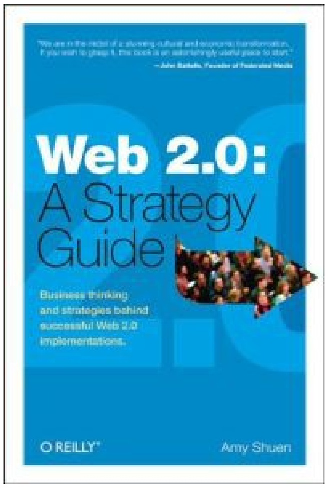

Book Web 2.0: A Strategy Guide

Business thinking and strategies behind successful Web 2.0 implementations

Amy Shuen
O'Reilly, 2008

Recommendation

Many of Web 2.0's foundational principles – for example, giving away your primary online product – are counterintuitive. Fortunately, Amy Shuen, a renowned expert on high-tech business models, dispels much of the mystery in her outstanding book. Its bona fides include being issued by the publishing company belonging to Tim O'Reilly, the high-tech guru who helped coin the phrase "Web 2.0." Shuen covers the social and business effects of Web 2.0, breaks down the Web 2.0 strategies of some of the most successful Internet companies and explains how business of any size can benefit from harnessing Web 2.0's limitless potential. *BooksInShort* recommends this book to executives who develop strategy, small-business owners who want to expand their operations and entrepreneurs who plan new business ventures.

Take-Aways

- With network power and social connectivity, Web 2.0 is the platform of the future.
- Web 2.0's counterintuitive economics can baffle seasoned marketing executives.
- Marketing in Web 2.0 increases profitability through "freemiums" – giving away something of value online to get users to pay for a premium version.
- As each new user joins a Web 2.0 social network or search site, its value increases.
- CEOs believe networks matter more for strategic planning than technological innovation.
- Web 2.0's networks allow users to "do, interact, combine, remix, upload, change and customize for themselves."
- Web 2.0 creates a "tippy market effect": Companies that do well with a concept quickly take all or most of the available profits.
- Many traditional corporations, including Procter & Gamble and Motorola, are adopting Web 2.0 strategies and exploiting them fully.
- Companies can monetize their expertise by syndicating it online.
- One successful Web 2.0 business model uses innovative high-tech advances to sell conventional products.

Summary

Web 2.0: A New Way to Do Business

Web 2.0 revolutionizes the business world by offering new ways for "businesses, customers and partners" to interact – often in the most counterintuitive manner possible. Google, for example, gives away its main product: Internet searches. American corporate icon Procter & Gamble gets 35% of its new product ideas from its millions of online contributors, resulting in an 80% success rate, better than double the 30% average for its competition. Another American company, Motorola, has "4,400 blogs, 4,200 wiki pages and 2,600 people" who actively tag online content and create social network bookmarks. Traditional firms can transform themselves via Web 2.0 into innovative online superstars.

Goldcorp's Crowdsourcing

Consider Goldcorp, a Canadian mining company. Its business, digging gold out of the earth, could hardly be more traditional or "old economy." In 2000, Goldcorp used Web 2.0 crowdsourcing techniques – "crowds collaborating to solve problems for companies" – to increase its annual gold output nearly tenfold. The company issued "the Goldcorp Challenge," posting "geological data" online from its Red Lake gold mine. It invited geologists around the world to recommend the best sites to locate “six million ounces of gold.” Prizes for the best recommendations totaled $575,000, with $105,000 going to the most productive idea.

> “Web 2.0 projects can start with an idea and a site, and grow from there.”

More than 1,400 “virtual prospectors” from 50 countries participated in the online gold rush; non-employees analyzed Goldcorp’s database to select the best mining sites. “We have drilled four of the winners’ top five targets, and have hit on all four,” says CEO Rob McEwen. Before the contest, Goldcorp excavated about 53,000 ounces of gold each year, at a cost per ounce of $360. After the contest, it recovered 504,000 ounces of gold, at a $59-per-ounce cost. Goldcorp alchemized crowdsourcing into gold.

