



CASE 14

FACEBOOK

I wake up and check my e-mail, then I go to Facebook. At night, I do the same thing. Facebook is like an ice cream sundae because you can do anything with it, and no matter what, it's still fun.

—Tiffany Chang, 17, student at University of California Davis¹

INTRODUCTION

In just over two years, Mark Zuckerberg had built the social directory Facebook from nothing more than an idea into a national phenomenon worthy of a reported \$750 million buyout offer. It had become so vital to the university lifestyle that first-years were creating their Facebook profiles long before they even set foot on campus.² By the end of 2005, college students all over the U.S. were spending countless hours every day on the addictive and rapidly growing website. Nevertheless, other well-funded, so-called “social networking” sites had come and gone long before Zuckerberg coded Facebook in his Harvard University dormitory. Was it just a fad that would disappear from the collegiate landscape as quickly and as vigorously as it had consumed it? Or would Facebook remain popular and overcome mounting competitive threats and intense media scrutiny?

The organization had grown from just a few friends programming around a kitchen table to a full-fledged technology business with over

100 employees and 7.5 million users. Zuckerberg would have to develop an organization strategy that could allow the company to keep up with its underlying growth metrics, while ensuring Facebook’s user experience was better than its alternatives. The company’s core market—college students—were prone to switching and potential new markets—college students outside of the U.S. and high school students—were rife with well-funded entrants that were a step ahead of Facebook. Focusing the organization on the right objectives would be critical; getting the company to perform efficiently against those objectives would be a challenge for Facebook CEO and 21-year-old Harvard drop-out Mark Zuckerberg.

Founder

As an undergraduate at Harvard, psychology major Zuckerberg enjoyed building computer software applications in his free time. He had been programming since he was 10 years old, and his skills had,

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in his words, “reached a point where it went into my intuition, and I wasn’t really thinking that much about it consciously.”³ He added:

I made a ton of random things when I was at Harvard, and most of them no one ever saw. A lot of them just weren’t meant for other people to see, and they were just things that I made for myself because I thought that they would be cool. I used to make stuff like a natural language interface to play my MP3s.

Nevertheless, his work had not always gone unnoticed. In his senior year at Exeter Academy, Zuckerberg and his friend, Adam D’Angelo, created a software plug-in called Synapse that generated music playlists based on a user’s listening habits. Synapse soon found an audience that stretched far beyond the boys’ prep school campus when the technology website Slashdot.com carried a mention of the program. Shortly thereafter, Zuckerberg began fielding buyout offers from a number of companies, including a \$2 million bid from Microsoft. In November 2003, he created facemash.com, a website that asked users to vote on the attractiveness of Harvard students, pitting two students’ photos against each other at a time. However, when reports of Zuckerberg’s handiwork reached university officials, he was put on probation and was asked to shut down his website. He obliged and by early 2004, he had moved on to another idea, a “facebook.”

Facebooks

Facebooks have been on college campuses for generations. In the past, facebooks were paper-based student directories that were distributed to first-year student mailboxes in the fall. They often contained an inventory of basic information about each newly matriculating student: hometown, high school, major, extracurricular interests, and, naturally, a photograph, ranging from formal high school graduation portraits to snapshots at the prom to action photos of students engaging in a summer hobby of choice. Ask any student on any college campus if he or she has finished *Moby Dick*, the *Iliad*, or *Candide*, and you might be surprised at the answer; ask the same students if they have studied their school’s facebook from A to Z, and you might be even more surprised.

Many had theirs committed to memory before the end of the first week of school.

Part of facebook’s enduring attraction can be explained by their merit-worthy functions. They can be a helpful resource for a student who is, say, attempting to learn the name of the person in astronomy class who has offered to start a study group, or for a student who wants to find someone who would also like to mountain bike or join a book club. Indeed, the first few weeks of college can be traumatizing for any student, and for decades facebook has helped first-years to bridge the gap between anonymity and familiarity.

Notwithstanding such honorable utilities, facebook has achieved mass appeal because of their purely social applications. Ask any college student why they have heavily dissected their facebook, and you probably will not hear an explanation similar to those mentioned herein (unless, of course, you are that student’s parent or teacher); what you will hear, however, will probably have something to do with vanity and dating, i.e., college kids are very concerned with how their facebook profile appears to others and with identifying potential romantic partners. Located at the intersection of these two primal instincts, facebook is as tethered to collegiate life as final exams and spring break.

New Venture

For that reason, Zuckerberg could not understand why no one had thought to put his college’s facebook online. He said, “During my sophomore year, I decided that Harvard needed a facebook. It didn’t have one, so I made it.” In January 2004, Harvard had facebook for different residential houses, but students could only search those to which they belonged. Zuckerberg’s idea was to create a college-wide facebook online, where students could access others regardless of where they lived. In just a couple of weeks, Zuckerberg had coded the original version of thefacebook.com and, on February 4, 2004, it was available for his classmates to access. The site was later renamed facebook.com.

The response to Facebook at Harvard was huge and immediate, and by late-February, 10,000 users had registered for the website. Zuckerberg said:

At Harvard, a few of my friends saw me developing Facebook, and they sent it out to a couple of their friends, and within two weeks

two-thirds of Harvard was using it. Then, we started getting e-mails from people at other schools asking, ‘How do we get Facebook? Could you license us the code so we could run a version of Facebook for our school?’ But when I started it, there was no concept of having Facebook across schools.

Nevertheless, by early March 2004, Facebook had launched at Yale, Columbia, and Stanford. Zuckerberg said:

We started with the schools at which we thought the people at Harvard were most likely to have a lot of friends. We decided that those were Yale, Columbia, and Stanford. It was not really scientific; it was just intuition and probably wrong.

