleviate fears that teenage users will flee at the onset of commercial intervention.

Indeed, MySpace's partnership with Google is one indication that it will continue to move toward more relevant and contextualized advertising opportunities, which could soon involve the verticalization of content across its network. Beyond this, it is possible and arguably advisable that MySpace slowly transform itself into an entertainment and information portal that is built upon the tenets of social media and networking.

### **Final Thoughts: Where Google May Take This**

On a search engine, the unifying product feature is the search box. Consumers enter keyword phrases and are offered Web results based on their query. On top of this consumer product feature, Google, for example, places relevant advertisements that are targeted to the query. Google's effective RPS (revenue per search) is about 10 cents. High-frequency keywords like "Real Estate" were the first to be successfully monetized, since there are lots of searches with many advertisers interested in these terms. The less frequent keyword phrases contained in the "long tail" of search queries often do not have advertisements placed on them. It is fair to say that it is more difficult to successfully target these phrases, since they are often ambiguous.

This leads to one of the core issues often discussed around monetizing social networking sites. There are a lot of users, but their interactions within the context of the sites are not unified around, for example, a search experience. What MySpace and other social networking sites do offer, however, is reliable consumer information from which to build a demographic and behavioral targeting engine. The data are accurate because MySpace users are creating profiles about themselves. Think for a minute about all the press around people literally revealing too much personal information on such sites.

With the Google-MySpace deal, we have two incredibly powerful factors in play. The first — the world's best search monetization engine in terms of relevancy (measured by clickthrough rates on ads). The second — accurate demographic and geographic information. The sheer amount of data that exists will allow Google to build an entirely new behavioral and demographic targeting engine.

Think about it this way: In the magazine subscription world, BusinessWeek might target Wall Street Journal readers because its research has led it to believe those individuals are more likely to become new subscribers. In this example, it's more art than science, but this level of targeting is still more effective than asking everyone if they want to subscribe. On the search engine and social networking side, it's not at all art. It is about using analytical models to predict behavior based on similar groups of people — or real-time direct marketing.

If search engine keyword targeting is Web 1.0, then behavioral ad targeting is truly the next evolution in the search advertising business. The deal suggests to us that Google is further down this product path than most people have suggested. This deal and its own internal search traffic give Google the foundation data to perfect a behavioral and demographic targeting engine. We expect this targeting to profoundly affect everything from ad models around video to content targeting and even the types of information returned in search results.