

TEACHING NOTE

Facebook, Inc.

Case Overview

In 2017, Facebook was the fourth most valuable company on the planet, with a market capitalization of almost \$500 billion (just behind Apple, Alphabet, and Microsoft, but ahead of Amazon).

The protagonist of the case is Sheryl Sandberg, Facebook's COO. The case opens with her reviewing the company's Q3 2017 earning data in preparation for the ensuing investors' call. Notably, the company continued a strong run in the mobile ad space and significant revenues that Facebook had generated. As COO, she is looking to take the company to the next level: not only continued growth in mobile ads, but dominance in the *digital* ad space. For this to occur, Facebook would somehow have to top Google in both display and search ads, despite only having notable presence and expertise in display ads.

The case looks back at the history of Facebook, detailing its growth from Harvard's campus to Silicon Valley. Facebook went from an online student directory at one campus (Harvard) to the dominant worldwide social network. In 2017, it has close to two billion monthly users. Americans spend one-third of their internet time on Facebook, mainly on mobile devices.

Key Concepts

- Strategic Leadership
- Business Model
- External and Internal Analyses
- Competitive Strategy
- Platform Strategy
- Innovation and Technology Strategy
- Organizational Structure

Suggested Discussion Questions

1. Describe Sheryl Sandberg's strategic leadership. Which qualities stand out to you, and why? Is she an effective strategy leader? Why, or why not?
2. What is Facebook's business model? How is it making money?
3. Apply the PESTEL framework to identify challenges Facebook is facing. Provide some recommendations for how Sheryl Sandberg should address them.
4. What "industry" is Facebook competing in, and how is this industry changing? Who are Facebook's most important competitors? Why?
5. What are Facebook's resources and capabilities? What is Facebook's core competency? Can its resources and capabilities form the basis of a competitive advantage? Why or why not?
6. How should Facebook compete more effectively against Google? Provide recommendations for Sheryl Sandberg.

Suggested Answers

1. Describe Sheryl Sandberg's strategic leadership. Which qualities stand out to you, and why? Is she an effective strategy leader? Why, or why not?

Sheryl Sandberg was persuaded by Mark Zuckerberg to join Facebook and look after its business. She had led Google and its Ad division and had proved to be a versatile leader. She joined Facebook as COO and brought with her the necessary business skills which Facebook lacked under Zuckerberg's leadership. Like she had done at Google (she was responsible for two of the most enterprising products at Google—AdSense and AdWords), she helped Facebook grow. Sandberg was largely responsible for driving Facebook's attention towards its bottom-line, especially after it had a lackluster IPO in 2012. She was also quick to spot the opportunity in mobile advertising in her bid to challenge the supremacy of Google in the advertising market. She is also a strong advocate for women in leadership roles and is herself on multiple boards, including Facebook's. Her effectiveness as a leader can be gauged by the turnaround she brought in Facebook's share price in 2012. The very fact that Zuckerberg trusts her with running the business end of his company while he works on new tech and product offerings says a lot about her leadership and effectiveness. Sheryl Sandberg's strategic leadership can be best deciphered and described using the Level-5 Leadership Pyramid (see Exhibit TN-1).

2. What is Facebook's business model? How is it making money?

Facebook uses the classic two-sided platform model. The social networking platform has users on one side who are also the consumers and content generators in this case, and developers of application, marketers, and advertisers on the other side (the producer side). See Exhibit TN-2.

Like any two-sided platform, Facebook subsidizes one of its side (users must pay nothing to access Facebook and its products and services) while it charges the advertisers and marketers to display their content to the relevant audience. In 2016, a whopping 97 percent of Facebook's revenue came from advertising. The launch of Atlas advertising platform and a laser sharp focus on mobile advertising is helping Facebook fuel this growth story. Atlas allows marketers to understand which Facebook users have interacted and acted on ads both on Facebook and third-party platforms. It also is a bidding platform which allows marketers to automatically bid for ad slots on Facebook. Facebook is also making a massive push on the video ads front. This advertising revenue growth is ably added by growing active users of the platform. This was done by augmenting its consumer-facing services. Facebook acquired Instagram and WhatsApp which adds on to its already huge active user base. This large active user base keeps the marketers interested and pushes up the bid price for ad slots on the platform.

