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Considerations in the Development of Commercially Based Online Communities

Dorine Andrews
Georgetown University

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Dorine C. Andrews
Georgetown University
dca4@georgetown.edu

Abstract

Hagel and Armstrong, in their 1997 book Net.gain, proclaim an approach for transforming people into avid and loyal customers who generate continuous revenue streams through the "power" of online community. However, current economic realities suggest that implementing commercially based online communities is not the economic savior for Internet businesses as suggested. More over, commercial online communities may be fraught with issues not encountered in the early years of online community development. This paper explores two of the issues, audience characteristics and business model alternatives, that must be considered before attempting to use online community as a customer loyalty and revenue building feature.

Introduction

Given the recent availability of user friendly computer mediated communication technologies, online community development is a fairly new phenomenon for enhancing online commercial, grassroots and non-profit organizations. These online communities, linked to commercial goals, create new issues concerning community purpose and control (Werry 2000). In addition, research by Forrester of 20 websites showed that their community areas accounted for 22% of traffic but only 7% of revenues (Schwartz 2000). These findings and current economic "dot.com" realities suggest that implementing commercially based online communities is not the economic savior for Internet businesses as suggested by Hagel and Armstrong (1997).

Building community in the "offline" physical business-to-business world is not a new phenomenon. Starting in the 1960's and 1970's technology companies (e.g., hardware and software manufacturers) and other business-to-business companies (e.g., insurance, pharmaceuticals and industrial manufacturers) created the first customer communities called "user groups." The user group organizers/owners' goals were to build loyalty among their business customers, generate feedback for product development and keep customers focused on the organizers/owners products and services, not those of the competition. This history of successful offline customer community development should lend credibility to similar online community building as the goals for both groups are the same. They just use different technologies.

Audience Characteristics

The question arises as to whether online communities are feasible in consumer-oriented websites. Early online communities were developed as self-help online networks of people who came together for mutual aid and benefit (Rheingold 1993, Wellman 1997). The focus was not membership growth. Some of these online communities restricted membership or, at least, did not encourage rapid and intense expansion beyond that required for self-sustaining critical mass. However, beginning in 1994-1995, graphical user interfaces (GUIs) and browser technologies made the Internet and online communities accessible to the millions of people who were not part of this early online community movement. The new Internet users are not technically experienced as the early adopters. These new users are more mainstream and pragmatic (Moore 1991). They will participate and develop technical competence only when they foresee significant incremental improvement for their efforts. They are willing to take closely managed risks if safety nets are present. Their trust in technology and its providers cannot be assumed. They may be active users of the Internet for information gathering, but resistant to using computer mediated communication for relationship building for multiple psychological and experiential reasons (Wallace 1999, Andrews etal 2001). Therefore, to transform these people into online community members, it appears that many of these people may need to be convinced of online community usefulness, safety and security.

Audiences Do Not Constitute Communities

In the language of commercial business, these new Internet users are target markets or audiences. People in these audiences share one or more common needs, in addition to sharing typical demographic characteristics such as age, gender, living patterns, income distribution and ethnicity. These needs may include the interests, goals and/or problems people have concerning a particular product purchase or topic. However, these audiences do not constitute communities because people within an audience do not share existing social relationships and do not expect to form such relationships. They do not work in the same industry, attend the same schools or belong to the same associations or companies. They perceive no benefit to establishing social networks online when their physical social networks appear to be adequate (Andrews 2001). It is only when people recognize the benefits of association will they create social relationships to communicate with each other, to find answers to questions, to solve problems or to get empathetic support from each other. It is only then that an audience is transformed into a community (Mickelson 1997).

For non-profit or grass roots organizations, the concept of community may be stronger than it is for consumer for-profit businesses because the common interest of the audience is "a cause," not just products and service purchases. However, the same kinds of pressures may exist in the non-profit online communities as in commercial ones as they reach out beyond existing members to acquire new members. The goal of the non-profit online community organizers/owners may include business-like goals of "loyalty" to the cause and revenue generation through donations as well as community-like goals of helping members get information, solve problems and build supportive relationships.

