Small Firm Strategies: A Case Study on The Rise of Facebook

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Emerging firms face several challenges when competing with incumbent firms, but sometimes, despite these disadvantages, they successfully disrupt industries and gain market share. This paper discusses the challenges of limited resources and low market share that small firms face as they struggle to compete with larger firms that benefit from network effects and economies of scale. To combat these challenges, small firms can differentiate themselves from their competitors, adapt to their market, and target a specific customer base. This case study of Facebook's rise to dominance in the social media industry details its initial challenges when it was a new platform competing against a larger more dominant Myspace and assesses how the company's strategies may also prove effective (or not) for other players in the social media industry and other sectors of the economy.

Keywords: Small firms, Entrepreneurship, Disruption, Competition, Social media, Technology Entrepreneurship

Introduction

Entrepreneurship is a way for ambitious people to forge their paths, establish and grow businesses, and accomplish financial goals. Furthermore, entrepreneurship is a strong motivator for creativity and innovation, leading to the creation of countless new ideas. However, starting as a small business in an industry dominated by already successful companies poses many limitations to success and growth. About 18% of small firms fail in their first year and 50% fail within the first 5 years [1]. This statistic is partly due to the competitive edge large incumbent firms have over small firms. This competitive edge results from the greater market share and financial resources of larger firms, as well as their existing reputation and customer relationships. As a result, small firms face strenuous challenges when attempting to compete with industry giants. This dynamic is illustrated in the competition between Facebook and Myspace. In the early 2000s, Myspace dominated the social networking landscape with a large user base and majority market share [2]. However, Facebook, founded by Mark Zuckerberg in 2004, quickly emerged as a formidable competitor and eventually surpassed Myspace in terms of popularity and user engagement. Facebook's story is a testament to how, with proper strategy and execution, small firms can challenge advantaged incumbents.

This paper lists common challenges small firms face when competing with larger firms and recommends several strategies small firms can employ to achieve success in their industries. This framework is then applied to the case study of Facebook and Myspace, aiming to explain the combination of strategies that led to Facebook's success and to address how and when those winning strategies could also be effective (or not) in other contexts.

Common Challenges Small Firms Face

Small firms often encounter unique sets of challenges that can significantly impact their growth and success. This section explores the common obstacles these firms face and looks at specific scenarios within the social media industry. If small firms don't understand how to navigate these challenges effectively, they are likely to be among the 18% who fail within their first year.

Limited Resources

Small firms generally have fewer financial resources than larger firms. Due to this discrepancy, smaller firms are at a severe disadvantage when investing in technology, marketing, or human resources. Conversely, larger firms are typically able to scale more easily and invest in a wider variety of growth opportunities. In addition, larger firms can spend more on Research and Development (R&D) than smaller firms. Since smaller firms are limited in their ability to research and develop new products, services, and technologies, they may struggle to innovate and distinguish themselves, which may inhibit their profitability and ultimate success. Alternately, companies with vast resources can grow and succeed more easily. For instance, seven out of the ten top companies by market cap in the world are digital innovators. These companies include Alphabet, Facebook, Apple, Microsoft, Amazon, Alibaba, and Tencent. Of these companies, Alphabet, Apple, Facebook, Amazon, and Microsoft spent over $58 billion on R&D in 2017 according to PricewaterhouseCoopers [3]. This suggests that investment in R&D is critical for companies to stay at the forefront of technological innovations. For example, if Apple were to stop investing in R&D, it would likely fall behind its competitors. However, small firms don't have access to billions of dollars to spend on R&D. During the time Facebook was emerging as a small firm, they did not have the luxury to invest billions in R&D.

Figure 1 displays two graphs, one showing the increasing size gap between small and large firms, and the other showing the increasing trend in the R&D expenditures of large firms. The increase in R&D expenditures of large firms shows that because of their resources, they can spend much more on developing their business and gain a competitive edge. Investing in R&D can provide new information that can increase efficiency and decrease costs. It can also provide new insights and innovations that can beat competitors and attract consumers. However, small firms do not have as much funding to allocate toward R&D, making it harder to keep up with market trends and competitors. Furthermore, as illustrated in the figure above, there is an expanding gap in market cap between large and small companies. This highlights the advantage of having a greater spending capacity on R&D which causes disproportionate growth compared to smaller firms.