At Stanford, half or two-thirds of the school joined Facebook in the first week or two. At Yale, there was a similar story. Columbia’s community, on the other hand, was a little more penetrated by an existing application, and Facebook didn’t pick up right away. A little later, when we launched at Dartmouth, half the school signed up in one night.

By June 2004, Facebook was serving about 30 colleges and had about 150,000 registered users.⁴ Before long, Zuckerberg was so busy maintaining the website that he could not keep up with his studies. Consequently, he called upon his two roommates Dustin Moskovitz and Chris Hughes for help, and together the trio spent the rest of the 2004 school year trying to respond to the flood of demand for the service from students on college campuses nationwide. Zuckerberg said:

Early on, we weren’t intending this to be a company. We had no cash to run it. We actually operated it for the first three months for \$85 a month—the cost of renting one server. We had a network of banner ads, but it’s not like we were making money.

Zuckerberg and Moskovitz agreed to spend the summer of 2004 in Silicon Valley because they had friends doing internships in the area, and also “because this was a place that a lot of startups had been from, and it seemed like a pretty fun place to be and someplace that it made sense for us to be at some point in our lives,” Zuckerberg said. Indeed, Facebook already had been a hit on the Bay Area

scene, having raced through Stanford a few months earlier. Moreover, similar services had already been received with the local stamp of approval: venture capital funding and a jargon classification; Facebook and a large stable of online communities became known as “social networking” websites.

INDUSTRY OVERVIEW

Social Networking Websites

Early Entrants Websites designed explicitly for the creation and discovery of social networks have been in existence since the late 1990s. In January 1997, SixDegrees.com was founded by Andrew Weinreich in New York City. The online service asked users to create a list of friends, family members, and acquaintances and allowed users to send messages and post bulletin board items to people in their first, second, and third degrees. In December 2000, the website had almost three million registered users in over 165 countries and was acquired by YouthStream Media Networks in a stock transaction valued at approximately \$125 million.⁵ Weinreich said:

From the beginning, our vision has been to create a vibrant, growing online community of members who are able to leverage the power of their relationships in a way that was never before possible. Over the last three years, we have been able to make this vision a reality for nearly three million members through our viral growth engine.

However, after the stock market plunged in the early 2000s, many technology companies struggled to stay in business. In October 2002, YouthStream received a delisting notice from NASDAQ because it did not comply with either its minimum \$2 million net tangible asset requirement or the alternative minimum \$2.5 million stockholders’ equity requirement.⁶ In the end, SixDegrees.com failed to get traction after 2000.

Communications Services Other web services were developed in the late 1990s to enable communications across social networks. In January 1997, Scott Hassan started an e-mail archiving service called FindMail which later became eGroups. eGroups enabled e-mail group communications

through mailing lists; each group also had a shared calendar, file space, group chat, and a simple database. In August 2000, the company had 18 million users and was purchased by Yahoo! Inc. for \$432 million in a stock deal and became part of Yahoo! Groups.

In 1996, an Israeli-based start-up created an instant messaging program called ICQ that enabled rapid communications between “buddies.” The tool became wildly popular and was acquired by AOL in 1998 for \$287 million. In 1998, Evite launched to become a successful social-planning website for creating, sending, and managing online invitations.

Business and Professional Services In 2003, Spoke Software, ZeroDegrees, Visible Path, Contact Network, and a number of other companies raised venture capital to help facilitate the creation of online business and professional networks. In November 2003, LinkedIn raised \$4.7 million in a series A financing led by Sequoia Capital. LinkedIn CEO Reid Hoffman said:

We are very pleased with the rapid adoption of LinkedIn among hiring managers, venture capitalists and executives from public companies in a broad set of industries. It is particularly gratifying to see that it took less than two months for LinkedIn to help hiring managers not only reach top talent through referrals, but also interview and hire them.⁷

Recreational Services In the early 2000s, a flood of web services were formed to create recreational social networks. In 2002, Jonathan Abrams founded Friendster, and it became a prominent dating website. Friendster asked users to create an online presence by filling out a questionnaire profile and uploading a user picture, and then defining a pool of friends. In September 2003, the site attracted 1.5 million unique visitors, up from 110,000 in April 2003. In October 2003, the company rejected a \$30 million buyout offer from Google and instead raised \$13 million in second-round financing led by venture firms Kleiner Perkins Caufield & Byers and Benchmark Capital.⁸ “They’re obviously growing by leaps and bounds and spending no money on marketing. That they’re using very powerful human relationships to connect is really at the core of what makes this for me quite compelling,” said board member John Doerr.⁹

In July 2003, Chris DeWolfe and Tom Anderson founded MySpace, which is described on the website as “an online community that lets you meet your friends’ friends.” In addition to its basic social networking service, MySpace also incorporated a wide-range of features into its platform, including groups, invitations, events, classifieds, and forums. However, the Los Angeles-based start-up became mostly known as a combination dating and music discovery destination, featuring music streams and downloads from both unsigned artists and major label acts like Weezer and REM. In December 2004, the company raised \$11 million from Redpoint Ventures.¹⁰

Another prominent recreational social network was launched by the Internet juggernaut Google. Started by a Turkish-born Google software engineer in January 2004, the social network called Orkut restricted membership to invitation-only (only existing members could invite new users to the network). By the end of July 2004, the site had over one million members, and by the end of September, it had surpassed the two million mark. In November 2004, over 62 percent of Orkut’s users listed Brazil as their country of residence.¹¹

FACEBOOK COMPANY OVERVIEW

In 2004, Facebook was a free service and accessible to anyone with a “.edu” e-mail account, which limited its use mostly to college students. Members of the network were encouraged to create a personal profile including contact information (e.g., phone number, address, instant messenger ID, and e-mail address), interests, and current course schedule. Zuckerberg said:

It’s essentially an online directory for students where [they] can go and look up other people and find relevant information about them—everything from what they’re interested in, to their contact information, what courses they’re taking, who they know, who their friends are, what people say about them, what photos they have. I guess it’s mostly a utility for people to figure out just what’s going on in their friends’ lives, [and those] people they care about.

