LABRADOR VENTURES

WWW.LABRADOR.COM

Should you invest in Web 2.0 innovations?

by: Larry Kubal, Labrador Ventures – June, 2006

There are currently over 75,000 new blogs created every day – sounds like a pretty compelling market opportunity, or is it?

Larry Kubal

As seen in the...

VCJ Venture Capital Journal

David Sifry, founder and CEO of website *Technorati*, has compiled some pretty amazing statistics. According to Technorati, which currently tracks 35 million blogs, the blogosphere continues to double in size roughly every six months and is over 60 times larger today than it was only three years ago. Moreover, there are currently over 75,000 new blogs created every day.

Sounds like a pretty compelling market opportunity, or is it?

For some VCs, there's no question Web 2.0 companies – those Internet businesses now using blogs, RSS feeds, vlogs (video blogs), social networking tools, podcasts and the like – represent strong bets for their funds. David Hornik, a partner with August Capital and a contributor to *VentureBlog*, notes that his firm has four new media companies in its portfolio: *LiveJournal*, *Trumba*, *VideoEgg* and *Technorati*. Yet in the same breath, Hornik also admits there are 33 competitors to these four portfolio companies across each of their respective verticals. And those competitors represent just the startup competition. Yahoo, Microsoft, Google, AOL, and others surely have more in store for this space.

Thus, the Web 2.0 opportunity has created some interesting cross currents within venture capital and startup circles. On one hand, there's no stopping the blogosphere, the adoption and reach of RSS feeds, or the mania that companies such as MySpace have created in terms of "social networking" opportunities. On the other hand, monetizing such "tools" or "features" has been tricky for VCs. First, they must determine how exactly such features might help in generating marginal revenue. Second, they must figure out how such features add to the success of fundable media businesses (i.e. through increased valuations or liquidity events). Third, they must determine how such technology tools might stand on their own as investible venture opportunities.

"The early software infrastructure for publishers – for example, *SixApart* for content management systems, *FeedBurner* for feed management and advertising, *Newsgator* and *Pluck* for private label feed readers or *Technorati* for search – are all real businesses. Yet, VCs have significantly over-funded 'features' at this point," says Brad Feld, a managing director with Mobius Venture Capital. "Though a small percentage of these companies will be acquired by Google, Yahoo, Microsoft and the like, many of them will ultimately fail because they aren't addressing a big enough thing."

Does it come standard?

There was a point in time – more years ago than we might care to remember – when airbags in cars were nonexistent. They weren't even an option. Then, suddenly, there they were, first as a nifty add-on, then as a mark of enhanced safety, and now as pretty much standard fare on any vehicle sold. It's entirely possible that the same will hold true for blogs, RSS feeds, podcasts, and many of the other emerging tools most consumer-facing sites have adopted.

Just as the fax machine and email blazed the same trail, so too will these features we're seeing today – as much out of competitive necessity as out of the shift in control from business to the consumer. In today's marketplace, such features represent far less the next logical extension of marketing and advertising, and more the changing nature of the "conversation" companies must now have with their existing and potential customers.

"Though not too many people know this, when GM now announces the release of a new car, they also have podcasts containing interviews with several of the car's designers," says Stuart Watson, CTO and founder of SyndicateIQ, a Dallas-based startup that helps companies "manage, measure and monetize" syndicated content. "Out of those podcasts, they receive lots of comments on car features, colors, design, etc., and they can use those comments to help further the design and marketing process."

That "dialogue" with the customer – what would have just been referred to in the past as a "focus

cont.

LABRADOR VENTURES
101 UNIVERSITY AVENUE
FOURTH FLOOR
PALO ALTO, CA 94301
TEL: 650-366-6000
FAX: 650-366-6430

group" – is now real time, technology-enabled feedback that corporations and startups alike can use to tie consumers more deeply into the "marketing" process. "Ultimately, whether it's blogs or podcasts or whatever, it's another form of marketing to drive leads," says Watson. "If companies don't include these features will it hurt them? Probably not, at least not yet. But not including such tools definitely doesn't do anything to drive the selling process forward."