The Multiplier Effect

Web 2.0’s network effects give Internet users unlimited ability to “do, interact, combine, remix, upload, change and customize for themselves.” The Web’s economies of scale and connectivity, and the multiplier effect – people’s efforts don’t simply combine online, they mushroom – suit businesses with innovative concepts. Online, customers provide more than money; their very presence creates value.

> “The transition from the old static Web to the new dynamic Web creates challenges for all businesses.” (William Sahlman, senior associate dean, Harvard Business School)

High-tech guru and publisher Tim O’Reilly explains, “Web 2.0 is the business revolution in the computer industry caused by the move to the Internet as a platform.” As people master tactics for succeeding online, he advises, “Build applications that harness network effects that get better the more people use them.”

“Flickr and Collective User Value”

Flickr demonstrates how to succeed online with the “freemium” business strategy. Flickr builds “collective user value” by enabling its army of users to upload, store, index, tag and share their photos online at the company’s website – all for free. The company makes money by offering premium services (“Pro Accounts” are $24.95 annually) that many users prefer. The site also earns money from ads and “transaction/revenue sharing.” Flickr’s three separate revenue streams drive its profits: 1) subscribers provide steady income, 2) Flickr makes money from “contextual advertising,” and 3) it derives additional revenues from retailer Target, which shares a portion of “its Flickr clickstream photo development revenue.”

> “What’s new about Web 2.0 is that both businesses and individuals can make money by providing services to customers for free.”

Traditional businesses operate according to “supply-side driven scale economies” wherein as output increases, unit costs fall. In contrast, “demand-side scale economies” rule Web 2.0: When networks attain critical mass they achieve exponential growth, and users become willing to pay more for online services. Look to increase “positive network effects” in your company, and seek ways to monetize them. The photo-sharing website Flickr provides a perfect example: The more people share photos, the more their friends come to see the photos and then share their own. Flickr’s monetization practices never interfere with any of its users adding photographs, which ensures that the positive network effects can only grow.

“Google’s Combination of Network Effects”

Powerful Web 2.0 network platforms such as Google, Yahoo, eBay, Skype, Wikipedia, Craigslist and Flickr define the Internet. Google dominates the “‘winner-takes-most’ paid search marketplace” according to the following phenomena:

- **”Direct Search Network Effects” –** Each Google search increases Google’s relevance in a profitable “virtuous cycle.”
- **“Direct advertiser network effects” –** Advertisers pay $5 to enroll and 5 cents per user click.
- **“Advertiser-searcher cross-network effects” –** Advertisers seek to place their ads where the most searches occur, thereby continually reinforcing Google’s top position.

LinkedIn: “People Build Connections”

While the Internet covers the globe, it remains, in effect, a “small world.” With only a couple of clicks, you can connect with almost anyone online. LinkedIn, like Facebook, owes its existence to the ease of this kind of connectivity. Through LinkedIn, you can connect with your friends, colleagues and clients, and with practically everyone they know, as well. LinkedIn thrives utilizing the ubiquitous freemium model.

Salesforce: “Software as a Service” (SaaS)

Web 2.0 enables “knowledge-based businesses” to thrive by using online syndication (RSS) to transfer their “digitized know-how” efficiently across the globe. Salesforce.com, for example, provides customers, via syndication, with “on-demand, web-browser-based, hosted software services.” The company’s AppExchange (the “ecosystem” model) lets third-party firms develop add-on applications. Salesforce works to establish open and profitable connections with other firms. To emulate Salesforce’s success, identify your firm’s prime “outward-facing” competencies.

Apple’s iPod: “New Recombines With Old”

All the innovations of Web 2.0 work well with traditional, even staid businesses. Apple’s iPod is not an Internet application, but it exemplifies this flexibility. The iPod hardware plays multimedia – music, images and video. It hooks up to the web through its iTunes software, combining conventional systems with innovative technologies.

> “Even recent MBAs have a hard time pulling together all the necessary pieces of the Web 2.0 business model.”

The iPod has 451 different parts, many off-the-shelf, which Apple then joined to make a magical, new product that proved to be a huge success. Think of the iPod and the iPhone as prime examples of "recombinant innovation." To increase your firm's profits, consider which conventional business practices you might merge with new high-tech developments. Look for products that you might recombine.