Unlike Friendster and MySpace, where divisions between various networks were not explicit, Facebook made its members' school their primary network and offered only limited access beyond that. "What makes it so much better than Friendster is that it's your peers rather than a random assortment of people," said Sarah Williams, a freshman at Berklee School of Music in Boston.¹² On Facebook's customer support page, it read:

Facebook was intentionally designed to limit the availability of your profile to only your friends and other students at your school. This simple but important security measure promotes local networking and makes sure that your information is seen by people you want to share it with, and not seen by folks you don't.

Additionally, Facebook put its members in charge of their own privacy settings. In some cases, members allowed only their friends to view their profile on the website. However, Facebook's default setting was more open: everyone at a member's school could see their profile. (See Exhibit 1 for Facebook principles related to privacy). Zuckerberg said:

We're not asking anyone to put anything out there that they wouldn't be comfortable putting out there. We're not forcing anyone to publicize any information about themselves.

We give people pretty good control over their privacy.

Despite his company's similarities to other so-called social networking sites, Zuckerberg did not believe that the term was accurate for describing Facebook. He said:

The use of [Facebook] is definitely aided by . . . friends and people around you using it. But I think that it's a utility and something that people use in their daily lives to look people up and find information about [them]. . . . In that way, maybe there's some form of networking going on.

Friendster, MySpace, and Facebook are all very different things, but you can apply the [term] social network to them because they have this model of having friends sending invitations [to friends]. I think that they all kind of use it to achieve the same result, which is getting people to come to the site . . . but then they kind of parlay that into different uses.

We have this directory utility. Friendster was a dating site. Facebook does not, in any way, aim to be a dating site, even though maybe some of that goes on.

Exhibit 1 Facebook Principles

We built Facebook to make it easy to share information with your friends and people around you. We understand you may not want everyone in the world to have the information you share on Facebook; that is why we give you control of your information. Our default privacy settings limit the information displayed in your profile to your school, your specified local area, and other reasonable community limitations that we tell you about.

Facebook follows two core principles:

1. **You should have control over your personal information.** Facebook helps you share information with your friends and people around you. You choose what information you put in your profile, including contact and personal information, pictures, interests and groups you join. And you control with whom you share that information through the privacy settings on the My Privacy page.
2. **You should have access to the information others want to share.** There is an increasing amount of information available out there, and you may want to know what relates to you, your friends, and people around you. We want to help you easily get that information.

Sharing information should be easy. And we want to provide you with the privacy tools necessary to control how and with whom you share that information. If you have questions or ideas, please send them to privacy@facebook.com.

Source: Facebook's "Privacy Policy" page.

On the other hand, Facebook shared a number of features with MySpace, including some of the messaging utilities of earlier social communications tools (e.g., e-mail, groups, invitations, events), sharing utilities between friends, and, yes, even some dating. (See Exhibit 2 for a description of selected Facebook features).

Financing

In the summer 2004, while a flurry of venture financings took place in the social networking sector, Zuckerberg and a few of his friends lived in a rented house in Palo Alto, CA and worked on Facebook and also on a file-sharing side venture

Exhibit 2 Selected Facebook Website Features

Friends

You can invite anyone that you can see on the network to be your friend. Just use the “Search” page to find people you know and then click on the “Add to Friends” button on the right side of the screen. A friend request will be sent to that person. Once they confirm that they actually are friends with you, they will show up in your friends list.

Messaging and Poking

Communicating with other people on Facebook is easy:

1. You can choose to send a message while viewing someone’s profile by selecting the “Send a Message” button under their profile picture. This option is also available from the right side of any search results screen.
2. Once you call up the message box, just type a subject and message and click “send.” The person you are messaging will be notified the next time they login.

Social Timeline

Social Timeline breaks down the different ways you have interacted with your friends over the course of your life. All the information displayed comes from the friend details you have listed. To add more details, simply go to the My Friends page and fill out the fields for “How you know someone.”

Wall

Your wall is a forum for your friends to post comments or insights about you. You can always remove comments you don’t like from your own wall. If you want your wall turned off, you can do that on the My Privacy Page.

Pulse

Pulse uses information provided in Facebook profiles to show the most popular listings and the latest trends on the network.

Groups

You can join any public group at your school. Just search or browse groups (from the Search page) and click on the “join group” on the right side of the screen. Some groups require administrative approval for you to join. If you try to join these groups, you will have to wait for an admin to let you in. Finally, there are some groups on Facebook that are invitation only. You cannot request to join these. Only an invitation from a group admin will give you access.

Events

Looking for something to do? You can hunt for events from the Events tab of the Search Page. This page also allows you to browse upcoming events. Browsing will pull up ten random events that are scheduled for a future date. The browse option is also available from the “My Events” page.

Source: Facebook customer support pages.

called Wirehog. The team redesigned and relaunched Facebook and began adding new servers to host the rapidly growing website. Meanwhile, Zuckerberg developed a friendship with the 25-year-old Sean Parker, who had co-founded Napster and the online contacts management service Plaxo. Parker began advising the company informally and, by the end of the summer, he had signed on to become president of Facebook.

