Maybe Google isn't losing big bucks on YouTube after all
Rob Hof

Ever since Credit Suisse came out with a report in early April estimating that Google's YouTube will lose as much as $470 million this year, many people have been predicting the video sharing site is doomed and calling Google stupid for continuing to run it as is.

Well, maybe not that stupid. A new report on how much YouTube costs to run concludes that Google is at most losing $174 million—no chicken feed but neither is it a figure that makes you doubt the sanity of Google CEO Eric Schmidt. The report, from RampRate, which advises companies on sourcing Internet bandwidth, content delivery, and other infotech services, makes the case that Google pays far less for bandwidth to receive and play all those videos than Credit Suisse assumed: only $49 million, not $360 million. RampRate also thinks Google's hardware and data center costs are considerably less than Credit Suisse estimated. Here's a comparison chart provided by RampRate:

YouTube Cost ($M)	Credit Suisse	RampRate
Content & Overhead	$331.8	$331.8
Bandwidth	$360.4	$48.7
Peering	Not Analyzed	$26.3
Hardware: Storage	$12.7	$3.3
Data Center & Software	$6.4	$4.9
Total Annual Cost ($M)	**$711.3**	**$414.9**
Operating Loss ($M)	**-$470.6**	**-$174.2**

The difference chiefly comes down to something called peering, whereby Internet networks exchange traffic from their customers without paying each other. Google, with massive networks around the world--unlike most companies--can pay very little because of these agreements. "They're paying only a little bit for that bandwidth," says RampRate Chairman Tony Greenberg.

RampRate notes that it's not the first to notice the apparent flaws in the Credit Suisse analysis. Brough Turner, founder and chief technology officer, at Ashtonbrooke and chief strategy officer at Dialogic, noted back in April that YouTube's fine thanks to the peering agreements with top-tier Internet service providers. As he explains:

"Google does not pay for Internet Transit the way most tier 2/3 ISPs or most content providers must. The economics are simple. If you are a Tier 2 ISP, you have to purchase Internet Transit services from a Tier 1 network to handle that customer traffic which goes off your network and for which you cannot make other arrangements. The most notable "other arrangement" is peering. If you have significant traffic to/from another specific network, you and the other network can both save Internet Transit costs by exchanging traffic locally, i.e. peering. Of course an enormous amount of your traffic is directed to Google. If you have a presence in any data center where Google has a presence, you would love to peer with Google, as that saves an enormous amount on your payments for upstream Internet Transit.

A similar effect plays out among Tier 1 providers. If one tier 1 network cuts a special deal with Google, Google routes all their traffic through this provider and suddenly the other tier 1 networks have large asymmetries in their tier 1 peering arrangements. Either they also cut deals with Google or they have to renegotiate their tier 1 peering arrangements to pay for the traffic asymmetry (something that's highly unlikely!). Google is the one with leverage here!"

Still, even if its costs are far less than they might appear, YouTube almost certainly is losing money (though it's certainly trying to reverse that trend). So why does Google continue to accept these losses? RampRate provides one answer:

“One surprising factor is fundamental, no matter the revenue potential: YouTube lowers the cost of infrastructure for all other Google properties. As discussed in the Telco 2.0 blog six months before the Credit Suisse report was published, YouTube is essential to giving Google significant leverage in peering negotiations. ... Although one might think that Google is already succeeding in that department with its other properties, the reality is that it peers with less than 1/10th the number of ISPs that Microsoft does, and takes 0.4 more hops to get to an average user. In other words, Google still has room to improve. YouTube is central to enabling its ability to catch up with its top rival.”

Or as Greenberg sums up: "They're building out a real Trojan horse for delivering Internet content."

RampRate also offers a reason why Google hasn't seen fit to reveal exactly how much YouTube costs to operate:

“Google is no doubt thrilled to let YouTube be known as a financial folly. In the dangerous waters of online content, a whiff of potential profit is an irresistible lure for predators such as copyright lawyers circling user generated content monetization and content partners that are all too ready to turn on their distributors in a feeding frenzy.”

I'm not so sure about that particular statement. Privately, people close to YouTube have been slamming Credit Suisse's cost estimates as way too high. And YouTube specifically avoids running ads on videos for which it doesn't have agreements to run. Not to mention it's already the subject of a $1 billion lawsuit by Viacom. Seems to me that Google's keeping financial info close to the vest for competitive reasons more than anything else.

For the record, RampRate does have a dog in this hunt. Part of its business is helping clients that want to build video networks, and showing that costs aren't as onerous as expected might help them pull the trigger on those projects. "We want to pull the dagger out of the back of the video delivery service," says Greenberg.

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