3. Apply the PESTEL framework to identify challenges Facebook is facing. Provide some recommendations for how Sheryl Sandberg should address them.

PESTEL (Political, Economic, Socio-cultural, Technological, Ecological, Legal) can be used to understand challenges which any industry, strategic-group, or firm is facing from external environment (see Exhibit TN-3). Each of these aspects might have an impact on how Facebook's future road map will be shaped. Let's take each one of them individually and understand the challenges that Facebook and Sheryl Sandberg might face.

Political/Legal

"Fake News" is a big problem, especially in the US. There are also mounting concerns around data privacy. Increasingly, in major economies like China and Russia, penetration of Facebook amongst the audience remains low. The reason for this is mostly political. In China and Russia, local social networking websites (Weibo in China and VKontakte in Russia) are seen to be promoted by the respective governments.

Economic

The advertising industry is being reshaped and is becoming more mobile-first. This is especially important as more than 90 percent of Facebook's revenue is from advertising. While it seems to have won the mobile advertising market for now, it will have to guard itself from imminent changes in future.

Socio-cultural

Constantly evolving landscape of social networking means that Facebook has been facing challenges from younger and quirkier concepts like Snap Chat. More and more young users are shying away from Facebook as they think it is too dated for them. People are also skeptical about posting anything on Facebook because it might be used against them in the future. Additionally, in developed

economies like Japan and South Korea, it continues to have low penetration because being openly social (self-promoting and boasting) is discouraged in those countries. All these are real challenges which may obstruct its growth.

Technological

As consumers move to smaller and more mobile screens for accessing content, the greatest challenge for Facebook is to capitalize on this trend. Its acquisition of WhatsApp and Instagram are a move in this direction. Facebook will have to crack the mobile internet market to get to the next billion active users.

4. What “industry” is Facebook competing in, and how is this industry changing? Who are Facebook’s most important competitors? Why?

Facebook, like other social media companies, is difficult to place into a specific industry. As far as industry standard classifications, Facebook is classified with:

- Computer programming, data processing, and computer services (SIC 7370)
- Internet publishing and broadcasting and web search portals (NAICS 519130)

However, as we learned from the case, Facebook is competing in multiple industries. Within each of these industries it is competing with different competitors. The major industries in which Facebook operates and competes are:

1. Advertising

Advertising is the main source of revenue for Facebook. It contributes more than 97 percent of Facebook’s annual revenue. A major trend in this industry is going to be mobile advertising as more and more users turn to smaller screens to access online content and video ads as consumption of online video is outstripping that of other forms. Facebook’s major competitors in advertising are Google (the market leader), Microsoft, Yahoo, and other social networking sites like Twitter. On Video ads front, Facebook faces stiff competition from Google’s YouTube.

2. Becoming the dominant platform

Facebook, at its core, is a platform that brings people together as a consumer of services, as developers, or as advertisers. It derives its strength of being the dominant social networking website from its high numbers of active monthly users. In this domain, it is being challenged by other social networking companies like Snap Inc., Google+, and Twitter. The changing needs and desires of consumers can determine the new dominant design. In fact, Facebook became the dominant design by replacing older social networks like MySpace, Friendster, and Orkut by Google.

Apart from these, Facebook is also competing in e-commerce, search, gaming, videos, etc. A detailed representation can be seen in **Exhibit TN-4**.

5. What are Facebook's resources and capabilities? What is Facebook's core competency? Can its resources and capabilities form the basis of a competitive advantage? Why or why not?

Several resources and capabilities work together to form a competitive advantage for Facebook. See **Exhibit TN-5** for a table of Facebook's resources.