The addition of Parker to the team helped Zuckerberg to secure a number of meetings with potential investors and entrepreneurs, many of whom were already actively involved with other social networking companies. In late August 2004, Peter Thiel, a venture capitalist and founder of PayPal, the online payment service acquired by eBay in 2002, became the company's first major investor with a \$500,000 cash infusion into Facebook. "A few other people have invested a few thousand dollars here and there, but I'm sort of the main investor, pre-venture," said Thiel.¹³ Zuckerberg added, "When we came out to the Bay Area, we realized that no other site really had this kind of activity, that it could be a big business, and it might be fun to do."

Only seven months old, Facebook had become something more than just another Zuckerberg lark. The company now had a widely known entrepreneur on the team and a deep pocketed and well connected investor. It also had over 200,000 users and an unresolved issue to address: Should Zuckerberg and his roommates go back to Harvard for their junior year? He said, "I mean, it was never a formal decision, like, should we go back to school? We all just kind of sat around one day and were like, 'We're not going back to school, are we? Nah.'"¹⁴ With that matter put to rest, another one would soon appear: On September 2, 2004, ConnectU.com, "an online meeting place for students," filed a lawsuit in the U.S. District Court of Massachusetts, charging that Zuckerberg stole the idea and source code for Facebook from them. Facebook staff and Zuckerberg publicly denied the claim.

Business Model

At the time, Zuckerberg needed Thiel's investment to keep the site running. He said, "I need servers just as much as I need food. I could probably go a while without eating, but if we don't have enough servers then the site is screwed."¹⁵ Even though the company

had been experimenting with running advertisements on the site to generate cash flow, revenues were not keeping up with the increasing costs of hosting Facebook. Nevertheless, Zuckerberg added:

When you're running a site, and you're four people around a kitchen table, your operating expenses are relatively low. [Now,] we have a very small sales force, and we sell some ads. . . . By doing that, we've been able to stay cash flow positive for, basically, the entire existence of the company.

Over time, the company developed three sources of revenues:

- **Facebook announcements:** Local advertisers could buy text-only advertisements targeted to specific schools in their geography. Facebook sets prices by school per day, ranging from \$5 to \$20 based on the number of impressions.
- **Banner advertisements:** National advertisers, on the other hand, could purchase graphical banner advertisements to run across a number of the website's pages.
- **Sponsored groups:** Companies like Apple and EA paid to sponsor groups, or promotional areas on the website. On Facebook's customer support page, it read, "The money from these promotions, like the money from all our ads, goes towards the Facebook's server and operational costs. Sponsored groups help us keep the service free and fast."

FACEBOOK 2005: SOPHOMORE YEAR

Additional Financing

By late May 2005, Facebook had attracted 2.8 million registered users on more than 800 college campuses, which meant that 80 percent of undergraduate students at participating universities were registered to the website, according to some reports. Meanwhile, a bidding war had broken out among various top-tier venture capital firms for a piece of the company. "It was probably the most competitive financing I've ever been involved in," said Parker. "I think we had 30 VCs who had expressed an interest in the deal."¹⁶

The winner: Accel Partners, a Palo Alto-based venture firm, announced a \$12.7 million investment in Facebook at a reported \$100 million valuation.¹⁷ Accel partner Jim Breyer and Facebook board member said, “It is a business that has seen tremendous underlying organic growth and the team itself is intellectually honest and breathtakingly brilliant in terms of understanding the college student experience.”¹⁸

Parker added, “College students everywhere live and breathe Facebook. Because virtually every student at schools across the country uses Facebook, the site has become an essential tool for helping college students manage their social and campus life.”

High School

In September 2005, Facebook entered a new market: U.S. high schools. College students who were registered on Facebook were asked to send invitations to high school students to join the service; those students could then invite other high school students at their school. Facebook posted the following message about the high school site on its frequently asked questions page:

The high school and college networks are completely separate. This means that features like searching, messaging, poking, and inviting people to be friends are restricted to the network you use. This is primarily for security reasons, but also because many people prefer it this way.¹⁹

The overall high school market was slightly smaller than the overall college market. However, most users of recreational social networking sites were under the age of 30. In the under 30 age bracket, there were more high schoolers than college students: in 2004, there were 16.6 million students enrolled in U.S. high schools under the age of 30 compared to only 13.2 million students enrolled in U.S. colleges under 30. (See Exhibits 3 & 4 for school enrollment statistics). Zuckerberg added:

Launching a high school product . . . was something that we could do really quickly, and the high school model was very similar to the college model that we had. And there are more high school students than college

students, and it just seemed like a very effective use of our time.

Sure enough, the high school market was eager to adopt Facebook. Zuckerberg said:

The high school network reached a million users way faster than the college network did. The college network took almost 11 months to reach a million, and the high school took only six or seven months.

However, there were two complications. First, entering the high school market elevated the stakes surrounding the security and privacy issues (perceived or otherwise) that had plagued social networking sites for years. Second, MySpace had beaten them to the high school market and was rapidly gaining a strong foothold in schools around the country.