Audience Attitudes, Beliefs and Behavior Influence Online Community Development

Misunderstanding the characteristics of an audience may give developers unrealistic expectations about the ease of attracting and transforming audiences into "loyal" customers using online community technologies. There appear to be significant differences between early online community members and today's audience members in their attitudes, beliefs and behavior regarding their common needs for online social interaction and their use of Internet technologies. An in-depth understanding of an audience is important because that knowledge can affect not only the design of the community, but also the amount of investment required to create and sustain the community and transform it into viable business operation. The greater the resistance of an audience to online community involvement, the greater the investment required. These investments include marketing and customer support activities to bring people to the online community for the first time, to engage them interactively and to provide content and dialog that will encourage them to return to become committed and loyal online community users. (Andrews etal 2001).

Business Models for Online Community

Commercial online community development economics concerns itself with three financial issues: (1) the costs to build and support online community; (2) the need to recover those costs, and (3) the need to generate revenues beyond cost recovery. Historically these financial issues were not relevant for online communities for several reasons. Originally, many online communities were "evolved" by people in universities and organizations involved in the technology. The implementations used low cost message sharing of email-based discussion list systems (e.g. Usenets, Listervs) and Internet Relay Chat (IRC). There was no need nor financial support for external content. Content came from the textual conversation. In addition, membership growth was organic and is still organic for many online communities associated with academic, government and not-for-profit organizations (Rheingold 1993). The Well is an early example of this organic growth and mutual benefit purpose. Its purpose is non-commercial, focusing on problem solving and the mutual support among its members. These online communities grew their membership slowly through word of mouth referrals and through associations in existing face-to-face social networks. In some cases, membership was limited. Organizers were not interested in large-scale audiences nor was there money available for promoting them to large numbers of people. These communities seem to sustain low costs through committed volunteerism and institutional funding.

This is not the case for audience-centric online communities of commercial operations. As discussed above, audiences have no intentions for social networking and the commercial goals of the new online community organizers/owners are not those of the potential community members. Organizers/owners are encouraged to define online community as a major "marketing theme" and a central mechanism for building revenue streams not for building mutual support (Hanson 2000, Hagel & Armstrong 1997). Arguments have even been made to move away from individual, personalized marketing to communities of interest and action (Henshall 2000). Given the current economic environment and withdrawal of large-scale investment for online business development, these arguments present many unsettling financial questions and unproven claims. Insights into business models for commercial online communities may be possible by examining economic structural alternatives and revenue generation alternatives.

Alternative Economic Structures

Two alternative economic structures should be considered for use by online community developers. They are derived from the four structures often used to discuss Internet businesses (Internetindicators.com 1999 & 2000; Forrester Research 1999). The first possible structure is the aggregator or portal structure and the second is the commercial or transactional structure. Either of these structures may be business-to-business or business-to-consumer oriented. Some organizations have an integrated structure that combines an aggregator portal with commercial sales.

The first, the aggregator structure, allows an Internet business to act as a broker or intermediary between suppliers/vendors and consumers/customers. The aggregator collects Internet resources and content of interest to the target audience and provides online community to support discussions around those resources and other topics of interest to the audience. The online communities become a mechanism for keep people returning to the website—to keep their "eyeballs" in front of advertisers. This structure generates revenues through multiple provider-based advertising, content subscription or commission fees (Hanson 2000). The website is free to the audience, the customers/users. Because the owner/organizer funds the online community, it can remain somewhat objective and impartial in its community management. The aggregator is not selling to its viewers, the advertisers are.

Aggregators may provide a broad or narrow range of resources, content and online community. Yahoo.com and MSN.com are classic broad range, aggregator portals. Millions of people pass through their websites each day. Their role is to help people find what they are looking for and offer a place for community as well. Narrow range aggregators are emerging also. Packexpo.com is an excellent example of a very focused aggregator portal providing resources to a specific set of customers, suppliers and manufacturers. In all cases, aggregators bring a marketplace to an audience that is not possible in the physical world. It brings customers together and enables them to do things for themselves and communicate in ways that only specialists could do before (Christensen 2000). These aggregator portals are "pure play" Internet businesses (Internetindicators.com 1999 & 2000; Forrester Research 1999). Although once thought positioned for profitability, recent thinking is questioning broad range portal viability without some type of offline presence or media connection (Christensen 2000). Recent downturns in advertising revenues at broad range portals may be a first sign of weakness (Streitfeld 2000).

