

Battling for Markets in Internet Advertising

Facebook Rolls Out Real-Time Ad Platform

Financial Times
September 14, 2012

Some of the world's largest advertising companies have signed up to Facebook's new real-time advertising platform, in a move that the social network hopes will bolster its revenue streams.

On Thursday, Facebook officially launched the platform, called Facebook Ad Exchange, or FBX, following months of testing. The system allows marketers to bid in real-time to buy ad impressions on the social networking site, and deliver their ads to users based on their immediate web-browsing habits, or linked to current events, such as sports results.

"Real-time marketing is getting to be a really important component of digital advertising," said Rebecca Lieb, an analyst with the Altimeter Group. "We'll see a lot of event-triggered marketing in the upcoming election cycle."

The ads use information gathered from computer browsing histories to target individual Facebook users, and the ad prices fluctuate as in auction-style bidding system. So a user who looks at shoes on a retail site could then see an ad for the same brand when clicking back to Facebook.

The capacity will help Facebook compete more directly with advertising rivals Google and Yahoo, which have long provided real-time bidding to advertisers. ...

Within one tenth of a second, the system notifies when an ad space is available, evaluates 2,000 data points to determine the most relevant ad, calculates a price and prompts the ad to appear.

The global real-time bidding sector is estimated to be worth some \$3bn-\$4bn, but industry observers expect this to reach as much as \$20bn by 2015. ...

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ESSENCE OF THE STORY

- Facebook is under pressure to generate advertising revenue.
- Real-time bidding is widely used for Internet advertising and its market share is growing rapidly.
- Facebook and Google are getting better at capturing user activity.
- A new Facebook system will target ads at the user's current interests.
- Advertisers will bid to get their ads in front of the right users.

ECONOMIC ANALYSIS

- Like all firms, Facebook and Google aim to maximize profit.
- Facebook provides social networking services and Google provides search services, a variety of other services, and with Google+ is offering a social networking service.
- Facebook and Google face constraints imposed by the market and technology.
- People who use social networks demand their services, and at the latest count Facebook and another 198 firms supply social networking services.
- People looking for information demand Internet search services, and Google and more than another 100 firms supply Internet search services.
- The equilibrium price of social networking services and of Internet search services is zero, and the equilibrium quantity of each is the quantity demanded at a zero price.
- Social network and Internet search providers enjoy economies of scope: They produce advertising services as well as their other service.
- Unlike social networking and search, Internet advertising is a big revenue and profit generator.
- Because the providers of social networking and search know a lot about their users, they can offer advertisers access to potential customers and charge a high price for this precision.
- Google has been enormously successful at delivering advertising based on a user's search activity, and its revenue has grown from almost zero in 2001 to \$38 billion in 2011 (see Fig. 1). Google's profit in 2011 was almost \$12 billion (see Fig. 2).
- Facebook is still learning how to tap its advertising potential and the news article describes its plans in 2012 to develop real-time bidding for advertising based on a user's browsing.
- Facebook's revenue is beginning to grow, but by 2011 it had reached only \$4 billion (see Fig. 1).
- Providing a social networking service or search service doesn't guarantee success in generating advertising revenue and profit.
- Yahoo! is an example of a firm that hasn't performed as well as its owners would wish.
- As Google and Facebook have seen explosive growth in users and revenues, Yahoo! has struggled.

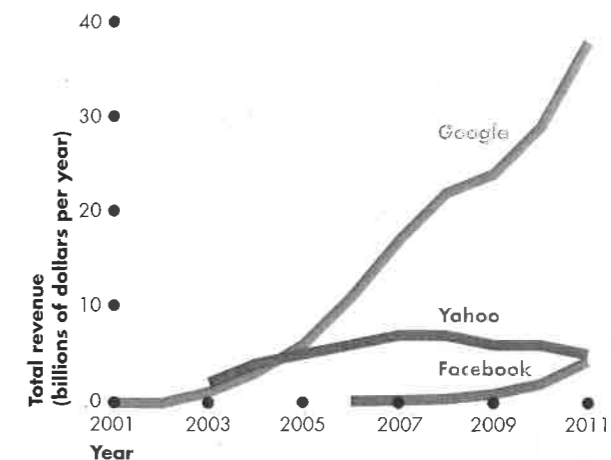


Figure 1 Total Revenue Comparison

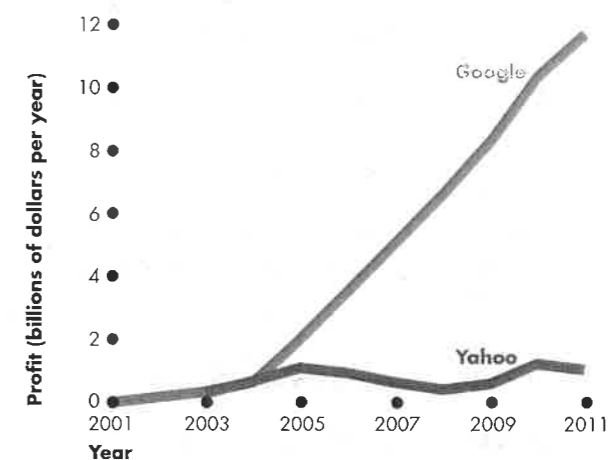


Figure 2 Profit Comparison

- Figure 1 shows that Yahoo's revenue peaked in 2008 and has been falling while Google's has soared and Facebook's has grown to almost equal that of Yahoo!
- Figure 2 shows that Yahoo's profit has been flat while Google's has soared. (We don't know how much profit Facebook has made.)
- The data shown in Figs. 1 and 2 suggest that so far, Internet search is a more effective tool for generating revenue and profit than social networking. Perhaps Facebook's new revenue model will change that.
- The data also suggest that Facebook's and Google's expansion is tightening the market constraint that Yahoo! faces.