Your Web 2.0 Action Plan

Follow this "action plan" to incorporate a Web 2.0 business model in your strategies and decisions, and to recruit others to join your firm as you monetize your Web 2.0 activities:

- **"Build on collective user value"** – Many successful Web 2.0 firms gather information from their users, and make that data available to others for a fee. The best plan of attack is to start with a brand new project or venture, not something already underway. For example, with nearly 130 million photos uploaded to its website by millions of users, Flickr has an enormous "user-generated image database." The company's value derives directly from this immense collection of public photos.
- **"Activate network effects"** – Determine the inherent value of your firm's "offline and online" network effects. Google is the ideal role model – as well as a prime cautionary tale. When it comes to Internet network effects, markets normally devolve into a "winner-take-all" or "winner-take-most" model. This is what economists term a "tippy market effect," because success tips to one firm or another.
- **"Work through social networks"** – Think and act innovatively to create your social network. Hotmail adds a line promoting their email website at the bottom of each email it sends, which results in continual viral growth. Facebook has achieved similar expansion through "socially influenced" distribution.
- **"Dynamically syndicate competence"** – Your firm may have special expertise and competencies that you can globally market via the Internet.
- **"Recombine innovations"** – Web 2.0 compliments traditional businesses without replacing them. Indeed, because of its remarkable networking, Web 2.0 is the ideal platform for aligning with other companies. To illustrate, Jajah, a Web 2.0 voice telephony firm, partners with Deutsche Telekom, which owns T-Mobile.

Your Business Plan for Web 2.0

A specific Web 2.0 business plan features different dynamics than a traditional plan, but market analysis is a crucial component in all cases. In standard businesses, assessing the value potential customers may assign to products can prove difficult. It is hard to know how quickly positive news about products will spread. Instead of investing in such estimates, Web 2.0 companies can conduct online experimentation to see what works – and what doesn't.

> "Positive network effects increase the value of a good or service as more people use or adopt it."

Conventional businesses evaluate their merchandise and services according to "per-unit or per-labor/service hour economics," and in the case of localized products, "per-local-market economics." Web 2.0 businesses evaluate their products or services based on "per-user and usage economics." Thoroughly define your Web 2.0 products or services. Consider how you view your offerings – are they "cost-based or customer/user-based"? Plan to exploit customer contributions to your Web 2.0 product. Parse the licensing and distribution of user-generated content, so you'll know how to utilize it and properly compensate your users. For your "time line and milestones" section, consider, "How much content users will generate, and how quickly?"

> "Business can make more money by selling lower volumes of hard-to-find products than by selling larger volumes of popular items."

Venture capitalists will study your business plan to learn about your management team, and that team's qualifications. Web 2.0 companies need executives who possess "collaborative skills," "speedy responsiveness" and "innovativeness."

Make sure that your financial accounting addresses "per-user economics" – that is, "customer acquisition and return." "Community value" translates into true financial value. Discuss "related businesses and communities." Refer to financially remunerative partnerships that will join in revenue sharing or investment. Your business plan should include three key points:

1. **"Online network effects are a powerful multiplying force"** – Facebook and Google provide the clearest examples.
2. **"A few active uploaders can create online critical mass and community"** – One to three percent of your users can catalyze your online community and social network.
3. **"Viral distribution and cooperative advantage can build ecosystems rapidly"** – The web is a powerful connectivity engine. Through it, online users quickly communicate about your company and its online products.

> "Google reached a billion dollars, one [advertising] nickel at a time."

The best ways to proceed with your Web 2.0 project may not always be apparent. Observe Web 2.0 leaders such as Amazon, Google, Twitter and Flickr. Learn from them and emulate their actions when appropriate. A saving grace of Web 2.0 is the Internet's "low cost and high connectivity," so you can quickly attempt different online approaches. If one doesn't work, it's easy to try something else.

About the Author

Amy Shuen is an expert in, and lectures on, innovation and high-tech economics.