The second structure that may be viable for audience-centric online communities is the commercial structure. Businesses that use this structure sell products and services to other businesses or consumers. Online community provides a way for people to share their buying experiences and interests with other customers as well as have a relationship with the community owner/organizer. Here the owner/organizer may want to "control the message" and may create a bias in the online community that may not be shared by the members themselves. Unlike the aggregator structure, businesses in the commercial structure may be outgrowths of "bricks and mortar world" or Internet "pure plays." These distinctions are important because "pure plays" have significantly different and more burdensome awareness building and sustainability challenges with target audiences than those with connections to the "bricks and mortar" world (Christensen 2000).

Revenue Generation Alternatives

The aggregator and commercial structure alternatives were originally based on a profitiablity model called the "Big Bang." In this model gaining market share "eyeballs" is more important than revenue generation for the first five to ten years of an Internet organization's operation (Tapscott 1995, Kelly 1998, Hagel & Armstrong 1997). Systematic research has yet to reliably validate this model, but by late 1999 and certainly in 2000 and early 2001, investors clearly were not satisfied with it (Useem & Brown 2000). Massive infusions of cash for audience awareness building and sustainability development are no longer available (Streitfeld 2000). Hundreds of websites with significant online community capabilities and memberships have declared bankruptcy (e.g., drkoop.com), have sagging stock prices after eight years of losses (e.g., amazon.com) or are about to be delisted from the NASDAQ (women.com) ("Dot-com Death Watch" 2001). Many using commercial structures are moving from a "pure play" presence to a physical presence by opening stores, distributing print catalogs and/or striking alliances with "bricks and mortar" companies to create a more traditional marketplace presence in an effort to survive (Christensen 2000). The inability to generate sufficient revenues, control costs or both makes investors unwilling to wait for this unproven profitability model to "kick-in."

In contrast, the traditional profitability model has a bottom-line that is revenue and cost management driven emphasizing annual incremental but consistently increasing profitability growth. Whether a new profitability model or the traditional one will prove sustainable in the online world is a question that cannot be answered as yet. To survive, commercial businesses must generate revenues that exceed costs. Non-profits must ensure costs are less than the funding they can raise. Without funding for marketing and promotional activities, it appears that audience transformation into online community is difficult to achieve and the price for membership building can be quite high.

The Price of Awareness Building

To understand the costs involved in creating an audience-centric online community, examine the cost structure for a typical small commercial online community involving travel (Hagel & Armstrong 1997). Start-up costs range from one to two million dollars, then explode rather dramatically. For the first years of operation, the costs of member acquisition can exceed 43% of the total operating costs. When advertiser/vendor acquisition costs and content related costs are included with member acquisition costs, they become approximately 65% of total operating costs. These costs sound lopsided, but interestingly enough, they are very much the model of expenses for traditional "bricks and mortar" non-technology companies whose profit models are incremental and continual (Hagel & Armstrong 1997).

Useem & Brown (2000) speculate as to why the impact of spending has been so much more dramatic than the historically plodding, but profitable "bricks and mortar" world. Multiple factors are perceived to contribute to the downfall. For example, spending a lot of money a very short time for awareness building (e.g., brand recognition) makes the cost of new member acquisition extremely high. Another factor is that acquiring market share "eyeballs" is much more difficult than it looks, especially when a company does not understand its audience members, their needs, how they do business, and assume that "branding" is a business strategy rather than a communications strategy. Useem & Brown conclude that too many Internet "pure-play" organizations attempted to grow much too fast, skipping too much fundamental infrastructure work.

Therefore, building an audience-centric online community requires revenue generation to offset the expected costs of marketing to stimulate membership growth among people who express little need initially for online community. And, it appears logical to conclude that there must be a trade-off between the costs and the speed with which that growth can occur. An examination of revenue sources defines some of the alternatives for audience-centric online community.

Revenue Sources

The are two categories of revenue sources: provider-based and user-based (Hanson 2000). Provider-based revenue sources are those in which fees are paid to the online community organizers/owners by third parties who want to reach the online community members (e.g., vendors, retailers, and suppliers). The first of these sources is *content sponsorship* where a single entity financially backs the operation. When this occurs, sponsor recognition advertising is the only required "commercialization" of the online community.

The second type of provider-based revenue sources, *retail alliances*, are exclusive or near-exclusive deals where a retailer becomes the preferred vendor for a topic category within the website and/or online community. The vendor receives clickable buttons at specified locations on the community. The online community organizers/owners are paid a negotiated fee for the deal. Here and with the other provider-based revenue sources, people are encouraged to become customers of the retailer in addition to being members of the online community. The third source is the *exclusive deal*, similar to content sponsorships, but is limited to a topic category that includes prominent banners and special keyword links. Guarantees of negotiated traffic volume and the exclusion of competitors make these deals attractive to third parties. Other provider-based revenue sources include *variations on banner advertising,* paid for by number of exposures, click-throughs or even actual sales at the retailer web-site.