Network Effects

Small firms are at a disadvantage because their networks are not as established as those of larger firms. Network effects are at play when the value of a product is determined by the number of users[5]. There are two types of network effects: (1) direct and (2) indirect. Direct network effects occur when the value of a product increases the more it is consumed. For example, any social media platform gains value to the user base both as a whole and to each individual as more users join the network. Similarly, Apple's iPhone has more value than competitor phones due to the magnitude of people who have and use the iPhone because they can interact through iMessage, Facetime, and other Apple services. Indirect network effects happen when the value of a product increases for a specific user group when a member of a different group joins the network[5]. Network effects are especially important for platforms, such as Twitter or Facebook, because their companies aim to provide value by connecting users. Typically, direct network effects apply to the social media industry. The more users join Facebook's network, the more valuable it becomes to other Facebook users (direct network effect). An example of an indirect network effect is Uber. If a driver were to join Uber, the value of Uber would not change for other drivers but the value would increase for riders because there would be more availability. Network effects fortify the advantage of large firms, which have already accumulated strong user bases.

Market Dominance

Market dominance is defined as the control of a market by a specific firm. A firm with established market dominance makes a large proportion of overall market sales and thereby establishes a strong reputation through relationships with its many customers. This reputation further fortifies large firms' advantages by attracting even more consumers. Firms that have achieved market dominance are referred to as market leaders, as they are reputable and well-known, and competitors are called market challengers. Small firms that have just entered a market will have challenges competing with any larger firm that has market dominance.

A social media firm with market dominance holds significant influence in the industry. It has established its platform as the go-to platform for a majority of users meaning their users spend large amounts of time on the platform sharing posts, engaging with other users, and exploring content. This engagement strengthens the user's connection to the platform and increases the challenge for emerging platforms to attract users.

Economies of Scale

Cost advantages, commonly referred to as "economies of scale," occur when production gets more efficient while becoming less expensive as the number of goods being produced increases. The cost of the product depends on the size of the industry and/or company. Small companies cannot maintain low prices like larger firms because they simply do not have enough capital and customers to maintain a low price.

Economies of scale benefit larger social media firms because the large upfront cost to set up their platform is divided over more users, creating a lower average cost per user while simultaneously network effects generate more value per user. Also, larger social media firms gain better prices for expenses like cybersecurity, cloud services, or CRM (Customer Relationship Management) software, because of the number of users who use their products. A small social media platform with limited funds must pay higher rates per user for these expenses.

Strategies Small Firms Can Utilize

Even though large incumbent firms possess numerous advantages, small firms still sometimes succeed in breaking into competitive markets. There are several strategies small firms can apply to successfully thrive and grow.

Differentiation

Differentiation, also referred to as product differentiation, is a strategy used by companies to distinguish their product/service. This is a strategy small firms can use to compete with large

