5

CHAPTER 5

In the company environment

5 In the company environment

Many executives and entrepreneurs know—or at least sense—the opportunities Web 2.0 offers for their businesses. Yet the question they most often ask themselves is "How can I successfully develop all these possibilities in my business and what business opportunities are there in this field?". We believe there are plenty of opportunities, to judge by the fact that by 2008, the majority of the companies on the Global 1000 list will have adopted various technological aspects of Web 2.0.

The new Web 2.0 philosophy, which requires a low level of initial investment, short company-creation period and a lightweight organisational structure allows new companies to compete quickly with traditional companies already established on the market. And traditional companies can also benefit from Web 2.0.

One of the advantages for traditional companies is that Web 2.0 enables them to unify their information flows with suppliers and customers.

In this way, a company reaches new dimensions, identifying information flows ranging from product conception, design and supplier performance all the way through to the end customer, taking in the functions of production, distribution, marketing and customers (extended enterprise).

Although Web 2.0 is a global phenomenon, it does not impact all sectors equally. Illustration 3 shows a list of sectors where it has the greatest impact, according to the FTF experts.

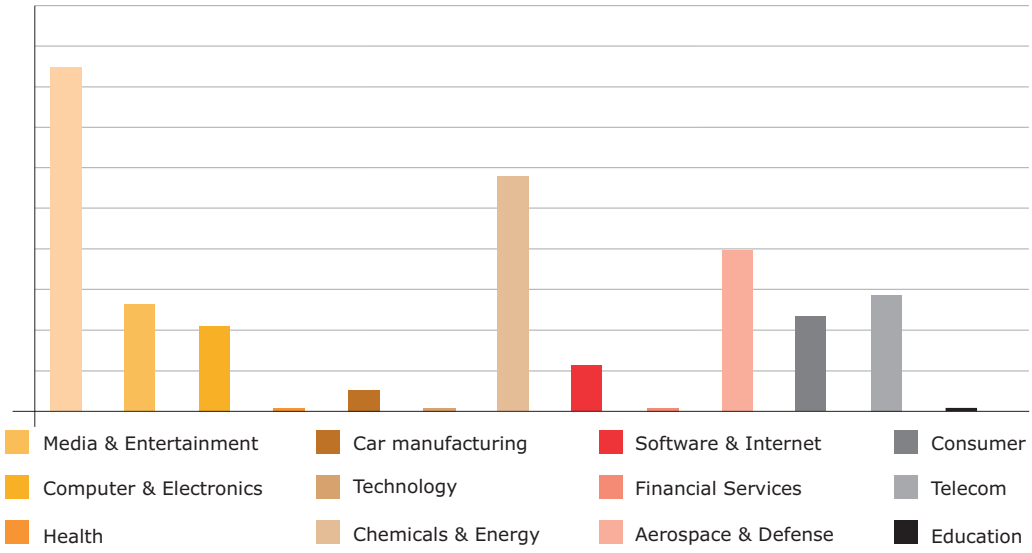


Illustration 3. Web 2.0 impact by sectors.
Source: Drawn from conclusions within the Future Trends Forum.

(C) 2007 Fundación de la Innovación **Bankinter**. All rights Reserved

5.1. Business models of Web 2.0 companies

In the new Web 2.0 generation, a business model has to establish the way a company plans to make money in the long term using the Internet. Some models are quite simple. All the company need to do is offer an online service, distribute it to its customers and, if all goes well, sales revenues will exceed costs and it will make a profit; the model is that simple.

Others, however, are more complex, as is the case of free-to-air radio and television broadcasts. Anyone with a normal everyday receiver can pick up the signal and enjoy the broadcast. This process is part of a complex network of distributors, content creators, advertising agencies, listeners and viewers. With so many different agents involved, it is not always clear who generates the earnings, let alone how much they come to, because it all depends on a series of factors.

There is no clear classification for all existing Web 2.0 business models in the physical world, let alone on the Internet, but Illustration 4 gives a broad outline.

Tactical - Direct Revenue
Advertising
Subscriptions (flat rate, variable rate, flat+fixed rate)
Transaction Commissions
Sales revenue
Revenue from services
Donations

Strategy
Mergers and take-overs
The "Long Tail"
Hard-to-copy Databases
User Confidence
Reputation
Creation of a Platform
Increase in Competitiveness
Customer Self-service
Network effect

Illustration 4. Web 2.0 business models.
Source: Drawn from conclusions within the Future Trends Forum.

