



Internet strategy

The alliance against Google

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What today's internet firms can learn from 19th-century history

PRINCE KLEMENS VON METTERNICH, foreign minister of the Austrian Empire during the Napoleonic era and its aftermath, would have no trouble recognising Google. To him, the world's most popular web-search engine would closely resemble the Napoleonic France that in his youth humiliated Austria and Europe's other powers. Its rivals-Yahoo!, the largest of the traditional web gateways, eBay, the biggest online auction and trading site, and Microsoft, a software empire that owns MSN, a struggling web portal-would look a lot like Russia, Prussia, and Austria. Metternich responded by forging an alliance among those three monarchies to create a "balance of power" against France. Google's enemies, he might say, ought now to do the same thing.

Google announced two new conquests on August 14th. It struck a deal with Viacom, an "old" media firm, under which it will syndicate video clips from Viacom brands such as MTV and Nickelodeon to other websites, and integrate advertisements into them. This makes Google the clear leader in the fledgling but promising market for web-video advertising. It also announced a deal with News Corporation, another media giant, under which it will provide all the search and text-advertising technology on News Corporation's websites, including MySpace, an enormously

popular social-networking site.

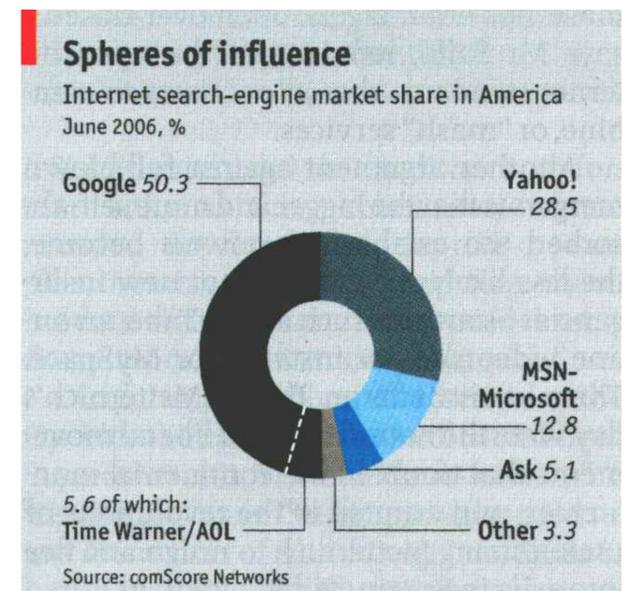
These are hard blows for Yahoo! and MSN, which had also been negotiating with News Corporation. Both firms have been losing market share in web search to Google over the past year-Google now has half the market. They have also fallen further behind in their advertising technologies and networks, so that both make less money than Google does from the same number of searches. Safa Rashtchy, an analyst at Piper Jaffray, a securities firm, estimates that for every advertising dollar that Google makes on a search query, Yahoo! makes only 60-70 cents. Last month Yahoo! said that a new advertising algorithm that it had designed to close the gap in profitability will be delayed, and its share price fell by 22%, its biggest-ever one-day drop.

MSN is further behind Google than Yahoo! in search, and its parent, Microsoft, faces an even more fundamental threat from the expansionist new power. Many of Google's new ventures beyond web search enable users to do things free of charge through their web browsers that they now do using Microsoft software on their personal computers. Google offers a rudimentary but free online word processor and spreadsheet, for instance.

The smaller eBay, on the other hand, might in one sense claim Google as an ally.

Google's search results send a lot of traffic to eBay's auction site, and eBay is one of the biggest advertisers on Google's network. But the relationship is imbalanced. An influential recent study from Berkeley's Haas School of Business estimated that about 12% of eBay's revenues come indirectly from Google, whereas Google gets only 3% of its revenues from eBay. Worst of all for eBay, Google is starting to undercut its core business. Sellers are setting up their own websites and buying text advertisements from Google, and buyers are using its search rather than eBay to connect with sellers directly. As a result, "eBay would be wise to strike a deep partnership with Yahoo! or Microsoft in order to regain a balance of power in the industry," said the study's authors, Julien Decot and Steve Lee, sounding like diplomats at the Congress of Vienna in 1814.

The alliances are already being struck. Last year Yahoo! and Microsoft announced that they would connect their instant-messaging systems-both of which are much more popular than Google's al-



ternative-and in July they said that they would extend this co-operation to "voice chat" (formerly known as "calling"). In May, Yahoo! and eBay struck an alliance in which eBay will use technology from Yahoo! to place advertisements on its auction site. On the other side of the bargain, Yahoo! will use PayPal, eBay's online payment mechanism, for transactions from Yahoo!'s pages. (Google recently launched a rival payment system of its own.)

The strongest alliance, of course, would be a merger or takeover. MSN and Yahoo! both wanted to buy some or all of AOL, a big, troubled internet-access company owned by Time Warner, a media conglomerate. But Google pre-empted its rivals last winter and bought a defensive stake in AOL. It still has its search and advertising technology stationed on AOL'S site. Google may also make its instant-messaging service interoperable with AOL'S, the most popular in the world.

Ally or annex?

With AOL lost to the enemy, what of a deal between Microsoft and either Yahoo! or eBay? Justin Post, an analyst at Merrill Lynch, said recently that Microsoft's "acquisition probability" is now so high that it may soon start pushing up the share prices of eBay and Yahoo! Mr Post thinks that Microsoft is most likely to bid for Yahoo! This would help Microsoft strategically, he says. Others are not sure. "I don't see it as a terribly good merger," says Mr Rashtchy. There would be big cultural differences between a media company and a software firm. He thinks that a merger of Yahoo! and eBay, on the other hand, might make sense because both live mainly from serving on-line communities.

Paul Saffo, a Silicon Valley analyst and a fellow of the Institute for the Future, a research group, thinks that any merger between the three middle powers would be a "grand dramatic gesture" that would only hasten their decline. AOL'S merger with Time Warner in 2000 is the relevant warning from recent history. Big mergers also run counter to a number of other trends on the internet today, which are collectively known as "Web 2.0". "This is the age of mash-ups not mergers, open over closed," says Mr Saffo, referring to the open internet standards that allow users to combine, or "mash" services.

Another argument against full-blown mergers is that the bigger and more self-absorbed the established powers become, the less likely they are to spot new insurgencies-start-ups such as YouTube, an on-line video site, for instance, or MySpace. Their equivalents in Prince Metternich's day were the nationalist and liberal movements that troubled the continental monarchies, and erupted in the revolutions of 1848-forcing Metternich to resign and flee into exile in Britain. •