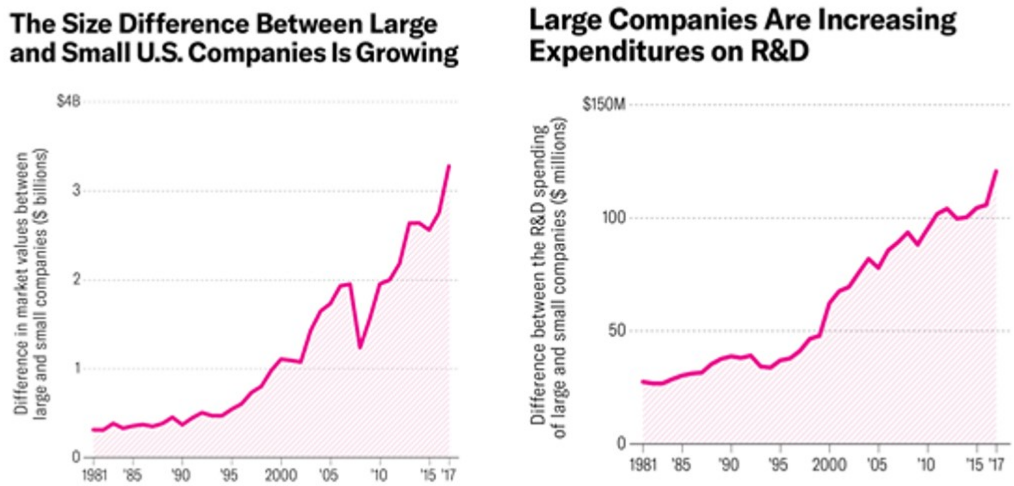

Fig. 1 Size Difference Between Large and Small U.S. Companies and R&D Expenditures of Large Companies [4]

firms. If a firm successfully differentiates its product, customers see its products as more desirable and advantageous to use than those of competitors. One way a small firm can differentiate is by innovating and focusing on developing new features and processes that are more desirable. Product differentiation also builds intangible value and strengthens customer loyalty. Additionally, this allows for a larger profit margin which is even more beneficial for smaller firms that lack resources. A smaller firm that has established differentiation in its product or service should be able to begin to compete against larger competitors.

Differentiation is an essential element of a firm, especially for an emerging social media firm. It can add or modify platform features that users will find useful or interesting to draw new users to their platform. They can provide specialized features and functions that provide users with distinct experiences exclusive to their platform. Furthermore, small platforms can use data analytics and user feedback to offer content recommendations and personalized notifications specific to the user. A small platform must find a way to offer different and more desirable features to attract new customers and grow (Network Effects, 2023)[5].

One example of a small firm successfully differentiating is Tesla. Founded in 2003, Tesla is an electric vehicle manufacturer that has revolutionized the automotive industry. Headquartered in Palo Alto, California, the company was established with a vision to accelerate the world's transition to sustainable energy. To differentiate itself, the company created a car that would increase the demand for electric vehicles instead of focusing on an affordable electric car. Founder and CEO of Tesla, Elon Musk stated, "Our first product was going to be expensive no matter what it looked like, so we decided to build a sports car, as that seemed like it had the best chance of being competitive with its gasoline alternatives."[6]. Breaking away from the conventional trends, Tesla chose to redefine expectations by manufacturing a premium car that not only exemplified cutting-edge technology and performance but sparked a widespread shift towards electric vehicles. With this unique approach, Tesla grew into one of the most successful car companies in the world.

Adaptability

Emerging firms, although disadvantaged in many ways, can compete with incumbents by being more adaptable. Smaller firms face fewer restrictions and can often pivot more efficiently, making them adaptable to factors like economic downturns, changes in consumer demand, market trends, and increased competition. Small firms should leverage their adaptability because it can accelerate their growth and allow them to better serve changing customer needs and preferences.

Ultimately, small firms can compete more successfully with larger firms by being more adaptable, customer-focused, innovative, and efficient. Small firms can leverage their strengths and succeed in competitive markets by embracing change and proactively adapting their tactics and strategies. An article from the Harvard Business Review studied a large media company that was dealing with a high rate of "customer churn," which means they were losing customers fast. To solve this problem, this firm restructured its strategy by utilizing customer data and recognizing the patterns driving this customer churn. Companies can become more adaptive by applying advanced data mining to their work, allowing them to recognize patterns and become more efficient. Insights provided by superior analytics can give companies a huge advantage in remaining agile, attentive, and flexible in their ever-changing environments. Such insights can also help firms identify what processes can be made more efficient.