Long Tail

The **Long Tail** is the colloquial name given to a long-known feature of some statistical distributions (Pareto distributions). The Internet and the digital environment have changed the laws of distribution and the rules of the market. There are now two markets: the traditional one, centring on high performance by a few products, and a new and still unfamiliar market, based on accumulation of all the small sales of many products, which may equal or even exceed the conventional one. These are the old mass market and the new niche market, represented by the head and tail of the well-known statistical distribution graph.

There are therefore two ways to make money out of Web 2.0: direct or **tactica**l and indirect or **strategic**, which often go unnoticed. Some of the indirect paths lead to an increase in revenue, a rise in the number of users or a greater resistance to competition, which in turn translates into an increase in subscriptions, advertising and income from commissions.

(C) 2007 Fundación de la Innovación **Bankinter**. All rights Reserved

Here are some examples of successful business models of Web 2.0 companies:

Advertising-based:

- Whyville (check video) is a virtual educational world targeted at children aged between 8 and 15. It has 2.4 million registered users around the world, whose aim is to learn, create and just have fun together. On any given day in Whyville there are between 100,000 and 150,000 children in the community (represented by avatars), with an average of 3.5 hours a month per user and 8.5 million educational games played. This virtual world gets more than 2 million visitors a month and around 60,000 new subscriptions.

  The business model of this virtual world is founded on payments from sponsors, who not only pay development costs, but also make incremental payments depending on the number of visitors. However, their contribution is not exclusively financial; they also provide knowledge. NASA, for example offers games that teach next-generation technology for long-distance space travel.

  Another form of income in this virtual world is generated through the sale of CLAMS –a virtual local currency– and premium subscriptions.

Commission-based:

- Innocentive is a new Internet-based community, which brings top scientists together to resolve major R&D challenges posed by leading companies throughout the world, in exchange for payments of up to $100,000. The online forum enables leading companies to reward scientific innovation with financial incentives.

  The main advantages of Innocentive for companies in search of solutions are access to the best scientists of the world and speed in obtaining solutions to difficult problems in the R&D area.

  However, there are also benefits for the scientists: recognition, access to significant problems in the R&D area related to their areas of interest and specialisation, the possibility of participating in the intellectual challenge

(C) 2007 Fundación de la Innovación **Bankinter**. All rights Reserved

of solving world-class R&D problems and of obtaining considerable financial rewards if they come up with successful solutions.

Based on **income from sales**:

- Threadless was founded in 2000 to market T-shirts, with the distinguishing feature that users could send in their own designs. After a public vote, the best designs are printed on T-shirts, which are then sold over the Web. The creators of the winning designs are paid in cash and in coupons which they can use to buy products from the website.

  To ensure efficient stock management, users are polled prior to production in order to estimate the demand for a given design.

Donation-based:

- The Sunlight Foundation was founded in 2006 to create a bridge between politics and citizenship through technology. The site allows ordinary people to learn more about politicians, help reduce corruption, ensure greater transparency and accountability, etc.

  Some of its most important projects include: enabling access to information on Congress, encouraging citizen collaboration to provide political information, identifying areas on which taxpayers' money is spent and assessing the transparency of official websites, among others.

  The Sunlight Foundation's business model is based on financial donations and the names of its contributors are published on the website to ensure total transparency.

Not all Web 2.0 applications are profitable or generate enough revenue to Ensure the success of the business. However, many of them have succeeded in opening up a whole field of new services and new ways of satisfying users' needs, where capitalising on these opportunities is a key feature for developers, users and organisations alike.

Illustration 5 shows the principal Web 2.0-based business models in Europe, according to the FTF experts.

