



## From the Web 2.0 Trenches: How to Build Real Businesses

By Michael McDerment, Founder

2ndSite Inc. – <http://www.2ndsite.biz/>

There is a lot of buzz and discussion about Web 2.0: what it is and what it means. The debate over its importance and/or relevance has been fuelled by thought leaders such as Tim O'Reilly and Nicholas Carr, but what appears to be getting lost is how viable businesses can be built, and how entrepreneurs can succeed in this changing landscape.

### What is Web 2.0?

To be blunt, Web 2.0 is not a revolution nor, for that matter, much of an evolution. It is just a new name for age-old business practices. O'Reilly and others use terms like "perpetual beta" to describe concepts that were hot in the 1980s. "Customer focus", one of the pillars of Total Quality Management (TQM), was the mantra of the 1980s auto industry. To me, Web 2.0 is about one very simple thing: helping people do more online with services that are easy to use.

Since the barriers to creating a Web service are so low, countless would-be entrepreneurs are jumping in. As venture capitalist Peter Rip has pointed out, an "entrepreneurial bubble" is forming because new and cool ideas can easily be created and distributed – often with little venture capital. But for successful Web 2.0 businesses to be built, entrepreneurs must focus much more on traditional business practices than what appears to be happening today. The idea of building a cool service on a part-time basis while still maintaining your day job has little to do with creating a viable business. Viable businesses are what true entrepreneurs want to build. Viable businesses are what will survive Web 2.0, so let's look at how to build them.

### How Can Entrepreneurs Survive Web 2.0?

There are two routes:

#### Route #1 – Solve a Big Problem

This is the one that VCs should be focused on because this is where the biggest opportunities exist. Skype is a great example of a Web 2.0 company that solved a complex problem – VoIP – while cutting big players out of the loop (read Telcos). Skype succeeded by developing a disruptive technology that was easy to use and freely distributed. They marketed the product very effectively and acquired a huge user base. Then, they focused on converting a small percentage of that user base to subscription-based customers by adding the next level of premium services such as SkypeOut and SkypeIn, which are expected to let the company generate sales of \$200 million next year. At the same time, Skype encouraged third-party developers to create their own fee-based services. This helped to establish a business ecosystem



in which everyone is focused on the same goal: offering useful, revenue-generating services.

Like the founders of Skype, entrepreneurs looking to tackle big problems will need:

- **a first-rate management team**
- **a large addressable market**
- **innovative developers**
- ...and, oh yeah, ... **SERIOUS FINANCING**

What's new about this? Nothing. It's the same old, same old.

#### Route #2 – Solve A Small Problem

The other Web 2.0 route is creating something “better” than the status quo. For smart entrepreneurs, there will be opportunities to build tools customized to meet the needs of countless niches. These entrepreneurs will need to:

- **focus 100% of their time on their business** because the market will be less forgiving than the geeks who rave about Web 2.0 today will tell you
- **base their business on a valid business model** and make sure it can make \$
- **not count on Web 2.0 buzz** to satisfy their marketing needs
- **not rely on positive feedback** to pay the bills

This second route – solving a smaller problem more effectively - is closer to my heart. Over the past two and a half years, I've built a business with Joe Sawada and Levi Cooperman called 2ndSite ([www.2ndSite.biz](http://www.2ndSite.biz)), which offers an online invoicing service. Sure, there is plenty of competition – some great competition like Blinksale ([www.blinksale.com](http://www.blinksale.com)) – but 2ndSite is growing because our service is useful and a snap to use. We now have more than 25,000 users, which keeps the lights on and the servers running. As important, we're in a position few Web 2.0 companies are in: if need be, we can scale back on business development and be profitable. While our company offers a free “lite” service to encourage people to try it, our focus is on building relationships that will attract users who will become paying clients that generate recurring revenue.

#### **Beyond Simplicity, What Else Matters To The Market?**

If the mass market comes online and starts to consume online services as enthusiastically as expected, it will be consumers – rather than the geeks who are all hot and bothered about Web 2.0 today – who will drive the market. At that point in time, tried and true business practices will prevail over cool apps thrown together during spare time. At 2ndSite, we believe consumers want to deal with REAL people. In fact, customer support is something we have focused on since day one. We are a Web 2.0 company but when people call (at least between 9 a.m. to 6 p.m. EST),



they get a person or we call them back within two hours – that’s our policy. Why is it important? We get good old-fashioned word of mouth referrals, which are invaluable.

### **What About the Big Guys?**

So where do major players such as AOL, Yahoo, Google, eBay and Microsoft fit in the Web 2.0 ecosystem? What does it mean for entrepreneurs?