Blockbuster is an example of a company that failed to adapt to changing market conditions. Blockbuster was a home movie and video game rental store chain, which had stores throughout the world. From the 90's to the early 2000s, Blockbuster quickly became the most popular video chain in the US. It grew to over 9,000 stores worldwide and over 45 million customers. However, their domination of their market didn't last forever, and a new competitor, Netflix, started to gain traction in the market. Contrary to Blockbuster, Netflix which previously offered a similar service to Blockbuster but without physical stores, recognized the demand for online streaming and offered a subscription-based service while Blockbuster remained with their rental model. Netflix was able to offer more value and convenience to customers which slowly overshadowed Blockbuster's offering. Blockbuster's failure shows the importance of adapting to changing market conditions[7]. Ultimately in 2010, Blockbuster filed for bankruptcy and had to pay one billion dollars in debt.

Market Targeting

Market targeting is another viable strategy that small firms can use to compete with larger firms. By focusing their efforts on a specific target market, small firms can adjust their products to meet the needs of the chosen market. If small firms utilize their adaptability and understand their target customers and market, they can effectively compete with larger firms and succeed in their niche market. As large firms grow, they often aim to appeal to a larger audience, leaving room for smaller firms to better serve niche markets[8].

Small social media platforms can target niche customer segments to create initial value, grow quality customer relationships, build a strong community, and gain popularity and brand recognition. They can partner with influential figures or organizations and expand into other segments in the future. Essentially, they can utilize the credibility and popularity they have created in a niche market to enhance their position.

Case Study: Facebook vs. Myspace

This study aims to understand how small businesses can succeed despite their disadvantages compared to incumbent firms by analyzing the case of Facebook as it entered the social media market, competing with the popular platform, Myspace. The main sources of information are publicly available data, including media articles, analyst reports, research papers, and information on Facebook and Myspace over the period 2004-2011, and the information is synthesized in this study to shed light on the core factors that led to Facebook's success.

In this context, this paper analyzes how Facebook experienced four key challenges that most startups face: (1) limited resources, (2) lack of network effects, (3) lack of market dominance, and (4) lack of economies of scale. Then the paper analyzes how Facebook overcame these challenges through three key entrepreneurial strategies: (1) differentiation, (2) adaptability, and (3) market targeting. In this case study, the unit of analysis is the firm– the paper analyzes firm-level challenges and strategies to understand the factors that led to Facebook's success. Common to most startups, Facebook entered the market with several disadvantages.

While other factors, such as leadership and luck, may have played a role in Facebook's success, the study argues that the three key entrepreneurial strategies were necessary conditions for Facebook's success and comments on why these strategies are important for any entrepreneur. Although some of these challenges and success factors are broadly applicable to other industries, the case study also comments on specific attributes of the social media industry that set the conditions for Facebook's success. Then the study comments on the generalizability of the findings.

Background

As social media became more popular around the turn of the century, many companies attempted to create social networking platforms to meet the growing demand. In the mid-2000s, the social networking site Myspace held the title of the most popular platform, capturing the attention and enthusiasm of millions of users worldwide. With its customizable profiles, music integration, and vibrant online communities, Myspace revolutionized the way people connected and expressed themselves online. These features drew many people to the platform. Myspace established an impressive network by attracting more users and gaining more value.

Figure 2 shows the use of social networking from July 2007 - May 2011. However, as years went by, a new contender in the social media scene began to rise: Facebook. At the time Facebook was launched in 2004, Myspace already had 1 million users. Once Myspace was sold to News Corp in 2005, they had 14 million and just a year later they reached 100 million users and surpassed Google as the most visited website[10]. Why did Myspace's popularity start to decline then?

When Myspace was bought by News Corp, they lost their ability to adapt and gained "corporate restrictions", which hindered their ability to innovate. News Corp did not regard Myspace as a top priority: the main purpose of acquiring Myspace was to increase sales with advertising. News Corp gave impossible targets and Myspace's developer resources were drained. Users ended up leaving the site for other platforms because Myspace no longer satisfied customer needs and usability was not prioritized[11]. On the other hand, Facebook quickly gained popularity as a result of its user-friendly design, streamlined functionality, and focus on real-life connections. Users tended to favor a more