Before Facebook, the dominant social network was MySpace (now spelled "Myspace"). MySpace, started in 2003, was acquired by NewsCorp in 2005. After the acquisition, the company shifted focus from growing its user base to generating revenue. By the economic downturn of 2008, Facebook surpassed MySpace as the most popular social network because it had been able to focus on growing subscribers without outside pressure to grow the bottom line. In a market where network effects have a strong influence on the value of your product, larger user bases give your firm an exponential advantage over competitors.

Facebook's *core competency* is designing web and mobile tools for mapping the social graph by engaging users to share information privately and, more importantly, publicly. The "public" posts are very important for marketers who want to leverage social media to spark interest in their brand. When users "like" a subscriber or leave comments about a brand, they are becoming engaged with that product in a way that spreads interest by virtual "word-of-mouth" and by increasing the user's likelihood of recalling that product.

Of the resources that Facebook has acquired over time, without its strong user base, Facebook would not have as compelling an argument for advertisers and marketers. As the shift to mobile proceeds, without the Facebook ID every user has, Facebook would not be able to further augment this argument in the manner it has over recent years. Without the ability to manage and interpret big data, Facebook would not be able to deliver results to advertisers. Before these, Facebook needed the website to draw in users and convince them to share vast amounts of information.

Facebook has formed a clear competitive advantage with its resources (see **Exhibit TN-6**). To maintain this advantage, it must be flexible and sensitive to the wave of changes in how its users are engaging the world through newer technology, mobile in particular. Moreover, startups and other competitors are trying to enter the valuable social media space, and Facebook needs to be vigilant on how these companies will affect its advantage, and whether it makes sense to build/buy analogous capabilities to preserve its advantage (like Instagram and WhatsApp).

6. How should Facebook compete more effectively against Google? Provide recommendations for Sheryl Sandberg.

There are a number of factors that play to Facebook's advantage as alluded to in the case:

- Facebook has an incredibly large and valuable user base of almost 2 billion MAUs, and almost 1,200 million DAUs

- The company has not only recovered from its sluggish reaction to the rise of mobile, but has leveraged its core competency and capabilities to generate a mobile platform, applications and content that is efficient in generating ad revenue from mobile users
- The Facebook ID can be used to track user habits (in terms of both online habits as well as interaction with ads) across multiple devices and websites
- The nature of the Facebook products (Newsfeed, Timeline, and so forth) are highly amenable to interaction with users in multiple ways, and the page can be tailored/optimized for efficient interaction with users
- Facebook also caters for all the various forms of content, be it banner ads, video, and so forth
- Facebook also owns two other social networking/messaging applications, Instagram and WhatsApp, which adds to its already large pool of MAUs and DAUs.

By contrast:

- Google has not been able to create the installed user base the way that Facebook has, and Google+ is yet to truly gain traction in the realm of social media
- While Google generate significant traction with YouTube, Facebook now offers the ability to directly place video tailored to a user's preferences directly onto a user's Timeline or Newsfeed
- Google appears to be slower in reacting to the continued development of mobile technology than is Facebook – seemingly repeating the errors that Facebook made around the time of the Facebook IPO

Nonetheless, Google has a significant advantage to any company seeking to challenge its dominance in digital advertising: search ads. Google's search engine interacts with millions of users every day. Despite ads being largely limited to the top of a search page, the prime real estate and sheer volume of users creates a significant value proposition to marketers and advertisers with respect to reach and impact. Moreover, Google also has a user ID that can be leveraged in order to tailor ads not only according to search parameters, but also to demographic information of the user (although as the case suggest, Google is yet to leverage their ID the way Facebook has).

In sum, Facebook would need to innovate in order for it to be able to compete effectively with Google and circumvent the grip that Google has on the search ad space. Mobile is an obvious area to leverage: while the company has thus far innovated effectively on the product/technical front, Facebook will need to adapt and develop expertise as well as business models in order to begin nullifying Google's dominance (for Google's part, it will need to innovate with respect to search ads on a mobile platform in order to preserve its competitive advantage in this space).