(C) 2007 Fundación de la Innovación **Bankinter**. All rights Reserved

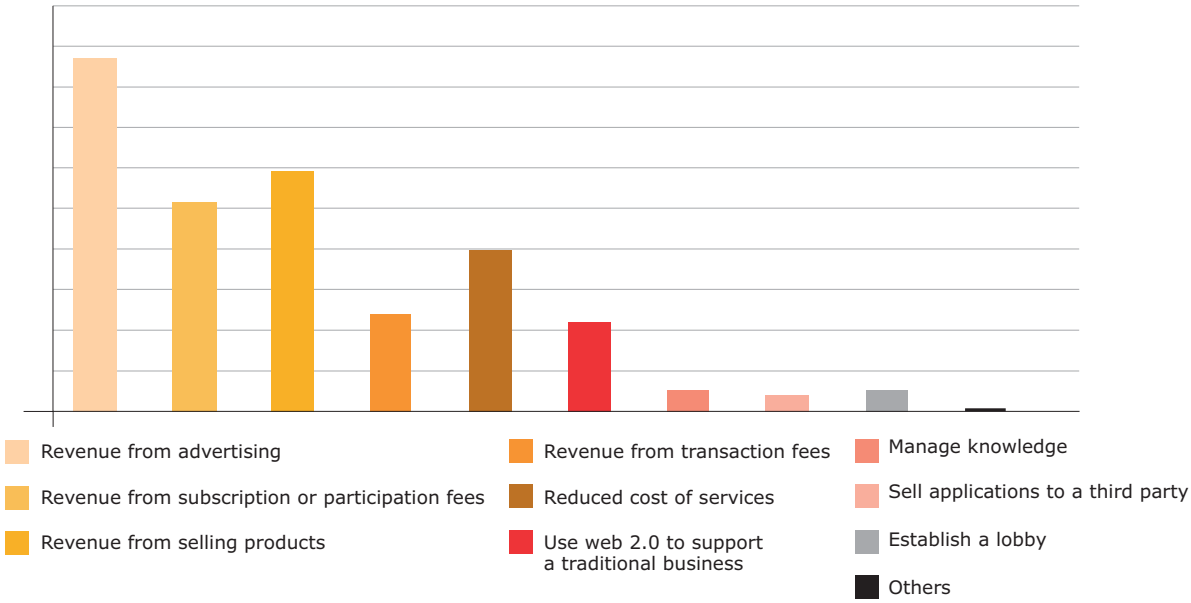


Illustration 5. Principal business models in Web 2.0 companies: Europe.
Source: Drawn from conclusions within the Future Trends Forum

Whatever model is chosen, there seems to be a certain consensus that any Web 2.0 company aspiring to succeed must be capable of generating value for the customer. The difficulty comes in making these applications—which were not necessarily created as money-making machines—profitable and sustainable.

So, what are the keys to making Web 2.0-based businesses sustainable? This is what the FTF experts say:

- Achieving a "network effect", i.e., offering a useful service for users which also increases in value as the number of connections increases.

- Creating a product or service that the user will use. In the case of advertising-based business models, it is also very important to ask how exponential growth can be achieved through user participation.

- A large user base—given that these companies have only a small unit margin.

- Understanding the percentage of their time and available income and expenses the customer is willing to devote.

- Being a profitable business for all those involved. Profitability is often not measured in economic terms, but, if the ultimate aim is for the business model to be sustainable, some sort of profit must be made.

(C) 2007 Fundación de la Innovación **Bankinter**. All rights Reserved

- Confirming the business' position as a stable source of income.
- Finding a market niche for a business and offering a good service that satisfies an existing demand.
- Achieving interaction with the user. If there is no user input, there's no Web 2.0.

In short, business models for companies Web 2.0 share many features with those of traditional companies, although it is particularly important to achieve active participation by the user in order to ensure the sustainability of the model.

5.2. Web 2.0 applications for traditional companies

Viral marketing

Viral marketing a strategy whereby people are encouraged to forward a marketing message to others, leading to an exponential growth in the numbers viewing the message.

Web 2.0 not only offers good opportunities for creating new companies, it also has many applications for traditional companies.

According to The Economist most executives agree that Web 2.0 is going to **change the way they relate internally and externally**, with a shift towards greater networking.

Apart from the increase in communication, one of the reasons the managers give for using these applications is cost reduction, especially in customer care (so important in many companies), R&D (by using the customer as a betatester), and advertising (by replacing advertisements with viral marketing.

The illustration lists the most useful Web 2.0 tools, according to a survey of 250 management staff by InformationWeek Research:

(C) 2007 Fundación de la Innovación **Bankinter**. All rights Reserved

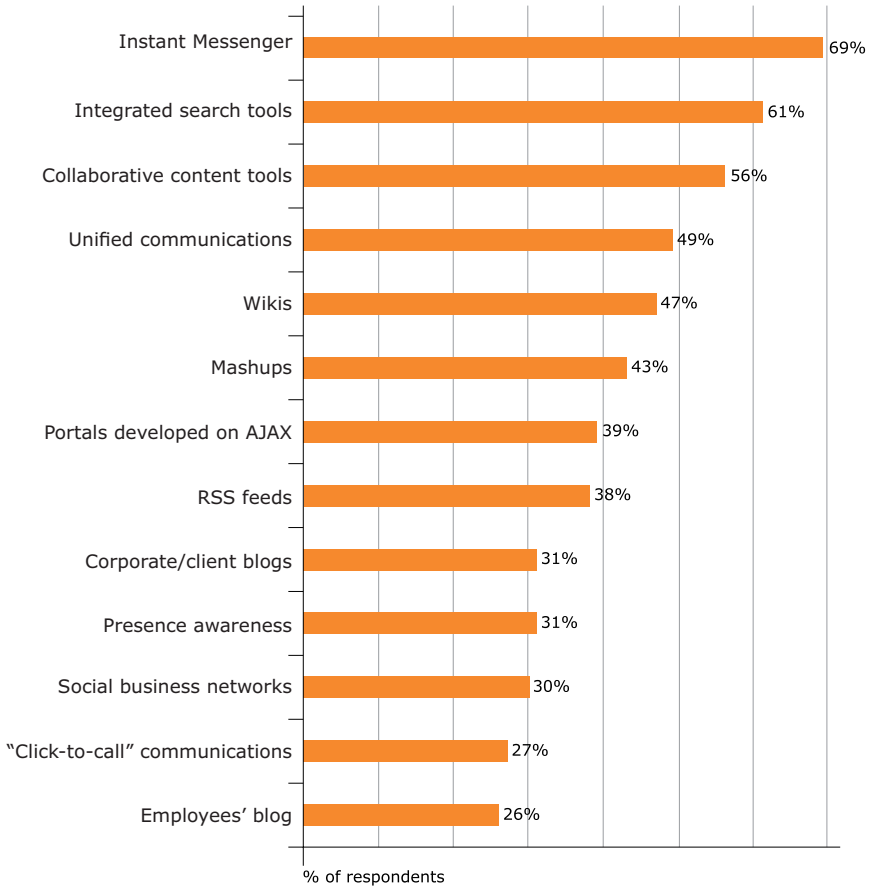


Illustration 6. Most useful Web 2.0 tools.
Source: Information Week Research survey.

Mashup

A **mashup** is a web application that uses resources from more than one online source to create a new service.

Web feed

In IT jargon, a **web feed** is a data format used to provide frequently updated content. Web feeds generally include the headlines of news stories or articles, often accompanied by a short summary. They are widely extensively in blogs.

Although they do not feature in the list, it's also worth mentioning webtop applications. These are traditional desktop applications (word processors, spreadsheets, project management tools, etc.) which can be used across a network. Although they are not yet in mass use, these applications will bring major savings in companies, in licences, disk space, LAN loads, etc.

The fact that the executives are aware of the usefulness of these tools is in itself very significant. Yet to what extent are they actually investing in them?

(C) 2007 Fundación de la Innovación **Bankinter**. All rights Reserved

According to McKinsey [3] , more than 75% of executives claim that their companies are investing in Web 2.0, and they seem to be willing to maintain or increase their investments in this type of technology, which fosters user collaboration.

As Illustration 7 shows, the level of acceptance in the company varies depending on the tool under consideration.