Security and Privacy

In 2005, various media outlets offered condemning reports on social networking sites on a variety of privacy and security topics. Newspaper and magazine reporters across the country warned that students posting their phone number or home address (and on Facebook, their specific whereabouts) were opening themselves up for danger. Even the students themselves complained about how the websites were being abused. College newspapers reported that employers were screening the Facebook and MySpace profiles of job applicants. High school students feared that college admissions staff were monitoring the websites. Such intrusions were viewed as violations by students, some of whom offered evidence of underage drinking or illegal drug use on their profiles. Breyer said:

In many ways, I think our challenge—from a business perspective and a usage standpoint—would be similar to how eBay evolved. We certainly spend a lot of time thinking about what are the privacy issues. . . . We think medium and long term about privacy issues, security issues, and perhaps the closest model out there, in my view, would be how eBay had to make some fundamental decisions along the way relative to the democratization, if you will, of their user base.

Indeed, whether or not there were actual security and privacy breaches on Facebook, media stories on

Exhibit 3 School Enrollment Statistics, By Age and Level (in thousands)

	Nursery or kindergarten	Elementary	High School	College	Total
3 and 4 years old	4,552	—	—	—	4,552
5 and 6 years old	4,136	3,425	—	—	7,561
7 to 9 years old	44	11,466	—	—	11,510
10 to 13 years old	—	16,237	259	—	16,496
14 and 15 years old	—	1,347	6,971	8	8,327
16 and 17 years old	—	34	7,862	190	8,086
18 and 19 years old	—	10	1,266	3,685	4,961
20 and 21 years old	—	1	126	3,777	3,904
22 to 24 years old	—	1	72	3,149	3,221
25 to 29 years old	—	11	65	2,403	2,479
30 to 34 years old	—	6	28	1,287	1,321
35 to 44 years old	—	11	67	1,615	1,692
45 to 54 years old	—	6	49	924	979
55 years old and over	—	1	25	345	371
Total	8,731	32,556	16,791	17,383	75,461

Source: U.S. Census Bureau, Current Population Survey, October 2004

Exhibit 4 College Enrollment Statistics, by Age and Level (in thousands)

	Total Enrolled	Year Enrolled in College						Two-Year College		Four-Year College		Graduate School
		1st	2nd	3rd	4th	5th	6th or Higher	1st and 2nd Year	3rd and 4th Year	1st and 2nd Year	3rd and 4th Year	
15 to 19 years old	3,883	2,364	1,260	231	8	20	—	1,219	24	2,405	215	20
20 to 24 years old	6,926	795	1,507	1,970	1,859	400	395	1,051	320	1,251	3,510	795
25 to 34 years old	3,690	560	582	540	574	555	878	697	201	445	914	1,433
35 years old and over	2,884	431	458	549	315	350	781	585	244	304	620	1,131
Total	17,383	4,150	3,807	3,291	2,757	1,324	2,054	3,552	788	4,404	5,260	3,378

Source: U.S. Census Bureau, Current Population Survey, October 2004

these topics proliferated, and the company was on high alert. Like MySpace, Facebook took a variety of proactive measures to protect its members, such as using technology to crawl the site for fake profiles. Nevertheless, an inherent tension existed: on the one side, parents, school administrators, and law enforcement officials were, justifiably, encouraging students to err on the side of caution and reveal very little about themselves. On the other side, Zuckerberg and Facebook had built a directory utility that became more useful to its members the more they revealed about themselves. Consequently, Facebook was architected to enable, in Zuckerberg's words, "a freer flow of information." He added:

Our mission is to increase information flow between people and to help people learn what's going on in their world and express themselves.

People use Facebook because the good far outweighs the bad. People realize that if they put their information up there, certain people are going to be able to see it. That's why you have more than a third of Facebook users putting up their cell phone numbers. On Facebook, people make this information available, and then are able to get this information from other people, and then are able to express themselves about what they are into. This turns out to be a pretty valuable thing, and that's why people spend a lot of time on the site. They're just trying to understand what's going on in their world.

There is some negative information flow in there, and I feel that's what people are reacting to, but it's a minority. But there's also a lot of confusion, and especially with all this press now about safety issues on MySpace. People use Facebook differently and we view our site differently: we view ourselves as a utility instead of a media property. Some of the safety concerns about MySpace just aren't really relevant on Facebook.

Clearly, Facebook management would be loath to censor its members, or even place restrictions on their ability to express themselves. Further, Zuckerberg knew that too much institutional influence on Facebook would be met by user backlash. However, the company was in the media spotlight, and Breyer

was not about to let Facebook's management take a cavalier attitude towards these sensitive matters. Even though he had called the 21-year-old Zuckerberg "very much the long-term CEO," Breyer advised him to hire seasoned senior management talent. Whether the Facebook management team would be adding more experienced members was not questioned (they would be); how the introduction of older executives (who were long since removed from college) to the mix would impact the website was.

Organization

By April 2006, the Facebook organization had grown to over 100 employees, and most were located in a single office in Palo Alto, CA. The management team consisted of Zuckerberg (CEO), Moskovitz (CTO), Owen Van Natta (COO), and Matt Cohler (VP of strategy and business operations). Both Van Natta and Cohler joined Facebook from executive roles in Internet companies: Van Natta from Internet commerce giant Amazon and Cohler from LinkedIn. Parker left the company to pursue other opportunities, and Hughes remained company spokesperson. Naturally, work processes within the company were also evolving. Zuckerberg said:

[Early on], it was me and my roommate, Dustin, just sitting there working serially on one project; and then finishing it, and then planning . . . and then doing the next project . . . but trying to figure out how to manage the transition from doing that . . . to thinking at a higher level about how the landscape is playing out and in terms of—you need to not only have engineers who can directly work on the product that you're working on, but then you need to start having a finance department. . .