Possible recommendations for Sheryl Sandberg may include:

- Build out additional ad features for mobile users that capitalize on the unique abilities of the mobile platform.
- Consider natural extensions of Facebook's services that focus on its core competencies.

- Continue to attract new users. The problem with this solution is that the cost to acquire a new customer will grow as the users left to acquire become increasingly harder to reach.
- Find new ways to increase advertisers spending:
 - Charge access fees for company pages. At the time of the case, Facebook allowed companies to create business fan pages for free. By either charging companies a fee to maintain these pages or by adding premium services, Facebook could increase ad revenues substantially. The downside to this strategy is that some small businesses might be priced out of the ecosystem which not only would reflect poorly on Facebook but also would alienate a large demographic who adds value for subscribers.
 - Develop the use of rich media and video to make it more appealing for advertisers to spend more on higher margin ads.

All of this perhaps overlooks the question as to whether it is a good idea to attempt to compete head-on with Google, and the notion that Facebook may wish to leverage its experience, capabilities, and core competency to own the mobile ad space as a whole. The latter strategy perhaps warrants further discussion, particularly as search ads on a mobile device are often very different from the desktop analog given the mobile context of a smaller screen, use of wireless networks, and so forth. By becoming highly competent in terms of mobile, Facebook may position itself to compete more effectively with Google especially given

1. More users continue to go mobile as the mobile evolution accelerates,
2. Facebook's effective capabilities in mobile, and
3. Google's apparent sluggish response to the accelerating mobile phenomenon.

