Should Facebook consider breaking itself up?

By Niraj Dawar

At some point in the future regulators may look at the industry and argue that dominant social networks are "natural monopolies" with too great a concentration of market power. But long before that hypothetical eventuality, is it smart strategy forFacebook to break itself up?

If history is a guide, Facebook's strategy should be driven by its consideration of the market and competitors. These eventually take a greater toll on the 800 lb. gorilla's market share and market power than do the actions of regulators. Microsoft may have been slowed down by its legal battles, but eventually it was nimbler competitors that ran circles around it.

And Microsoft, as we know, was a harbinger of a new type of market power – companies that are dominant and have few competitors because that is the market structure that makes the most sense from the customers' standpoint.

How can less competition make sense for the customer?

The answer, of course, is in *network effects*. Take the social networking world. For those who want to socially network, it makes sense to congregate where everybody else is hanging out. There is only one village square. Being on a different square from everyone else doesn't get you anywhere – you just miss the party. So it makes sense to have an account on Facebook, where you can easily connect with everyone else who is on Facebook. It's kind of self-defeating to be on Diaspora or Friendster or My (empty) Space.

(The same logic applies to Twitter: if you tweeted outside of twitter, would anyone hear it? And also to LinkedIn). Network effects make Facebook and Twitter and LinkedIn very powerful. But unlike powerful companies of the past, they don't claim rents on that power in the form of higher prices – they're all still largely free for end-users. Still, the network effects do entice users to share considerable amounts of information. That information is very valuable – by some valuations, **Facebook, though still privately held, is worth well over $50 billion**.Smaller, newer social networks invariably offer "greater privacy" as a hook: see Pip.io, Altly.com, The Fridge, Collegiate Nation, etc. Despite that, these upstarts are not yet getting very far — they lack network effects.   But network effects can fool the company into believing it must remain a single, unified, and monolithic entity to end users — that there can only be one Facebook. What if that's not true?Imagine a different world. One in which Facebook retains control of the back end of its operations — the customer accounts, the development and delivery of affiliated products and services, the servers housing customer information, and so on — but hives off the customer facing side of the business to third party companies who pay Facebook a fee for access to the village square.In this world there would be, say, three dozen variants of the social network, each offering a different value proposition: greater privacy, easier Chinese character recognition and display, better video uploads and downloads, etc. – you could have an account on any one (or more) of them, but still choose to be seamlessly connected to friends on any of the other 35 social networks, since the back end would be run by Facebook.

This structure would transform Facebook into a truly 21st century company: the first information utility.

So why would Facebook do something like this?

Most of the reasons are competitive and strategic, but the approach might also have the benefit of keeping regulators off its back. We could fast forward or even skip a process that some see coming: regulators investigate Facebook (and perhaps other dominant companies in the social network space), drag them through the courts, declare them "natural monopolies" that should not be concentrated in one entity, and demand their break-up.

Why not skip ten years, spare the company and the taxpayers a lot of headache, headlines, time, and money? (Sure, it'd be lousy for the lawyers — but hey, you can't please everybody).

And since the company would be breaking up pro-actively rather than under a regulatory gun, it would do so on its own terms, not ones dictated by regulators.

There’d be dozens of companies that would jump at the opportunity to play at the front-end — many of which are currently nipping at Facebook’s heels. These potential rivals could become front-end channel partners, each building its own brand, and competing to acquire and serve customers.This would leave Facebook room to work with specialist partners at the back end,focusing on innovation to bring new services to users; monetizing and securing its mountains of customer data. There’s a lot of work to be done there, and a lot of unrealized opportunity. Why spend time and effort on the increasingly dreary, relatively low-return business of customer acquisition and service — how exciting can it be after the 700 millionth?But that’s not all. There’s another reason Facebook should consider breaking itself up: over time, the market takes a greater toll than the regulators. MySpace was once hot property. The party moved on — to Facebook. Facebook is well aware that it could move again — and its competitors are not standing still.

With multiple front-ends, the company spreads its risk: it has a much greater chance of continuing to benefit from the party, wherever it is happening.

Sometimes, it is better to eat your own lunch.

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