Provider-based sources can be tracked with great accuracy and can be implemented alone or as a mix. The problem is that in the last twelve to eighteen months revenues for online advertising have dropped dramatically, have not met advertiser expectations and are on their way to becoming a less attractive source for revenues in the future (Streitfeld 2000). The advertising industry is experimenting with new advertising approaches but its overall ability to increase brand recognition or revenues remains unproven (Lefton 2001).

Product and service sales revenue, subscription fees and pay-per-view transaction fees are classified as user-based revenues sources (Hanson 2000). The choices for audience-centric online community organizers/owners are more limited here. User-based subscription fees have only produced profitability for online consumer pornography websites although there is continued experimentation with subscription fees (Useem & Brown 2000). For example, the online version of the Wall Street Journal requires subscription fees. Salon.com moved to a subscription model in spring 2001. Hagel & Armstrong (1997) suggest that these sources appear to have more potential in business-to-business situations than consumer-based ones. Testing the value of subscription fees to obtain special services, increase community safety or eliminate advertising with an audience of mid-life career changers confirmed user expectations of free access (Andrews etal 2001).

Conclusions

As is seen from this paper, there is little peer reviewed literature upon which to make predictions for audience-centric online community success. In the past two years, the financial picture for Internet business has changed 180 degrees--going from euphoria to deep depression. It has truly been a bipolar time. There are serious questions as to whether organizer/owner developed audience-centric online communities are feasible either as independent entities or as features of larger websites. The aggregator portal structure with provider-based revenue generation appears to be the most logical business model approach, but long term profitability is untested. A diverse base of provider-based revenues allows owners/organizers to skirt the issue of user fees. Success also appears to require a slow growth approach, using incremental self-funding as the "big bang" financial model fizzles to its death. Also, from what little is known to date, more in-depth analyses of target audiences is needed to improve the selection of marketing techniques and activities.

If the independent aggregator portal using provider-based revenues is not viable in the long term, another alternative for audience-centric online community is for the community to be a feature within a successful Internet operation (in either aggregator or commercial structures) where continual financial support can be assured. For example, Yahoo has successfully added audience-centric online community as a loyalty building mechanism. But, even Yahoo's financial future is at stake today ("Yahoo! Stock" 2001). Perhaps a better future may be found with "bricks and clicks" businesses. More 'bricks and mortar" businesses are learning to use the web as a sustaining technology to provide another channel for their customers, and as a disruptive technology to build new customer bases (Christensen 2000). But, as stated earlier, dependence may raise issues of control and online community purpose. It may create divergent priorities and purposes between members and community owners/organizers. This may include conflicts regarding functionality and services, conflicts over control of the community discourse and conflicts over roles and relationships among members and the community owners/organizers. How these differences are addressed may enhance or deter customer loyalty and purchasing behavior. Systematic research into this issue should be explored.

We know from studies that online communities can be highly supportive and positive experiences for members in both dependent and independent structures (Rheingold 1993, Preece 1999). But those studies do not answer the business questions: Can they be profitable? Do they contribute to customer loyalty? To date, the answer appears to be no, but systematic analysis and academic research concerning the direct and indirect contributions of online community to business is needed.

This does not mean that online community in the commercial sector is doomed. There are hundreds of enthusiast and volunteer-driven common interest online communities, just as in the early days of the Well. Today, those communities are built around interests in brands. For example, a recent search on the Internet produced over 40 online communities of interest for the Barbie Doll brand spanning message boards, websites and chats. Barbie topics range from collecting and children's play to Barbie fetishes. These communities are not under the control of the brand owner, Mattel, who offers its own online community at its website where the dialog can be monitored, managed and directed. Mattel has even attempted to close down these communities in an effort to "protect its brand."

The question of how businesses create loyalty and generate revenue through owner/sponsor online communities may not the most appropriate question we should attempt to answer. Perhaps, businesses would be better served by learning more about these user-driven online communities of interest and finding ways to leverage them to promote the brand and build customer loyalty. These independent traditional online communities appear to be significant sources of "word of mouth" advertising that keeps the brand in the consumers mind.

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