Additional Resources

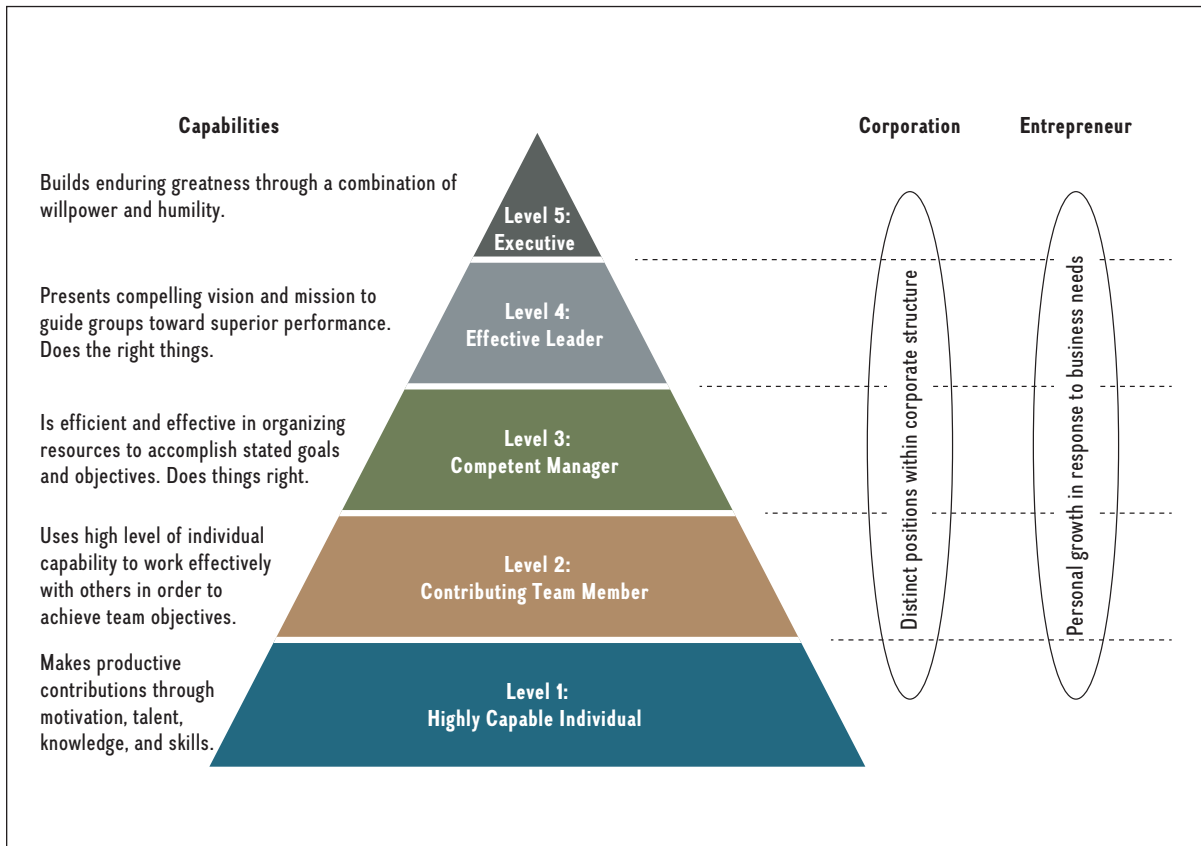
1. Articles / Books

- S. Sandberg, *Lean In: Women, Work, and the Will to Lead* (New York: Knopf, 2013).
- M. W. Van Alstyne, G. G. Parker, and S. P. Choudary, "Pipelines, Platforms, and the New Rules of Strategy," *Harvard Business Review*, April 2016.
- R. Amit, and C. Zott, "Creating value through business model innovation," *MIT Sloan Management Review*, 53: 3 (2012): 41–49.
- "How to Win Friends and Influence People," *Economist*, last modified April 9, 2016. The social network has turned itself into one of the world's most influential technology giants, and wants to become ever more powerful.
- "Imperial Ambitions," *Economist*, April 9, 2016. Mark Zuckerberg prepares to fight for dominance of the next era of computing.

2. Videos

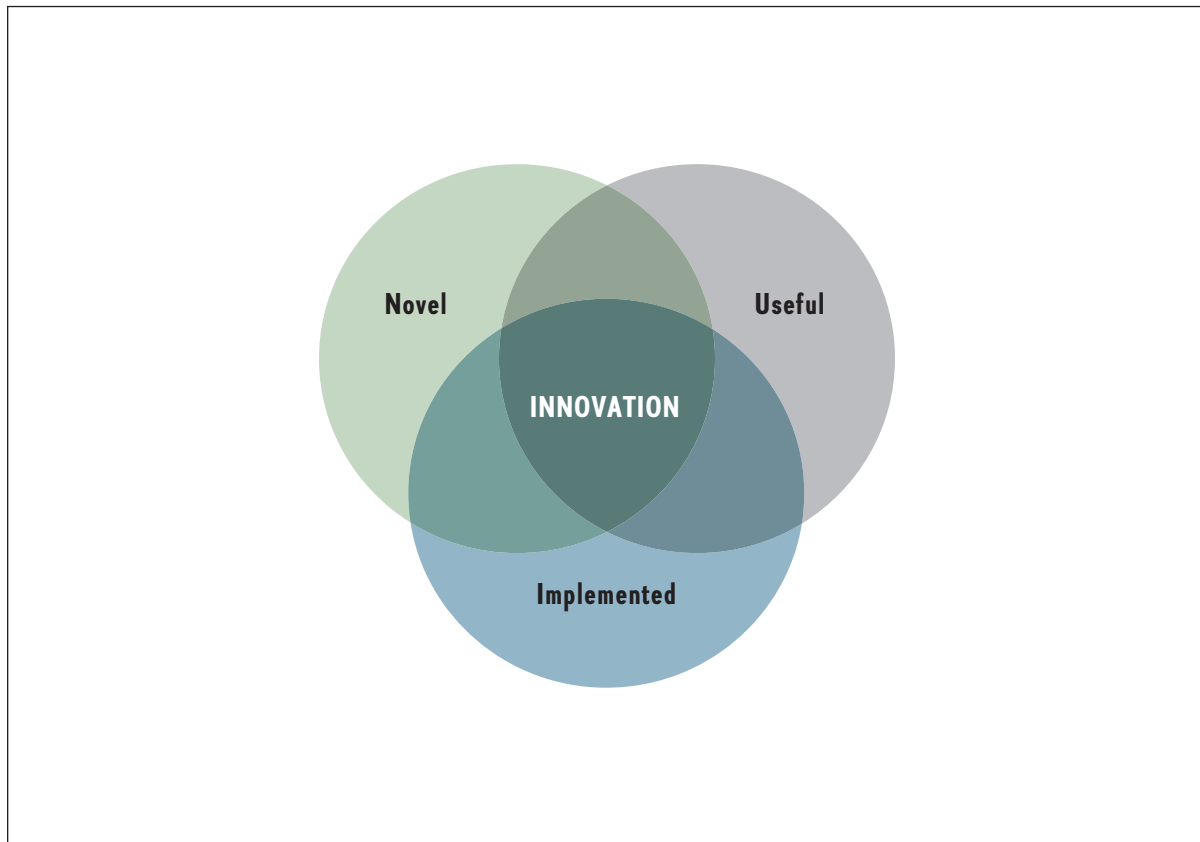
- Building Graph Search. <https://www.facebook.com/about/graphsearch> (3:19 min). Facebook
- “Why We Have too Few Women Leaders,” (14.58 min). TED Talk, Sheryl Sandberg.
- “The Social Network,” 2010 movie (120 min), available via Amazon Prime and Netflix, among other streaming options (PG-13).