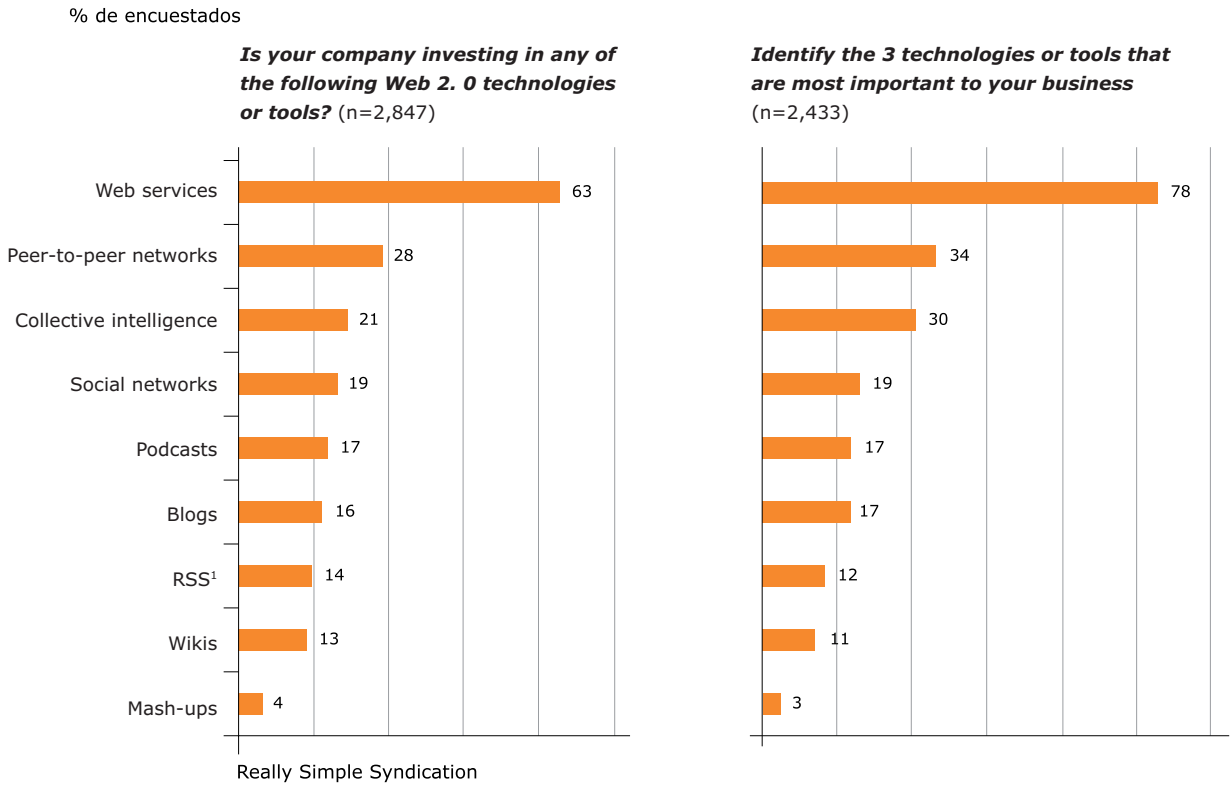


Illustration 7. Web 2.0 technologies in traditional companies.
Source: 2007 McKinsey Survey on Internet Technologies.

However, if we compare the tools that executives consider most useful with actual investment levels, the figures don't match. For example, the InformationWeek survey shows that companies invest more in RSS than in wikis or mashups but consider the latter two to be more useful.

http://www.mckinseyquarterly.com/article_abstract_visitor.aspx?ar=1913.

In any case, this data is general and varies depending on the type of company. We can draw a distinction between two separate groups of companies making this kind of investment:

(C) 2007 Fundación de la Innovación **Bankinter**. All rights Reserved

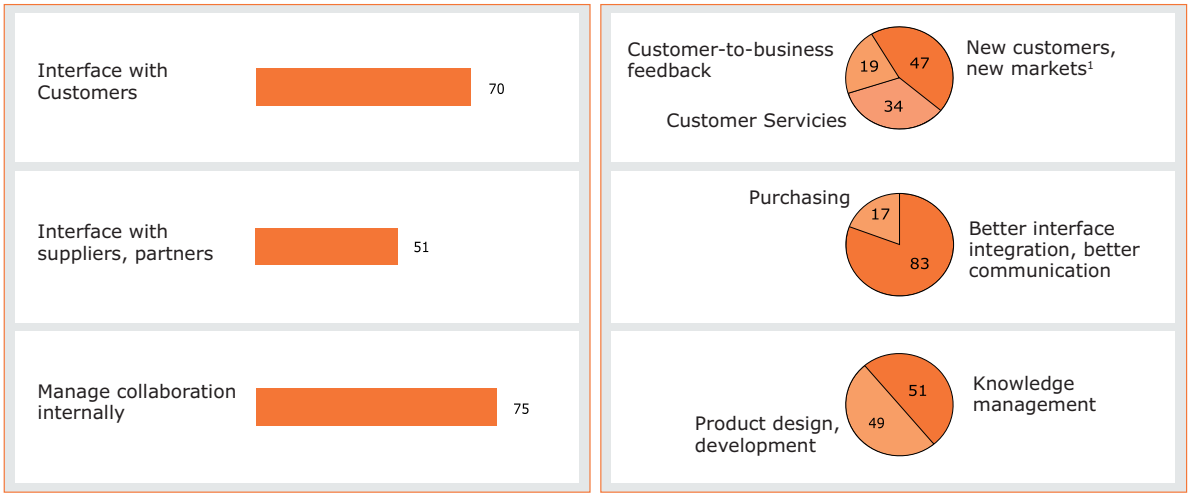
Collective intelligence

Collective intelligence is a system that seeks to unite the experience of a group as opposed to a single individual, thus generating knowledge through collaboration.

- Communication-centred companies, who invest more in RSS, blogs and podcasts.
- Knowledge-centred companies, which invest more in mashups, peer-to-peer networks, social networks and collective intelligence.

What are the principal uses of these tools? Their purpose is not so much to win over audiences as to **improve information processing and distribution in the internal area, encourage employee collaboration and improve communication with customers and suppliers.**

The results of the McKinsey survey are shown in Illustration 8.



[1] Sum of responses for entering new markets and acquiring new customers in existing markets

Illustration 8. Main uses of Web 2.0 in the company.
Source: 2007 McKinsey Survey on Internet Technologies.

Looking to the future, Illustration 9 shows the main reasons that FTF experts believe will lead companies to use Web 2.0 services.