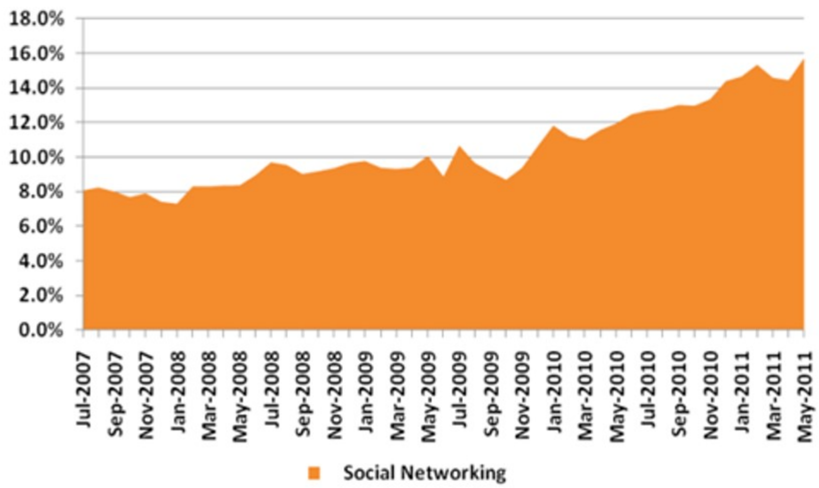

Fig. 2 Share of Total Time Spent Online on Social Networking[9]

structured and user-friendly platform, which Facebook was able to deliver.

Factors that Drove Facebook's Success

As social media platforms have evolved, each has differentiated and adopted distinct approaches to user engagement and privacy management. While Myspace was more concerned with self-promotion and expression, Facebook focused on promoting real-life relationships between people. Additionally, Facebook offered users greater control over who may access their information thanks to its stronger privacy settings than Myspace[12].

According to former CEO of Myspace, Mike Jones, Facebook's success was also partly due to the use of real names. Facebook also emphasized real-life connections and friend networks. Because of this differentiation in their platform features, Facebook became more useful for most users.

In its prime, Myspace was generally used by teenagers. Meanwhile, Facebook was initially used by college students, a more mature audience. Instead of releasing their platform to the public, Facebook first made it exclusive to the students from Harvard, Columbia, Stanford, and Yale. This allowed Facebook to establish a loyal user base that could advocate for Facebook[10]. In addition, Facebook was used by students and graduates from the most prestigious universities who tend to gain more respect and a better reputation in the eyes of many people. These students greatly influenced the network, with many people attempting to connect with these students and graduates.

At first, Facebook overcame its lack of network effects by starting in small closed communities (i.e., college campuses) and recruiting a high share of users in those communities to the platforms. But as it became larger, Facebook's success was fueled by network effects. As more people joined, the value of the platform increased for their users. Connecting and communicating with a larger network of friends created a positive feedback loop, attracting even more users and solidifying Facebook's position as the go-to social networking platform. Facebook was able to differentiate from Myspace with a more user-friendly interface that enhanced their users' experiences.

In mid-2009, Facebook was able to pull ahead of Myspace and consistently increase its lead ever since, thanks to its relentless focus on user experience, continuous innovation, and strategic partnerships. Myspace, however, has steadily declined in its number of unique visitors since the rise of Facebook. This is partly due to market dominance and the loyalty that is built between Facebook and its customers. From 2009 onward, most social media users shifted from Myspace to Facebook because of its popularity and practicality.

Modern-Day Facebook

Thanks to excellent differentiation, adaptability, and market targeting early on, Facebook overtook a strong incumbent player, Myspace, and is now the leading social media platform. The company has one of the largest customer bases in the world and has two billion active monthly users as of 2023. Facebook purchased other upcoming platforms like Instagram in 2012 and WhatsApp in 2014. Firm acquisition has been one of Facebook's primary strategies for defending themselves against disruption like how they were able to disrupt Myspace a few years earlier. Instead of letting Instagram specifically grow and possibly outperform Facebook (like Facebook did to Myspace), they bought Instagram to prevent that from happening.