EXHIBIT TN-1 The Level-5 Leadership Pyramid



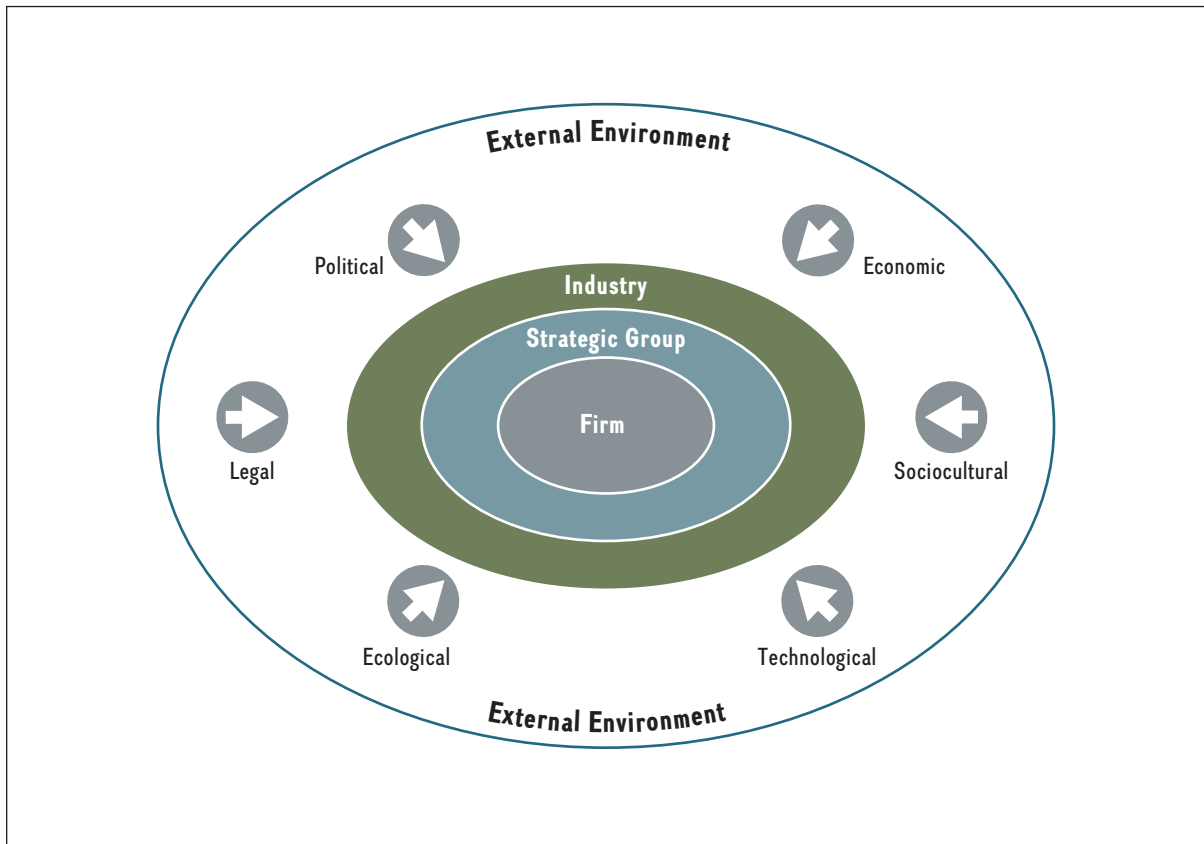
Source: Rothaermel, F.T. (2018), Strategic Management, 4th edition. Burr Ridge, IL: McGraw-Hill.