(C) 2007 Fundación de la Innovación **Bankinter**. All rights Reserved

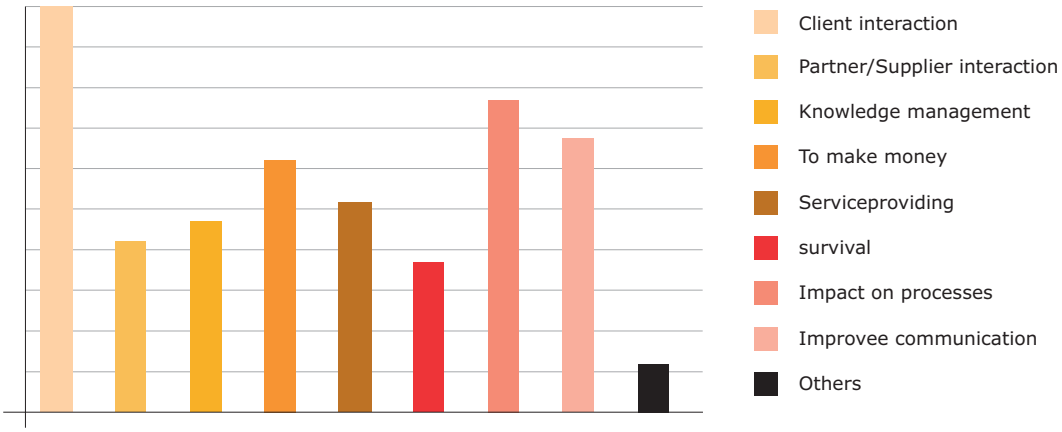


Illustration 9. Principal needs that encourage companies to use Web 2.0.
Source: Drawn from conclusions within the Future Trends Forum.

On their own, these would appear to be reason enough to persuade the most hardened sceptic, but they are not the only ones. Other important reasons include reputation management, commitment to the blogosphere, providing better customer experience and cost-cutting.

So according to the McKinsey survey, companies currently appear to be using Web 2.0 to manage collaboration internally, whereas in the long term, according to the FTF experts, their reasons for incorporating these technologies will target improved customer interaction.

As well as these utilities, the main benefits of Web 2.0 for these companies are:

- Greater efficiency of applications.
- Greater customer satisfaction resulting from improved communication.
- Increased navigation of internal and external information, especially on product consumption and use, through semantic technologies.
- Feedback on new products from Web 2.0. communities.
- Greater control over public image by the company, which will be able to "sell itself" better by pinpointing bloggers and other influential Web users.
- Optimisation of the marketing department's budget through web-based strategies.

Notes

(C) 2007 Fundación de la Innovación **Bankinter**. All rights Reserved

- Boost to the creation of, or move towards, an extended enterprise, a business strategy which is becoming increasingly popular and is essential in formulating competitive strategies for success.

Browsing the net we can see some examples of Web 2.0 applications being used by traditional companies, such as on-line brainstorming by a leading computer manufacturer a wiki to harness the fan base.

Although many companies have engaged with Web 2.0 technologies, however, there are still barriers to incorporating them into traditional companies. Illustration 10 shows the main barriers, according to the FTF experts.

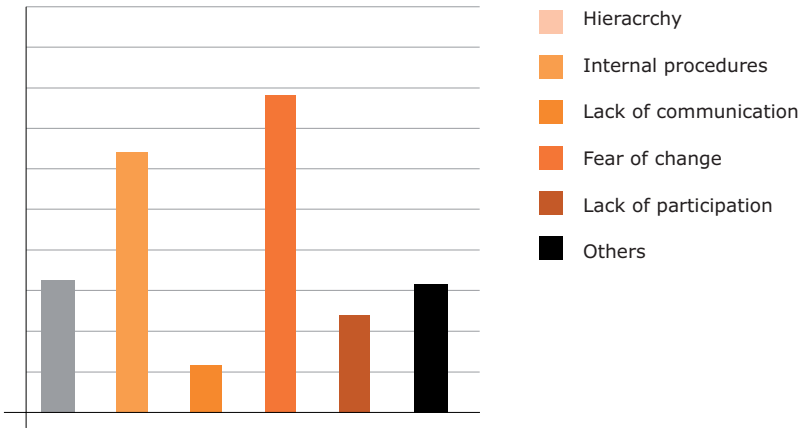


Illustration 10. Barriers to Web 2.0 in companies.
Source: Drawn from conclusions within the Future Trends Forum.

And there's more. Other barriers include ignorance of what Web 2.0 really is, a false feeling of control, leadership that insists on a bottom-up value within the hierarchy and the complexity of the systems.

Likewise, many executives are prevented from investing in these new technologies by a fear (that poor counsellor) of repeating previous experiences when they not only failed to achieve the anticipated returns on their investment, but actually failed to recover it.

