



The value of Facebook

There is a short entry in today's Financial Times about Facebook and the uncertainty surrounding its IPO. Essentially, people worry that Facebook may not have that much upside potential.

Sure enough, everyone sees the spectacular growth of membership: now around 800 million users and forecasted to be one billion by August 2012. The doubt is more about profitability. At nearly a billion users the market expects Facebook to be close to scale and, therefore, hugely profitable. Yet the company's profitability is average. According to the article, its revenues were 4-4,5 billion dollars in 2011. A useful benchmark here is Google of course, Facebook's biggest rival. Google's revenues stand at over 40 billion dollars, an order of magnitude higher. As an investor, there is reason to worry.

These simple heuristics hide a more profound consideration however, which is related to the rate of innovation in advertising technology. The reason Google is so profitable is because of its killer search advertising technology. This is a huge innovation compared to classic advertising formats. A similar potential innovation may happen soon for social networks, where the opportunity consists in harnessing word-of-mouth on a network of connected friends and relatives. If this problem is cracked, Facebook has tremendous advantage given its comparative size (just as Google benefits from its size in search advertising). The uncertainty is about when such innovation in 'network marketing' will happen? If a 100 years of media history is any guide, it is wise to remain patient.

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