EXHIBIT TN-2 The Players in a Platform Ecosystem



Source: Rothaermel, F.T. (2018), Strategic Management, 4th edition. Burr Ridge, IL: McGraw-Hill.

EXHIBIT TN-3 The PESTEL Framework



Source: Rothaermel, F.T. (2018), Strategic Management, 4th edition. Burr Ridge, IL: McGraw-Hill.

EXHIBIT TN-4 Facebook and Current Competitors, 2017

Industry	Facebook	Google	Amazon	Microsoft
Social Network	<ul style="list-style-type: none"> Facebook.com (Primary Service) 	<ul style="list-style-type: none"> Google+ 	<ul style="list-style-type: none"> Goodreads 	<ul style="list-style-type: none"> Skype
Online Search	<ul style="list-style-type: none"> Graph Search 	<ul style="list-style-type: none"> Google.com (Primary Service) 		<ul style="list-style-type: none"> Bing
eCommerce	<ul style="list-style-type: none"> Gifts Payments 	<ul style="list-style-type: none"> Google Offers, Wallet, Shopping, Local, Play 	<ul style="list-style-type: none"> Amazon.com & affiliate sites Amazon Prime (Primary Service) 	
Online Ads	<ul style="list-style-type: none"> Primary Revenue 	<ul style="list-style-type: none"> AdSense/AdWords (Primary Revenue) 		<ul style="list-style-type: none"> Bing Ads
Mobile Devices	<ul style="list-style-type: none"> Phone? 	<ul style="list-style-type: none"> Nexus (phone/tablet) Moto X (phone) 	<ul style="list-style-type: none"> Kindle 	<ul style="list-style-type: none"> Nokia (phone/tablet) Surface
Productivity Software		<ul style="list-style-type: none"> Google Docs Chrome OS 		<ul style="list-style-type: none"> Primary Revenue Microsoft Office Windows
Games	<ul style="list-style-type: none"> Facebook Platform 	<ul style="list-style-type: none"> Google Play 		<ul style="list-style-type: none"> Windows Store

Source: Courtesy of E.T. Rothaermel.

EXHIBIT TN-5 Facebook Resources

Tangible Resources	Intangible Resources
<ul style="list-style-type: none">• Server facilities• Cash on-hand	<ul style="list-style-type: none">• Website• Mobile Applications• Software• Network effects (billion+ users)• Talented engineers and managers• The Facebook ID• Business processes• User-generated content• Map of social graph• Instagram• Partnership with Microsoft• WhatsApp

Source: Courtesy of F.T. Rothaermel.

EXHIBIT TN-6 Resource-Based View – VRIO Framework

IBM's Resources and Capabilities ...are they?	Valuable V	Rare R	Costly to Imitate I	Organized to capture value O
Subscriber Base	yes	yes (on this scale)	yes	could improve
Website/Mobile Applications	yes	no	no	yes
Big Data IP	yes	yes (for now)	yes	yes
Developer Platform	yes	no	no	yes
Acquisitions (WhatsApp & Instagram)	yes	yes (for now)	yes	not currently

Source: Courtesy of F.T. Rothaermel.