Doesn't this all sound a bit like the 1980s, when many companies held out against buying computers? With the benefit of hindsight, it seems like a fairly quaint stance. For many people, Web 2.0 still sounds like science fiction, but interest

(C) 2007 Fundación de la Innovación **Bankinter**. All rights Reserved

in this type of application continues to grow, and it is therefore reasonable to presume that it will be useful in the future. As time goes by, it will be used ever more widely and, as always, the early bird will have the competitive edge.

For anyone interested, Gartner recently set out the following recommendations for companies wishing to get on the Web 2.0 bandwagon:

- Expose your trickiest business and technology challenges to open forums and learn how to identify real contributors.

- Solicit and respond to customers' input, feedback and new service ideas through communities of customers.

- Use social network analysis software to map out how information and ideas flow among your people.

- Pilot virtual markets in which customers and employees can trade "virtual shares" in promising ideas and innovations.

Another important aspect that needs to be analysed in this area of Web 2.0 business is the impact the new philosophy will have on venture capital (VC) and investment companies.

Although, as we have already seen, Web 2.0 offers plenty of new business opportunities, a priori these require less initial capital. As a result, the opportunities for VC will come in later phases in the growth or expansion of this type of company.

Because less initial capital is needed, more projects will emerge and new ideas will be developed which can be taken up by venture capital investment if they grow to be big enough to require such a capital injection.

In turn, this large quantity of new ideas and companies necessitates a search for new models of selection and assessment by investment companies.

Many of these Web 2.0 companies involve a significant "trial and error" component. As a result, many VCs will wait to see results, generally related to a user base, before getting involved in investment. Here there is a risk that these investment companies may be pipped to the post by other strategic buyers, unless the VCs can offer companies something extra in addition to funding.

(C) 2007 Fundación de la Innovación **Bankinter**. All rights Reserved

5.3. Advertising

The most common Web 2.0 business model is the advertising-based one. It may therefore be helpful to analyse the budget spent on Internet advertising, the medium's percentage of penetration and some of the differences between traditional and Internet advertising.

A new study by JupiterResearch, entitled *Media Consumption Patterns: Online Vies with TV As Primary Medium*, suggests that Internet users spend as much time on this medium as on television. However, advertisers continue to target most of their advertising budgets on television and the print media. Internet advertising accounts for little over 2% of total advertising spending in Spain, though it is growing at a rate of over 50% per annum.

Why is this? The answer is simple: it is partly due to the fact that users spend over half of their time online communicating, either by e-mail or by messenger, but, above all because television in Spain reaches nearly 90% of the population, whereas Internet use is below 20%, as the General Media Survey [*Estudio General de Medios*] performed between October 2006 and May 2007 shows (see Illustration 11).