In order to fulfill its organizational growth plans, the company leaned on Breyer for assistance in building out its management team and also conducted recruiting events at universities like Stanford and Harvard in late 2005 to build out its engineering team. Zuckerberg said:

I think that the two most important things that I look for are . . . one is just raw intelligence. The second is just alignment with what we're trying to do . . . the best people who

I've hired so far have been people who didn't really have that much engineering experience. I hired a couple of electrical engineers out of Stanford to do programming stuff, and they've had very little programming experience going in, but [they were] just really smart, and really willing to go at it.

Despite the rapid growth in size of the organization, Zuckerberg aimed to instill a culture of experimentation at Facebook. He said:

The Facebook organization is relatively flat, organic. I have found that you don't want to prescribe too much ahead of time because then you're kind of locked into stuff. For example, if you put someone in charge of 'local,' that means you're building a 'local' product, whether it's the right time to build a 'local' product or it's the right thing to be allocating your resources against. If you have a high-powered, high-level person in charge of 'local,' you are building something 'local.'

We try to let people like grow stuff that they think is good, and then we have some top-down strategic direction that we provide. There are a few priorities, and then there's a lot of experimentation.

Alumni Market

Naturally, one priority for Facebook's management team was attracting the alumni market. Zuckerberg said:

We have natural growth built into our system in that over 3 million people leave high school and enroll in college every year. Last year, we had somewhere between 700,000 and 800,000 seniors graduate from college and are now alums on the site. About 45 percent of that group still returns to Facebook each day. So even if you take out the college part of the site, this is probably still the stickiest site on the web.

At the end of this school year, we're going to have a group of seniors graduate who have been on Facebook for two years. Instead of just saying we'll let you on if you have an alumni e-mail address, we might try to do something more proactive to get them on the site.

Additional Growth Opportunities

Facebook's management was also exploring a number of other strategic growth opportunities. First, Facebook was not available at most colleges outside of the U.S.; other than a few prominent English-speaking schools in the United Kingdom and Canada, Facebook was largely a U.S. phenomenon. Zuckerberg added:

I've been sort of hesitant in terms of expanding outside of the U.S. We have a bunch of colleges, like Oxford and Cambridge, [already on Facebook]. There are large populations of colleges in countries like China, but I'm not quite sure whether the culture around universities there is similar enough such that the same application works. Localization is definitely necessary. They speak a different language, so we'd need to have the application in that language in order to have it be relevant. . .

I think that it might be pretty relevant, but it requires some thought about what those specific cultures are and maybe the density of students in those cultures . . . I think that, as time goes on, we'll definitely invest the time and resources into [growing internationally].

Second, Facebook management was evaluating possible avenues for expansion of the technology into new areas. One idea was to license the Facebook platform to other groups and institutions to develop their own Facebooks. For example, community groups or membership clubs could create their own social networks using the Facebook platform and set the rules for the service; and Facebook could collect a licensing fee. Another opportunity was to open up the Facebook platform for third-party development. For example, if Facebook users wanted to share videos and they did not want to have to wait until the company's engineering resources could develop an application of this nature, a more open technology architecture would enable enterprising third-party engineers to fill these needs.

Finally, Facebook management was committed to improving its existing directory utility for its core user base. With its horizontal application, Facebook needed to ensure that the breadth of what it offered (a wide-range of features) and its overall user experience were satisfactory. First and foremost, the

site needed to be lightning fast to hold the attention span of its young audience, which meant that Facebook's technical infrastructure needed to be able to scale to support massive usage growth. Second, Facebook needed to fully address the growing security and privacy issues. Third, its offering needed to be more appealing to its users than an evolving list of competitors.

Competition

MySpace, for its part, was growing at a rapid clip. According to comScore Media Metrix, MySpace.com had become the fifth most popular website by number of page views. It had also grown as music destination to include more than 350,000 bands and artists. On July 18, 2005, the multinational media conglomerate News Corporation announced that it would acquire MySpace's parent company Intermix Media, Inc. for approximately \$580 million in cash. (See Exhibit 5 for a copy of the press release.) In October 2005, MySpace.com had 24.3 million unique visitors to the site, up from 3.4 million in October 2004, an increase of more than 600 percent.²⁰

By contrast, Friendster had only 1.4 million unique visitors in October 2005, down from a high

of 1.75 million in October 2003.²¹ Notwithstanding the challenges it faced competing with other dating websites, Friendster had technical scalability issues, and users often paid the price by having to endure slow response times from the website. In October 2005, Friendster launched a redesigned site with expanded features, such as more file-sharing capabilities for all media types (music, photos, and videos). Taek Kwon, Friendster's fourth CEO in less than four years, said, "In the beginning, social networking was a way to connect with friends and having online references. But now that's not enough." In December 2005, CNFT reported that Friendster had hired the investment bank Montgomery & Co. to explore selling the company.²²

Even though Friendster appeared to be marginalized in 2005, competitive threats to Facebook loomed everywhere. First, the venture industry showed no signs of backing away from consumer Internet investments with network benefits. By late 2005, the terms "social software" and "web 2.0" were used to describe a flood of venture funded start-ups, many of which had consumer-sharing features and were targeted at the under-30 demographic. (See Exhibit 6 for a comparison of selected social networking websites). Second, many of the technology industry heavyweights were

Exhibit 5 News Corporation Press Release

News Corporation to Acquire Intermix Media, Inc.

Acquisition Includes World's Fastest-Growing Social Networking Portal, MySpace.com

Intermix's network of sites to join newly formed Fox Interactive Media

LOS ANGELES, CA, July 18, 2005—News Corporation announced today that it signed a definitive agreement to acquire Intermix Media, Inc. for approximately \$580 million in cash, or the equivalent of \$12 per common share. In a separate transaction, Intermix announced today that it exercised its option to acquire the 47 percent of MySpace.com that it does not already own. MySpace.com is the leading lifestyle portal for networking online. Both MySpace.com and Intermix's more than 30 sites will become part of News Corporation's newly formed Fox Interactive Media unit.

