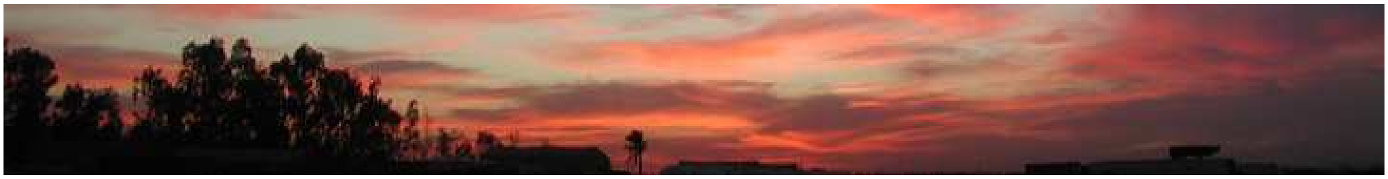

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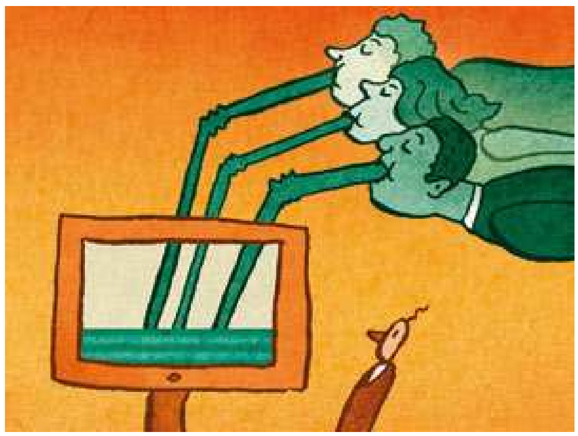
Internet companies

The end of the free lunch—again

Mar 19th 2009
From The Economist print edition

The demise of a popular but unsustainable business model now seems inevitable

Illustration by S. Kambayashi



“IN RECENT years, consumers have become used to feasting on online freebies of all sorts: news, share quotes, music, e-mail and even speedy internet access. These days, however, dotcoms are not making news with yet more free offerings, but with lay-offs—and with announcements that they are to start charging for their services.” These words appeared in *The Economist* in April 2001, but they’re just as applicable today. During the dotcom boom, the idea got about that there could be such a thing as a free lunch, or at least free internet services. Firms sprang up to offer content and services online, in the hope that they would eventually be able to “monetise” the resulting millions of “eyeballs” by selling advertising. Things did not work out that way, though, and the result was the dotcom crash. Companies tried other business models, such as charging customers for access, but very few succeeded in getting people to pay up.

Then it happened all over again, starting in 2004 with the listing of Google on the stockmarket, which inflated a new “Web 2.0” bubble. Google’s ability to place small, targeted text advertisements next to internet-search results, and on other websites, meant that many of the business models thought to have been killed by the dotcom bust now rose from the grave. It seemed there was indeed money to be made from internet advertising, provided you could target it accurately—a problem that could be conveniently outsourced to Google. The only reason it had not worked the first time around, it was generally agreed, was a shortage of broadband connections. The pursuit of eyeballs began again, and a series of new internet stars emerged: MySpace, YouTube, Facebook and now Twitter. Each provided a free service in order to attract a large audience that would then—at some unspecified point in the future—attract large amounts of advertising revenue. It had worked for Google, after all. The free lunch was back.

Now reality is reasserting itself once more, with familiar results. The number of companies that can be sustained by revenues from internet advertising turns out to be much smaller than many people thought, and Silicon Valley seems to be entering another “nuclear winter” (see article).

Internet companies are again laying people off, scaling back, shutting down, trying to sell themselves to deep-pocketed industry giants, or talking of charging for their content or services. Some Web 2.0 darlings (MySpace, YouTube) managed to find buyers before the bubble burst, thus passing the problem of finding a profitable business model to someone else (News Corporation and Google, respectively). But quite how Facebook or Twitter will be able to make enough money to keep the lights on for their millions of users remains unclear. Facebook has had several stabs at a solution, most recently with a scheme called Facebook Connect. Twitter’s founders had planned to forget about revenues until 2010, but the site now seems to be preparing for the inclusion of advertising.

The bill, sir

The idea that you can give things away online, and hope that advertising revenue will somehow materialise later on, undoubtedly appeals to users, who enjoy free services as a result. There is business logic to it, too. The nature of the internet means that the barrier to entry for new companies is very low—indeed, thanks to technological improvements, it is even lower in the Web 2.0 era than it was in the dotcom era. The internet also allows companies to exploit network effects to attract and retain users very quickly and cheaply. So it is not surprising that rival search engines, social networks or video-sharing sites give their services away in order to attract users, and put the difficult question of how to make money to one side. If you worry too much about a revenue model early on, you risk being left behind.

Ultimately, though, every business needs revenues—and advertising, it transpires, is not going to provide enough. Free content and services were a beguiling idea. But the lesson of two internet bubbles is that somebody somewhere is going to have to pick up the tab for lunch.