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The long tail of social networking. Revenue models of social networking sites

Albrecht Enders*, Harald Hungenberg, Hans-Peter Denker,
Sebastian Mauch

Strategic Management, University of Nuremberg, Lange Gasse 20, 90403 Nuremberg, Germany

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Summary Benefiting from new Internet technologies and altered user behavior, social networking sites have become the poster child of a series of new web services that have been emerging with the advent of “Web 2.0”. In this article, we follow a comparative case approach of two major German social networking sites—StayFriends and XING— in order to answer the question of how social networking sites create value for their users and how they can capture it. By transferring Chris Anderson’s concept of “The Long Tail” to internet-based social networks, we develop a novel perspective on the value creation of these new types of businesses. In particular, we examine how social networking sites can generate revenues through advertising, subscription, and transaction models. In addition, we identify the number of users, their willingness to pay, and their trust in peers and the platform as the key value drivers. Finally, we discuss managerial implications, providing examples from our case studies and recommendations for leveraging the value created through these services.

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Introduction

The advent of Web 2.0¹, which has opened up new ways to communicate, share content, and collaborate, symbolizes a paradigm shift from website provider- or “supplier”-gener-

ated content to user-generated content (Kolbitsch and Maurer, 2006). IT expert, author and media entrepreneur Tim O’Reilly, calls Web 2.0 “*the business revolution in the computer industry caused by the move to the Internet as [a] platform, and an attempt to understand the rules for success on that new platform.*” The applications should “[...] harness network effects to get better the more people use them.”²

These new opportunities for using the Internet were made possible by several simultaneous developments, the

* Corresponding author.

E-mail address: albrecht.enders@wiso.uni-erlangen.de (A. Enders).

¹ The term Web 2.0 originated from a series of conferences about new web technologies of the same title. These conferences were initiated by Tim O’Reilly, an internationally renowned expert on Internet and open source technologies.

² “Web 2.0 Compact Definition: Trying Again”, o’Reilly Radar, by Tim o’Reilly, URL: http://radar.oreilly.com/archives/2006/12/web_20_compact.html.

most important ones being the following: The creation and adoption of new syndication formats such as RSS³ and new technologies like AJAX⁴, the increased number of people accessing the Internet via broadband connections, and also a change in the behavior and mindset of Internet users who have come to perceive the web increasingly as a medium for sharing information and identity than for simply consuming content provided by portals (Kolbitsch and Maurer, 2006). These developments have led to changes in the way people use the Internet. Nowadays, for example, users spend significantly more time online and want to share more information about themselves.

Different business models, generally regarded as Web 2.0 applications, currently try to seize these new opportunities. Media-sharing portals such as Flickr and YouTube, the voice-over-IP-application Skype,⁵ the free collaborative online encyclopedia Wikipedia,⁶ and the broad "blogosphere"⁷ realm rely on new technologies to promote the collective spirit of the Internet. Another group of business models, which has benefited greatly from the changes mentioned above, entails internet-based social networking sites (called SNS in the remainder of the article). These online communities enable users to communicate and connect with each other, to build up a personal network, as well as to share personal content. On these sites, members create their personal profiles to present themselves to others (O'Murchu et al., 2004), while community providers primarily act as enablers, offering support capabilities as well as search and communication tools. This movement towards social interaction on online platforms has created a new basis for community, which is also called "network individualism" (Boase et al., 2006). While, in the past, individuals typically had to rely on geographically bounded communities for creating social capital (or social networks), users of online communities can now seek out a variety of appropriate contacts depending on their specific information needs at any given time.

The best known and biggest online community today is MySpace⁸, which was acquired for € 482 million by Rupert Murdoch's media conglomerate News Corp.⁹ in 2005.

³ RSS (Really Simple Syndication) is a web feed format enabling users to automatically include content of websites on their own website or read and organize this content with RSS-aware software.

⁴ AJAX (Asynchronous JavaScript and XML) is a web development technique for creating interactive web applications by enabling web pages to reload small amounts of data from a server, so that the entire web page does not have to be reloaded each time the user requests a change.

⁵ Voice over Internet Protocol (VoIP) is the routing of voice conversations over the Internet or through any other IP-based network.

⁶ URL Flickr: <http://www.flickr.com>; URL YouTube: <http://www.youtube.com>; URL Skype: <http://www.skype.com>; URL Wikipedia: <http://www.wikipedia.org>.

⁷ Blogosphere is the collective term encompassing all blogs as a community or social network. Many weblogs are densely interconnected, and have grown their own culture. Sites such as Technorati (URL: <http://www.technorati.com>) use the links made by bloggers to track their interconnections.

⁸ URL MySpace: <http://www.myspace.com>.

⁹ Business Week Online: "News Corp.'s Place in MySpace", URL: http://www.businessweek.com/technology/content/jul2005/tc20050719_5427_tc119.htm (accessed 01/05/07).

MySpace currently hosts more than 130 million profiles and managed to increase the number of unique visitors in 2005 by 367% to 38.4 million.¹⁰ The social networking site Facebook, which was originally set up as an online network for college students, has enjoyed similar success since it also has made membership possible for a broader public. New portals emerge almost every week and it seems that they are more than just a short-term hype.¹¹ More recently, in December 2006, the business networking site XING staged its IPO.¹²

The idea of capitalizing on bringing people together online is not entirely new. Prior literature has identified various motivations for bricks-and-mortar companies to integrate virtual communities (VCs) into their existing business models. For instance, they can be installed to serve communication, information, entertainment or transaction purposes (Armstrong and Hagel, 1996), to support a company's physical products (Walden, 2000) or to create a single point of access for information within a company (Williams and Cothrel, 2000). While also promoting communication amongst users or serving as a source of entertainment, the key characteristic of social networking business models is the visualization of individual social and professional networks among users and tools that help to leverage these networks. Literature concerned with the success factors of VCs is therefore not comprehensive in explaining the success of SNS. The latter have so far been addressed in the literature only in a descriptive and categorizing way (e.g. O'Murchu et al., 2004) without any emphasis on their business models and the underlying value creation and value capturing strategies. This is primarily due to the fact that SNS are a rather new phenomenon.

The research question we will address in this article is how SNS create and capture value using different types of business models. To do so, we first analyze the reasons for the rise of SNS in the wake of Web 2.0 by applying the concept of "The Long Tail" (Anderson, 2006) to SNS. Second, we use a qualitative comparative case study, as proposed by Yin (2003), and analyze the business models of two SNS, XING and StayFriends, in order to point out differences in the creation and capturing of value on SNS. Third, we generalize our findings and develop a theory of revenue drivers and corresponding revenue models for SNS. Finally, we derive generic strategy recommendations for each revenue model.

The long tail of social networking

In view of the rapid growth of SNS, the question arises of how they actually create customer value and how this value can be converted into sustainable revenue streams for SNS operators. We argue here that SNS create customer value

¹⁰ Nielsen/Netratings, New York, May 2006, URL: http://www.nielson-netratings.com/pr/pr_060511.pdf, (accessed 01/05/07).

¹¹ "MySpace, Facebook and Other Social Networking Sites: Hot Today, Gone Tomorrow?", Knowledge@Wharton, URL: <http://knowledge.wharton.upenn.edu> (accessed 01/02/07).

¹² e-consultancy: Web 2.0 company XING raises €35.7 million in IPO, URL: <http://www.e-consultancy.com/news-blog/362352/web-2-0-company-xing-raises-35-7-million-in-ipo.html> (accessed 01/05/07).

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