The acquisition of Intermix, combined with the recently announced formation of Fox Interactive Media, underscores News Corporation's commitment to expand its internet presence by offering a deeper, richer online experience for its millions of users.

With the addition of MySpace, and Intermix's network of sites, News Corporation's U.S. web traffic will nearly double to more than 45 million unique monthly users, putting the Company in the top echelon of most trafficked content sites on the Internet today. The Intermix network of sites is the largest multi-category online entertainment network with more than 27 million unique monthly users. Intermix's group of entertainment, humor, gaming and social networking sites has become the leading network for shareable digital entertainment such as pictures, music and video.

(continued)

Exhibit 5 News Corporation Press Release (*continued*)

Launched less than two years ago, MySpace.com is the fifth ranked web domain in terms of page views according to comScore Media Metrix.* Integrating web profiles, blogs, instant messaging, e-mail, music downloads, photo galleries, classified listings, events, groups, chatrooms, and user forums, MySpace.com has created a connected community where users put their lives online. As a result, MySpace.com is a favorite with online advertisers—in June the site served more than 8 percent of all ads on the Internet, putting it in the company of Web giants Yahoo!, Google and AOL. It has also become a key music destination, with more than 350,000 bands and artists—including REM, the Black Eyed Peas and Weezer—having used the site to launch new albums and enable users to sample and share songs.

One of Intermix's popular web sites is grab.com, a premier gaming and entertainment site that integrates social networking, community features, and viral entertainment. Intermix augments its content properties through its analytical optimization e-commerce division—Alena.

"Intermix is an important acquisition for News Corp., instantly doubling the number of visitors to our sites and providing an ideal foundation on which to meaningfully increase our internet presence," said News Corporation's Chairman and Chief Executive Officer, Rupert Murdoch. "Intermix's brands, such as MySpace.com, are some of the web's hottest properties and resonate with the same audiences that are most attracted to Fox's news, sports and entertainment offerings. We see a great opportunity to combine the popularity of Intermix's sites, particularly MySpace, with our existing online assets to provide a richer experience for today's internet users."

The transaction is expected to close in the 4th quarter of calendar 2005. The transaction is subject to certain customary conditions including approval of the Intermix common and preferred stockholders.

In a related transaction, News Corporation announced that it entered into a voting agreement with VantagePoint Venture Partners, the largest stockholder of Intermix. The agreement provides that VantagePoint will vote its shares, representing approximately 22.4 percent of the outstanding shares of Intermix, in favor of the transaction.

"We are very excited to combine our unique Internet reach and assets with one of the most exciting media companies in the world. We look forward to continuing to lead the market in unique content, social networking, and analytical marketing," said Richard Rosenblatt, Intermix Media's CEO.

Mr. Rosenblatt and MySpace CEO, Chris DeWolfe will continue in their roles following the completion of the acquisition. Messrs. Rosenblatt and DeWolfe will join Fox Interactive Media, led by Ross Levinsohn.

About News Corporation

News Corporation (NYSE: NWS, NWS.A; ASX: NWS, NWSLV) had total assets as of March 31, 2005 of approximately US\$56 billion and total annual revenues of approximately US\$23 billion. News Corporation is a diversified international media and entertainment company with operations in eight industry segments: filmed entertainment; television; cable network programming; direct broadcast satellite television; magazines and inserts; newspapers; book publishing; and other. The activities of News Corporation are conducted principally in the United States, Continental Europe, the United Kingdom, Australia, Asia and the Pacific Basin.

About Intermix

A leading online media and ecommerce enterprise, Intermix Media (Amex: MIX) and its subsidiaries utilize proprietary technologies and analytical marketing to develop unique content, an active community and innovative ecommerce offerings. The Intermix Network blends user-generated and proprietary online content to motivate its users to spend more time on its Network and to invite their friends to join them. By integrating social networking applications, self-publishing and viral marketing, the Intermix Network has grown to over 27 million unique visitors per month. Intermix also leverages its optimization technologies, marketing methodologies and the Internet through its Alena unit, where it launches branded consumer product offerings. Alena expands Intermix's consumer reach by marketing select high margin and innovative products directly to the consumer across the Internet. In doing so, Alena cost-effectively builds consumer brands and drives new users back to the Intermix Network.

Exhibit 6 Comparison of Selected Social Networking Websites

Name	Bebo	Facebook	MySpace	myYearbook	Sconex	Tagged	TagWorld	Xuqa
Description	Popular in the U.K. and Ireland	U.S. college and high school markets	U.S. market leader	Started by two high school kids	Targeting high school students	Allows only U.S. teens	Music discovery tool	College market
Launch Date	Jul-05	Feb-04	Jan-04	Apr-05	Jan-05	Oct-04	Nov-05	Sep-05
Registered Users	23 million	7.4 million	67 million	600,000	500,000	2.5 million	1.3 million	550,000
Signups per day	35,000	Not reported	250,000	4,500-6,000	4,000-5,000	10,000	15,000-20,000	5,000
Page views per month (U.S., February)	230 million	5.5 billion	23.6 billion	55 million	1.1 billion	354 million	14 million	Not measured
Unique visitors per month (U.S., February)	1.2 million	10.5 million	37 million	2.7 million	439,000	1.7 million	3.2 million	Not measured
Average minutes per visitor (U.S., February)	21.5 minutes	15 minutes	29.5 minutes	10 minutes	27 minutes	25 minutes	17 minutes	5 minutes
Employees	9	100	280	3	12	35	60	19
Funding	Bootstrapped	\$12.7 million from Accel Partners	Parent InterMix bought by News Corp in July 2005	\$1.5 million from angels	Bought for \$8.7 million by Alloy in March 2006	\$8.5 million from Mayfield, angels	\$7.5 million from Draper Fisher Jurvetson	\$1.3 million from Bessemer Venture Partners, angels

