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Old-Fashioned Snapchat

12-15 minutes

One of the most fascinating aspects of the Evan Spiegel emails that were leaked in the Sony Pictures hack was his seemingly changing view of Facebook. Spiegel was originally not a fan, arguing that Facebook's revenue was much too dependent on VC-funded app install ads; some time later, though, Spiegel ~~had~~ was urged to change his tune by Twitter CFO Anthony Noto:

> If the growth in Ads is primarily all driven by higher click-through rates due to better relevant ads on mobile, than all of the private mobile companies that have a great medium for advertising will be viewed much more favorably and be more valuable…Specifically if ads on mobile are more engaging for consumer and more relevant than desktop ads than the addressable ad market for mobile will be bigger than desktop ad market and the valuations of mobile companies will be greater than desktop all else equal on audience size etc. This would be a very positive factor for Snapchat.
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> If Facebook knows this to be true it would result in them being willing to pay higher valuation for mobile companies than other acquirers because Google won't know nor will yahoo msft etc because none of them have scale in mobile to understand these powerful secular trends and in essence they under value mobile vs FB and thus under invest and fall farther and farther behind.

Correction: *Snapchat has clarified that this section of the email was written by Anthony Noto, Twitter CFO, not Evan Spiegel; the introduction thus originally said that Spiegel "had changed his tune." I deeply regret the error*

In fact, just a couple of months earlier Facebook had shocked the world by buying WhatsApp for $19 billion; two months before that it had tried to buy Snapchat itself for $3 billion. At the time of the failed acquisition, beyond expressing (misplaced) shock at the dollar figure, many attributed Facebook's effort to some sort of existential struggle for relevance. I myself wrote in The Multitudes of Social:

> Last week Snapchat reportedly turned down a $3 billion dollar all-cash offer from Facebook. Apparently Facebook was worried about losing the teen demographic, or perhaps they were unnerved by the 350 million photos Snapchat claims to process per day. What seems clear, though, is that Facebook is intent on "owning social"…
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> Facebook needs to appreciate that their dominance of social on the PC was an artifact of the PC's lack of mobility and limited application in day-to-day life. Smartphones are with us literally everywhere, and there is so much more within us than any one social network can capture.

I already knew then that Facebook had the best (non-search) ad unit in tech; my concern was that Facebook shared the peanut gallery's concerns that Snapchat was somehow a threat to Facebook when there was clearly room for both. Like ~~Spiegel~~ Noto, though, my appreciation for Facebook's approach has only grown over time: I strongly suspect that the ~~Snapchat CEO~~ Twitter CFO had it exactly right: Facebook was making (or attempting) acquisitions like Instagram, WhatsApp, and Snapchat not for defensive reasons but for offensive ones. Mark Zuckerberg, earlier than just about anyone, clearly saw just how much money is going to be made on mobile.1 And, rumor has it, Snapchat's investors completely agree: Bloomberg reports the company will soon be valued at $19 billion.

To understand why you need to look not at other social networks, but rather TV.

The Shift in TV

In May 2013 I wrote a series about TV arguing against the widely-held sentiment that cord-cutting was imminent:

> Cable TV is socialism that works; subscribers pay equally for everything, and watch only what they want, to the benefit of everyone. Any "grand vision" Apple, or any other tech company, has for television is likely to sustain the current model, not disrupt it directly.

The piece was primarily focused on affiliate fees; ESPN, the most profitable cable network of them all, was then making $6.1 billion in affiliate fees a year, nearly twice the $3.3 billion it made in advertising.2 This shift made sense not just for macro reasons – in particular, the rise of "time-shifting" – but also for strategic ones: much like Apple ESPN – and several other "must-see" networks like AMC – use customer demand as leverage for better deals. ESPN, for example, has spent a tremendous amount of money to secure rights to must-see sporting events, which, by extension, makes the network a "must-have" for cable operators; this ultimately leaves ESPN's revenue dependent on the much more predictable – and profitable – true "fans" than they are on the casual viewers that drive total ratings. That is why ESPN in 2012 could have an average of 1 million viewers as compared to USA Network's 1.3 million, yet charge $5.04/month in affiliate fees, over 7x USA Network's $0.68.3 And while there have been some small-scale shifts in this model – I think Sling TV is very interesting (*members-only*) – I continue to believe that cable is stickier than most people in tech think; there simply are too many must-see events that enable customers to justify the monthly cost.

That said, note again that the affiliate model does *not* depend on total viewership, which is a good thing for the cable channels; after all, there is more and more evidence that actual viewership is in decline. According to Nielsen, after remaining steady for years average monthly viewing time in 2014 decreased by six hours; January was particularly bad, with viewership down 12.7 percent year over year. The biggest culprit is streaming, up 60% year over year. The problem with streaming, though, is that it too is for-pay; there are no ads on Netflix or Amazon Prime Video. In short, TV is increasingly shifting away from advertising, to affiliate fees on the network side and subscription fees on the streaming side.

Advertising's Inevitability

The question, then, is whither advertising? Surprisingly, advertising has had a remarkably consistent share of U.S. GDP. From Bloomberg:

> The advertising business is about as static and boring as they come. The industry has never grown in scale. Looking at data since the 1920s, the U.S. advertising industry has always been about 1 percent of U.S. GDP. It's surprisingly consistent, mostly tracking between 1 percent and 1.4 percent—and averaging 1.29 percent…This 1.29-percent number combines advertising spending on television, radio, billboard, newspaper, magazine, trade journals, and the Internet…
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> That means the only way to expand in this business is to steal share. "Everything is a share game," says [db5 Chief Strategy Officer Daniel] Goldstein, as declines in older media give way to growth in newer media.