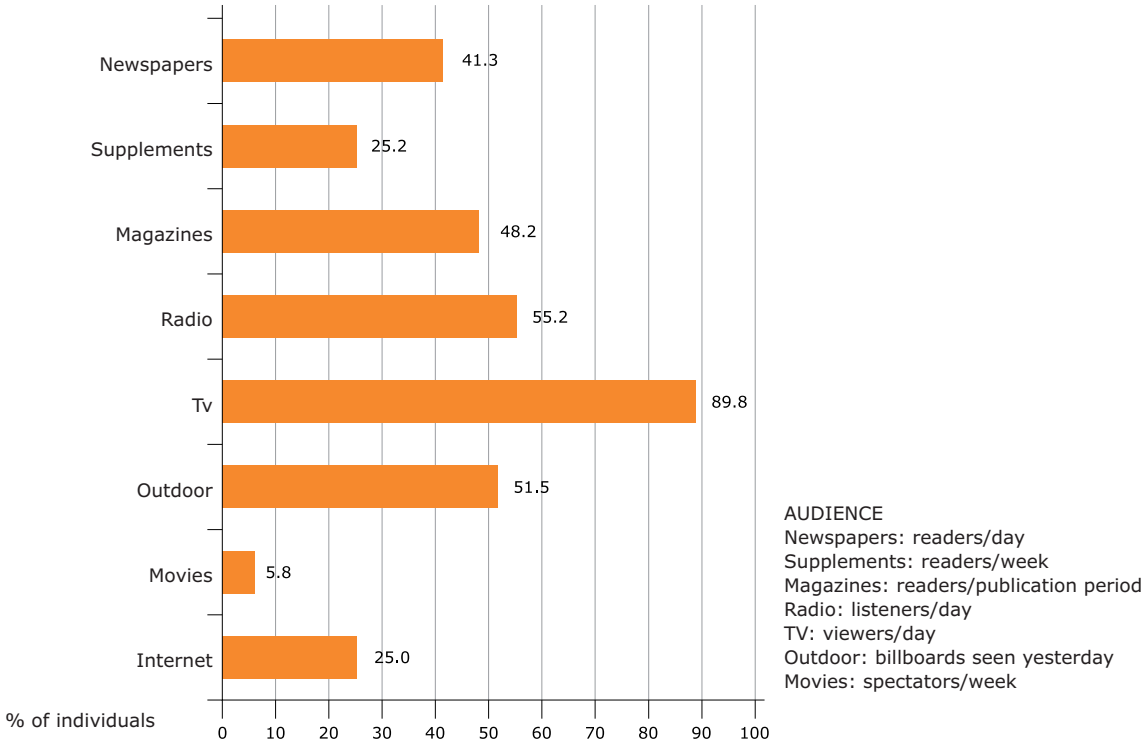


Illustration 11. General Media Audience Ratings.
Source: Asociación para la Investigación de Medios de Comunicación.

(C) 2007 Fundación de la Innovación **Bankinter**. All rights Reserved

Nonetheless, in segmentation terms, a medium like television is quite inefficient and as a result, the Internet and Web 2.0 are very attractive for marketing heads.

Web feeds are documents in RSS format. This format allows users to filter news, subscribe to certain sections and ignore others, and receive alerts when news breaks that will interest them. It is unquestionably an experience with which traditional media will find it difficult to compete. The picture of a group of editing staff deciding what news to include in the paper or on the TV is a think of the past.

RSS

RSS is a simple XML-data format used to syndicate (rebroadcast) contents to subscribers to a particular site.

Over the last five years, the Internet has brought about a profound social change. This is what is known as the **democratisation of the media**, whereby millions of people have been transformed from mere consumers into media producers.

There will therefore be an ever greater number of media and it will be increasingly complicated to reach consumers, who will be more scattered in this micromedia environment. Instead of reading the local print newspaper, they will read microcontent written by someone with the same interests as them, or listen to podcasts on an issue so specific that the radio would never have the time and resources to devote a programme to it.

This fragmented environment in which Web 2.0 thrives, makes it possible to send out commercial messages that are extremely relevant to a very specific target audience. Instead of targeting advertising at a uniform mass over television or the press, companies will now be able to target their messages more effectively.

Advertising agencies will therefore have to prepare to reach smaller and smaller target groups. New technologies will enable them to **target advertising messages at people with a specific interest** in the product, for which they'll have no choice but to use blogs, podcasts and videocasts, among others.

The American chain of department stores Target is a good example of the use of Web 2.0 technologies by companies to communicate with customers. In December 2005 it began publishing its offers for the week in RSS format, so that consumers with an RSS reader could receive the offers directly on their computers (and soon in other devices), together with the news of the day and articles from their favourite blogs.

The publicists' strategy has changed and their target audience now consists of opinion leaders, who can get the message across to a much more segmented audience, any time, anywhere.

(C) 2007 Fundación de la Innovación **Bankinter**. All rights Reserved

Added to this is the fact that **consumers will want to communicate with companies** and play a more active role than that of mere receivers. Advertising agencies therefore have to learn to get into dialogue with customers, instead of simply putting out a mass message.

Surreptitious advertising has proved inefficient for reaching a given segment, whereas contextual advertising programs, such as Google Adsense, offer a range of advantages:

- They make it possible efficiently to segment the market by stakeholders and by geographical areas.
- They allow very low cost advertising campaigns, tailored to a lower budget.
- They offer the possibility of keeping up the advertising campaign and monitoring results and benefits on a daily basis, provided the relationship between investment and income is positive and is performed over the Internet, as is the case, for example, with e-commerce.
- They make it possible to work with a broad range of options for assessing users' responses to each advertising strategy.
- They capitalise on viewing of the advertisements (as a billboard advertisement does), without generating expenses for the advertising company until the customer shows real interest and clicks on the ad.

Contextual advertising is just one example of how advertising in general will change.

We are used to being constantly bombarded with advertisements. Traditionally, advertising has consisted of a one-way communication, in which companies know more than consumers about product acceptance. This picture is changing, however. Thanks to new technologies, consumers can communicate with each other far more readily, obliging advertising to be more sincere and more transparent.

The connectivity of new technologies has favoured the emergence of viral marketing, or self-propagating advertising, an important phenomenon given the good returns some brands are garnering with very little investment. Viral marketing, however, does not just consist of videos doing the rounds over the Internet, nor is it exclusive to the Internet, though Web 2.0 connectivity has made it even more workable.

(C) 2007 Fundación de la Innovación **Bankinter**. All rights Reserved