Source: Red Herring, April 17, 2006.

spending aggressively on social applications: Google (e.g., Blogger, Picasa, Google Talk and Video), Yahoo! (e.g., del.icio.us, flickr), eBay (e.g., Craigslist, Skype), and AOL (e.g., instant messaging enhancements). Finally, and more directly, Facebook-like directory utilities were popping up everywhere (e.g., Bebo in the U.K. and Ireland, Tagged.com for teens in the U.S., and Xuqa in the college market).

Success

Competitive issues aside, Facebook had become an extraordinary phenomenon. Its user base was growing at an impressive rate: from ~5.0 million users in late October 2005 to over 7.5 million in mid April 2006, when Facebook was available in over

2,100 colleges and over 22,000 high schools. Even more impressive, however, were the usage patterns on Facebook. Zuckerberg said:

On a normal day, about two-thirds of our total user base comes back to the site. A lot of sites measure *monthly* retention, and if you have 25 percent (monthly retention), you are doing really well. I don't know any other site that measures their retention in *daily* retention. Facebook is a clearly different type of application. Perhaps, e-mail—among people who use computers a lot—has that amount of retention or frequency of use.

Apparently Facebook is the number one photo-sharing website on the Internet. We aren't a photo website. We just have the most

photos that people look at—somewhere between two and three billion photos.

MySpace has like 70 million users now—ten times as many users as we have. But we are so much more frequently used that I think they only get three times as many people coming to their site each day, or maybe it's not even that much. So it's going to be a lot easier for us to go from 7 million to 14 million or 20 million, than it is for them to go from 70 million to 140 million. Just by having an application that provides more utility, I don't actually think we're in a bad position against them or any of these other guys.

Sure, we have observed different growth patterns at our schools. Our biggest school is Penn State, and it has more than 60,000 people. A number of high schools, on the other hand, have just a few hundred students. The smaller schools are easier to hit critical mass. But we haven't seen any cases in which Facebook isn't really working. Even commuter schools, where we are getting a lower percentage of the population, we end up with phenomenal retention rates: between 45 and 75 percent for almost every school.

But, Why?

Notwithstanding such performance, Zuckerberg built Facebook's principal architecture in a couple weeks when he was a college sophomore. Naturally, there was rampant debate about what was so unique about Facebook and how it came to be so widely used.

This wasn't played out as a well-controlled experiment. I initially launched it at Harvard because I wanted the service. In fact, a lot of the functionality in the service that I thought was necessary is not really. For example, users can only see the people who are either in their school or their network. The reason for that is you want to be able to get access to the information and share your information to those people, but you don't necessarily want to share information with everyone.

One interesting thing about the expansion is that we were always over-subscribed on demand for the service versus what we could

provide. It would have been interesting to see how it played out if we had just come out in February of '04 and launched a site where every school was on it. It might have ended up being the same; I don't know.

Exit

Meanwhile, the capital markets were hungry for businesses with economics similar to the top performers in the social networking sector. Many argued that MySpace had sold out for too low of a price (one of its founders even filed a lawsuit making this claim), and that Accel's investment in Facebook at a \$100 million valuation was a steal. Indeed, Facebook's valuation was a topic of much debate on March 28, 2006, when *BusinessWeek Online* reported that Facebook had rejected a \$750 million buyout offer and was looking for as much as \$2 billion in a sale.²³ Kevin Efrusy, venture capitalist with Facebook investor Accel Partners responded to the reported acquisition offer saying, "Does [Facebook] have the potential to be worth more than \$2 billion, based on economic fundamentals and the value of its audience? Absolutely."²⁴ Others argued that at its revenue run-rate, Facebook's reported valuations were unsupported by rational financial models. Zuckerberg said:

We are going to be measured by the amount of money we make, so that's an important thing for us. But I think it's important to think about what stage of the business we're at, and we've really only been around for a little more than two years. At this point, a lot of businesses might just be coming to market with their products.

We're in this interesting paradox, where on the one hand we are the number seven most trafficked site on the Internet according to comScore Media Metrix. The other top sites are all multi-billion dollar media companies, or in the case of MySpace, just owned by one. On the other hand, we are just a 100-person startup that isn't quite sure of everything yet, but really shouldn't be, given our age and the maturity of the organization.

We want to be making money, and we will be making money. We're testing a bunch of stuff. I can tell you what I think will be good

revenue streams. But at this point, they're so young that it's not going to help anything. Companies want to give us huge valuations. But on the other hand, we don't have the revenues to support that, but we're not asking anyone to come in and to fix that either. It's not really where we are right now. But revenue is scaling much faster than we expected.

On April 19, 2006, Facebook ended the media's speculation about its potential buyout, when it announced the closing of its third round of financing.

Greylock Partners led the \$25 million fundraising, while Meritech Capital Partners and Facebook's existing investors Accel Partners and Peter Thiel also participated. Zuckerberg said:

We're building this company for the long term and this funding validates the viability of our business. We're still in the early stages of building Facebook. We're constantly developing new functionality to make Facebook more useful and this funding will help accelerate our development efforts.²⁵

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