Today, Meta (Facebook's parent company) owns Facebook, Facebook Messenger, WhatsApp, and Instagram. As of 2019, these were the 4 most downloaded social media apps in the world

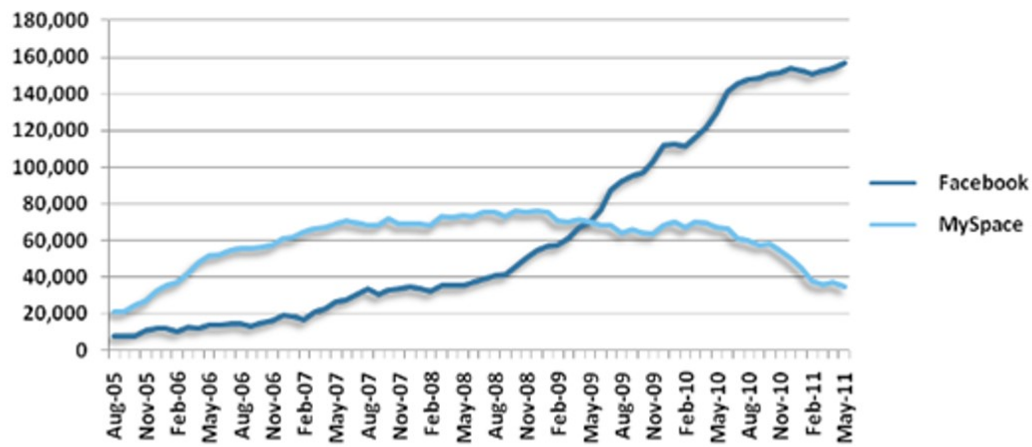

Fig. 3 Facebook and Myspace Monthly U.S. Unique Visitor Graph[9]

which essentially gave Meta a "data monopoly", with majority access to data relating to social media. consumer habits[13].

Figure 4 shows the massive growth and success Facebook has achieved from 2003-2018. Throughout Facebook's history, numerous social media sites attempted to break into the markets, but the vast majority faced failure or struggled to gain significant traction. Examples of some of these failures include platforms like Orkut, Friendster, and Google Buzz. Facebook is an anomaly in the social media industry because it successfully overcame Myspace which had a large user base, dominance of the industry, and adequate resources. Today, Facebook's market cap is over 800 billion USD and is now valued at over 1 trillion USD, making it one of five companies to reach this valuation[14]. Facebook succeeded in adapting the platform to changing trends and continuously innovating features in response to user feedback.

How Can These Results Apply to Other Industries?

The ability to adapt to changing market trends and user preferences is crucial for any firm in any industry. Companies should always try to meet their customer's needs and be willing to make necessary adjustments to their products or services. A failure to adapt can result in losing market share to more agile competitors. Facebook's ability to acquire platforms like Instagram shows the importance of staying ahead of the curve and embracing emerging trends. Similarly, industries such as retail are currently adapting to e-commerce and digital transformation to meet changing consumer behaviors. The tech and social media industries are characterized by fierce competition and rapid evolution. Companies constantly strive to innovate, capture and retain users, and adapt to changing trends and user preferences. This competitive landscape is also present in other industries, such as consumer electronics, automotive, and retail, where companies continuously compete to offer superior products, services, and customer experiences.

Furthermore, user acquisition and retention are major factors that companies should take into account. As observed in the graph above, Myspace was not able to retain its customers after it was surpassed by Facebook. This led many of their users to switch social media platforms and join Facebook. In social media and other industries, gaining and retaining users or customers is crucial for success. Companies need to provide compelling value propositions, differentiate themselves, and build trust to attract and retain a loyal user base. This involves understanding customer needs, delivering superior experiences, and leveraging effective marketing and user engagement strategies. In contrast to Facebook, which succeeded in delivering on these promises, Myspace struggled to satisfy user demands and provide better experiences.