As VCs, we have to now be at the leading edge of this curve: We have to assume that not including such features will indeed hurt us. One of our portfolio companies, *MeeVee.com*, a Burlingame, California-based video search startup, has accelerated the implementation of such tools – a blog for television, RSS feeds for shows, social networking to share what each registered user might be watching, and so on. It's what must be done to make sure we are having that next level of conversation with our target audience. That conversation starts now, not six months from now.

Glam.com, a Walden VC portfolio company, highlights this trend, having not only introduced blogging to its site in a meaningful way, but now maintaining seven of its own blogs and over 100 blogs across its entire Glam network, driving more traffic to its main site than the main *Glam.com* site had been previously generating all on its own. In another example, *InsideView*, a San Bruno, California-based sales software startup, has been building its own version of a social networking feature into its sales technology process – a *six degrees of separation* capability that brings seller, sales target, and buyer all into the same "community" while at the same time offering users RSS-type feeds/updates on business activity levels and relevant events as defined by a user's cross section of sales targets.

Business as usual?

As fellow VC Brad Feld points out, all of these tools and their potential commercial applications, "have a nice trajectory from consumer to enterprise." That is, perhaps, where we're headed, from "Web 2.0" to what Feld notes with some irony as "Enterprise 2.0." It's as if corporate America is not only learning the value of RSS feeds, podcasts and the like, but also how to pay close attention to their adoption in the consumer and business marketplace.

According to a study by Forrester Research, while only 3% of North American consumers last year published or maintained a blog, these bloggers yielded a disproportionate influence on a company's brand. Blog postings and social networking sites have moved well beyond politics, fashion trends and idle chatter, and now are beginning to have a meaningful impact on consumer decisions, which in turn have an impact on consumer purchasing. It's this latter point that's worthy of our attention as VCs.

In a 2005 study recently cited by Bear Stearns, research firm ComScore found that blog users and visitors possessed higher incomes, purchased more often online, and spent more time online than the average Internet user. In fact, according to ComScore, 41% of blog visitors are from households with annual incomes over $75,000, 51% of blog visitors are online buyers (as compared with an average of 39% of total Internet users who shop online), and the average blog visitor spent $390 online during the first quarter of 2005 vs. $368 for the average Internet user.

It is no wonder that VCs have invested heavily in this space and are increasingly encouraging many of their portfolio companies to leverage Web 2.0 tools. Moreover, mindful of News Corp.'s aggressively valued acquisition of the company that operates *MySpace.com*, other social networking companies have been able to raise money almost at will.

Which again raises the issue of cross currents. If valuations on potential acquisitions are soaring (the founders of *Facebook* reportedly passed on a $750 million buyout, looking for a roughly $2 billion payday), and if competition among startups using and/or developing Web 2.0 tools is expanding exponentially, where's the investible opportunity for us here, particularly at the earliest stages of company creation?

The answer may reside less in what we now choose to invest in, and more in how we build out our existing and future portfolios to provide users with the latest tools serving their blogging, social networking and RSS needs. These tools decrease the cost of member acquisition, decrease marketing costs, increase time spent on a site and increase overall user and customer loyalty. They not only enable new business models across a range of targeted industries, but create the basis for new businesses themselves – see *Pluck*, *Technorati*, *LinkedIn* and the rest. As these tools generate large amounts of new content, data and market feedback, they will further foster next-generation opportunities in navigation, discovery, analysis and measurable Web interactions, all of which will be able to be monetized in some fashion over time. If we pay close attention, VCs will be able to follow these trends, helping further create and define Web 2.0 – and even Web 3.0 and 4.0 – opportunities into the future.

This is one in a series of monthly columns on seed and early stage investing that Labrador Ventures was selected to contribute to the *Venture Capital Journal.*

Larry Kubal is a Partner at Labrador Ventures. He is the firm's representative with portfolio companies Akira Technologies, Aperto Networks, Proficient Systems, Pandora Media (formerly Savage Beast), Soligence and Teraburst Networks. He may be reached at lkubal@labrador.com