This particular article concludes on a pessimistic note with the assumption that Internet advertising has reached the limits of growth:

> There appears to be a predictable growth rate for new media. For each "new" medium at the time—radio, television, and Internet—the growth pattern has seen similar curves. The first five years saw rapid (but declining) growth rates, and after the fifth year, growth rates steadied. The Internet is certainly disruptive, but no more disruptive than TV and radio in the past.

I think, though, this isn't quite right. For while you can look at the "1 percent" rule as a cap, it is is also a floor, and the Internet is not just decreasing live TV's share of advertising, it is decreasing live TV's share of time. Here's one more data point, this time about the most coveted 18-34 demographic: earlier this month Nielsen reported:

> Traditional TV usage — which has been falling among viewers ages 18 to 34 at around 4 percent a year since 2012 — tumbled 10.6 percent between September and January…
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> In 2011, 21.7 million young adults tuned in to their TV sets. By the end of last month, that figure had fallen to 17.8 million, according to Nielsen figures. If the TV-as-an-anachronism trend holds, the implications for the media industry are huge, possibly causing a seismic shift in the $80 billion TV ad market.

How on earth are advertisers going to reach those young people?

What Matters for Branding

The one weird thing about TV advertising is how hard it is to measure; unlike, say, a Google search ad, which pays by the click and can be tracked all the way through conversion, your traditional TV ad is more about establishing a brand that theoretically will influence a viewer's purchase for years to come.4 Sure, outfits like Nielsen try to track effectiveness,5 but at the end of the day TV makes its money because of the old John Wanamaker adage:

> Half the money I spend on advertising is wasted; the trouble is I don't know which half

Indeed, get a few drinks in any brand advertiser and they'll admit that the number one reason they know that brand advertising works is that, if they stop, sales inevitably drop.

Tech companies, as you might expect, can't stand this level of uncertainty, and a central selling proposition of digital ads have been the ability to measure effectiveness. This is easiest to do with direct marketing campaigns, which are designed to drive an immediate purchase, and no one is better at this than Google. Facebook, though, is trying to provide the same sort of feedback for brand advertising with Atlas, an attempt to connect a Facebook ad to an offline purchase some time in the future.

Still, the fact remains that for brand advertising in particular, tracking is less important than simply ensuring your target customers are actually *experiencing* your ad. And there is no more attractive target for brand advertisers than young people, because their choices in everything from detergent to underwear will likely persist for decades.

And so we are back to Snapchat's rumored $19 billion valuation; it has nothing to do with "stealing teens" from Facebook, but rather the decline of TV viewership (again, a separate question from cord-cutting). Brands:

- Want to reach young people
- Value immersive engagement that enables emotional connections
- View tracking as a "nice-to-have" (as opposed to a "must-have" for direct marketing)6

Here is what Snapchat offers:

- Nearly 200 million monthly active users, including greater than 50% penetration among users 18-24 (33% among users 18-34), and those numbers continue to grow rapidly
- Very immersive ads that can only be viewed by holding your finger on the screen; brands can have a very high confidence their message is being viewed
- Not a single bit of tracking. No gender, no age, nothing

In fact, that sounds a lot like TV – particularly TV in the pre-time shifting age. A captive audience that you don't know that much about, except that it's the single best spot to build a brand. Slate's TV critic, Willa Paskin, wrote of the service's new Discovery service:

> If this sounds nothing at all like a "channel" to you, and just another way for Snapchat and its partners to make money while giving teens a way to waste time—well, that is, in fact, exactly the way in which Snapchat channels feel like television. Channel surfing, in which you plop down on the couch, pick up the remote, and make your way through your particular stations of the cross (TBS-TNT-FX-TCM-AMC-Bravo-E!-VH1-MTV-etc.-etc., or whatever your personal catechism), letting the TV offerings wash over you, is not as popular as it once was. DVRs, streaming television services, and cord-cutting have made it much more common to turn the television or computer on with a certain kind of intentionality, a will to watch something in particular.
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> But Snapchat channels are a throwback to the couch potato mode of passive consumption. Every day, Cosmo and CNN and their ilk have selected five or so stories for you to flip through, read, watch, or skip. The content may also be available on the Web, but consuming it here is even easier: You don't have to search for anything, click on anything, seek out anything. It has already been picked out for you. Everywhere you and your phone are has become the proverbial couch.

Thanks to smartphones we live in a mobile first world, and messaging is the killer app; perhaps, though, that just as advertising hasn't really changed, neither have we humans, much to the benefit of Snapchat, the mobile messaging app with the rather old-fashioned business model ready and willing to take the place of TV.

1. Note I specified "money"; Zuckerberg was famously late to mobile as a product, but before Facebook proved otherwise, everyone assumed that mobile would monetize worse than the desktop (as it still does for Google in particular) [↩]
2. Last quarter Disney's cable networks jointly made $2.9 billion in affiliate fees and $1.2 billion in advertising [↩]
3. Numbers from the Wall Street Journal. There are more numbers in part 2 of my series, Why TV Has Resisted Disruption [↩]
4. I wrote more about brand advertising in Peak Google [↩]
5. All those "Nielsen says" stories are just lead generation [↩]
6. To be clear, brands would love to track too; needless to say I remain hugely bullish on Facebook [↩]