Another lesson that can be learned from the Facebook vs. Myspace case is the importance of user-centricity, adaptability, and differentiation. Companies across industries should prioritize user experience, understand changing customer needs, and actively innovate to stay relevant. Additionally, the necessity of strategic alliances and acquisitions for growth and diversification is a lesson that can be applied to a variety of businesses pursuing market dominance and growth.

Although much can be learned from Facebook's success, it is important to acknowledge how business opportunities in the social media industry differ from others. Even though, network effects make it especially difficult for firms to enter and compete in this industry, the low cost of entry makes it more accessible for entrepreneurs than industries with a high entry cost, like car manufacturing. In such an industry, which is also characterized by high switching costs for customers, small firms may be

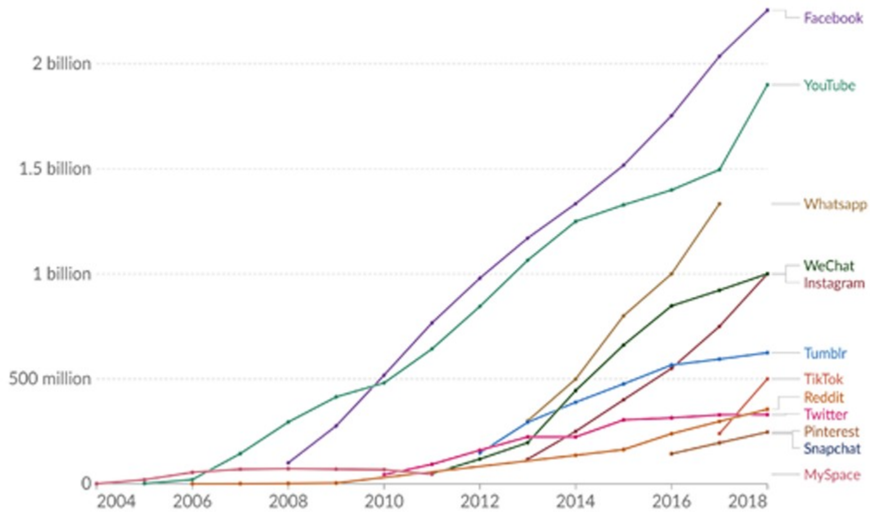

Fig. 4 Size Difference Between Large and Small U.S. Companies and R&D Expenditures of Large Companies[4]

even further disadvantaged. Even still, focusing on differentiation, adaptability, and market targeting should be integral in determining the success of any firm.

For example, major food retail store, Whole Foods, has implemented these strategies into their operation and business plan. Founded in 1980, Whole Foods differentiates itself by offering a healthy and diverse selection of goods and exceptional store quality and customer service. Beyond differentiation through product offerings and store quality, Whole Foods differentiates itself through non-food products and digital content. For example, they partnered with shows like Top Chef to promote their food, host events, and run blogs, building their brand recognition and market presence. The community that Whole Foods built ultimately transformed into a lifestyle brand, doing what other healthy grocery store companies have not done. Additionally, they developed an app, creating a more immersive shopping experience that paved the way for the future of grocery shopping. Furthermore, in 2008, Whole Foods adapted to their customer's values and promoted a greener lifestyle by becoming the first major food retailer to remove plastic bags from their stores (More Shoppers Bring Their Own Bags, 2009). They have established themselves as a leader in the organic and natural food segment. Because of their dedication to selling high-quality natural organic foods, they catered to younger customers who are concerned with eating more healthily. In conclusion, Whole Foods' well-rounded approach of offering a diverse product selection, exceptional quality and customer service, digital innovation, and a commitment to environmental sustainability, has not only positioned them as a leader in the organic and natural food segment but also as a prominent lifestyle brand which resonated with the loyal customer base.

Conclusion

This paper presents strategies that small firms can implement to compete with larger firms. The case study of Facebook shows that there are many strategies applicable to not only the social media industry but to various other sectors as well. By implementing (1) differentiation, (2) adaptability, and (3) market targeting, some small firms may be able to overcome some of the obstacles that arise when competing with a larger incumbent firm.

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