Big companies (and small ones) will fail (or at least their progress will be hampered) if they:

- **don't trust** their users
- **try to own** their users' data
- **don't listen accurately** to user feedback
- **do not move/develop the right changes** fast enough
- **restrict play** between their network and those of their competitors (see Yahoo/AOL and SMS)
- **put their stamp on acquisitions** too soon. Users like the little guy "novelty". Yahoo, for example, has done a great job of not re-branding Flickr

So far, the Big Guys have adopted a two-pronged approach for their Web 2.0 strategies: acquisitions (Yahoo-Flickr, AOL-Weblogs, eBay-Skype) and beta programs (Gmail, Froogle, Okrut, etc.) I believe the Big Guys should continue to buy rather than build because it makes more sense to let the entrepreneurs and VCs suffer through the growing pains. There is still plenty of time to be a fast follower and still dominate. Just look at News Corp.'s Rupert Murdoch. Over the last eight months, he has started to make his Internet plays after staying away from the market during the dot-com boom. Want another good reason? Look at the competition between blog searching services: Ice Rocket, Technorati and the latest entrant, Sphere. It's too early to tell who will come out on top and there is no dominant solution. In fact, new – perhaps better – entrants are still likely to emerge. With the landscape changing this quickly, buying early is likely buying badly.

### **What About the Little Guys?**

Will there be room within Web 2.0 for little guys? Definitely. Why? The key will be user feedback. Entrepreneurs are usually intimate with their customers – managers at Fortune 500 companies are not. Notice how most Web 2.0 companies are proud of coming out of a consultancy? I know we are at 2ndSite. We came from Anicon.ca. While running that consultancy, we discovered a point of pain for small business – invoicing. We built the solution we wanted. It turns out thousands of other businesses want it too. This intimacy with the "pain" is what makes development decisions easier in the Web 2.0 world where user feedback is continuous. The fact that we are and have been a small business *matters*. Big guys will have a hard time trying to "guess" at the real pain. That's why they should let the entrepreneurs build the apps/services and battle for position. Big guys can swoop in later and take their pick of the litter.



Another reason little companies will succeed in Web 2.0 is that when the big guys do come into the market, it may not matter too much because they are going to offer only one product in the market space. It is not going to serve everyone perfectly. While they may achieve a large market share, entrepreneurs will still be able to build businesses around offerings from larger more established players by providing “better fit” solutions for highly targeted markets. A good example is Google Maps, which has spawned a growing eco-system of related applications from entrepreneurs pursuing fertile niches. While it is unlikely Google will go after these opportunities themselves, the eco-system’s growth is positive for Google Maps because it enhances the value of the “core” service.

A third reason little companies will succeed in Web 2.0 is brand bias. There are millions of consumers out there who do NOT want to buy their goods from established brands. Take Microsoft for example. There are millions of consumers who will do virtually anything to avoid purchasing Microsoft products. Perhaps they have had a bad experience; perhaps they detest hugely successful companies and want to diffuse their personal purchasing power and support the little guy. Their motives do not really matter. If 1% of the market do not want to buy from established players, that is a huge audience in many markets.

### **What Will The Web Service Markets Look Like?**

So with all this jostling, where are we headed and what will the competitive landscape look like? I’ll tell you – cluttered at the low end.

It’s become so easy to create Web services that thousands of entrepreneurs are jumping into it. The trouble is virtually all this activity is happening in the low end of the market. Let me speak about the invoicing space. Before Web 2.0 got a full head of steam in 2005, there were only three real players in the low end (of which 2ndSite was one). Since invoicing is a common point of pain, many other little guys are now entering the space. Most of this activity, however, is happening in the low end, but virtually none in the middle or upper ends. This is no surprise because it takes real businesses with real development teams to build applications that solve larger problems for the upper and middle markets.

Fuelling this frenzy at the low end are prominent voices evangelizing software without “feature bloat”. While this strategy will work for early entrants, the downside is these are the applications with the least sustainable competitive advantage and the barriers to entry for these low-end services are so low that the space will be crowded. As a result, just about everyone in the low end is likely to starve.

### **What Will Keep My Business From Starving?**

Features, service, and solving customer pains are how applications will distinguish themselves. Any single application will be ideal for a relatively smaller market



(translation: niches within niches). 2ndSite is lucky because we are now pulling up out of the bottom end of the market. At the same time, we're starting to get calls from people who have tried low-end services who are telling us "you can't DO anything with them". Web 2.0 is about DOING. In the clamour to build Web services, there are many services being built that don't DO enough. Since Web 2.0 is also about not trying to be everything to everybody, developers need to know where they fit in the market and figure out how to thrive there.

### **Web 2.0 – It's All About Leverage**

The Web 2.0 is about applications that are simple to use and help users leverage the Internet more effectively. Although it has been a decade since the Internet moved into the mainstream and five years since the dot-com bubble, we have finally learned what it takes to make things really work online. This is what I believe Tim O'Reilly is addressing in his "practices and principles", which are merely guidelines that help reduce friction for the user so they can get more out of the Internet.

For entrepreneurs who have good ideas and solid business plans, Web 2.0 is ripe with opportunity because there are millions of consumers with lots of online experience and enthusiasm who now want to do more. The challenge for entrepreneurs will be to cater to their niche above all else. They must make decisions that are right for their users by drawing on their knowledge of their users' pain. They must also run their companies like any other successful business. If they can do all of this, like Web services, they will be here to stay.

**You can find my blog at:**

<http://www.michaelmcderment.com/web2chronicles/>

Please drop by and share your thoughts!