The Rise of Social Apponomics
How Social Media and Apps Are Transforming E-Commerce
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EXECUTIVE SUMMARY

A new evolutionary stage of e-commerce is emerging—the era of “social apponomics.” In this next stage of e-commerce evolution, new business models are made possible by social media, consumer insight, and tailored applications. The main value drivers for e-commerce are shifting from the direct monetization of online traffic to customer life-cycle management. The key to success is understanding customer needs and creating online customer experiences that translate into customer lifetime value. Best practices in social apponomics include not just adding social media and applications to an offering but combining them with the traditional and well-understood elements of customer experience—ease of use, brand and trust, personalized offers, and campaigns, coupled with high levels of support and advice. With this holistic approach to online customer experiences, a new elite of etailers are developing superior, profitable customer value propositions for the long haul.
THE TRUE OPPORTUNITY IN WEB 2.0

For several years, Web 2.0—the use of Web-based applications for interactive engagement and user-controlled media—has provided both an opportunity and a challenge for marketers. New billion-dollar companies and business models have emerged: The advent of social media such as MySpace, Facebook, and Twitter is changing the way companies market to, connect with, and build personalized relationships with their customers. At the same time, Apple’s online application store, with more than 3 billion downloads, has become a leader in the mobile applications market. It is changing the way Internet companies (finally) monetize content.

Amid the attention and hype, it is hard to separate ingenious new business models from the temporary darlings of an increasingly dynamic online pop culture. But the trends of Web 2.0 are here to stay and will continue to evolve. Social apponomics thus represents an evolutionary stage of e-commerce. The winners will be

Exhibit 1
Net Promoter Scores for Selected Retailers, 2010

<table>
<thead>
<tr>
<th>Retailer</th>
<th>Customer loyalty %</th>
<th>NPS average across industries: 10%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Zappos</td>
<td>90%</td>
<td></td>
</tr>
<tr>
<td>Apple</td>
<td>77%</td>
<td></td>
</tr>
<tr>
<td>Amazon</td>
<td>74%</td>
<td></td>
</tr>
<tr>
<td>Costco</td>
<td>53%</td>
<td></td>
</tr>
<tr>
<td>Target</td>
<td>44%</td>
<td></td>
</tr>
</tbody>
</table>

Note: Metrics were calculated by subtracting the percentage of “detractors” from the percentage of “promoters” of each retailer, as measured by a survey asking customers if they would recommend the brand to others.
Source: Netpromoter.com; Booz & Company
those businesses that master three elements of this domain—social media, community-based marketing, and personalized and tailored applications—and use them to break down the barriers to monetizing content online, not just for individual transactions but as part of an ongoing customer relationship.

All three of these elements are critical. Social media, or places where people congregate to share information and mutual understanding, are replacing broadcast media as the primary way many people learn about products and services. Community-based marketing is driven by keen insight, drawn not just from surveys and studies of customers, but from analysis of how they engage with products and services online. And the new personalized and tailored applications attract users by singling them out according to their interests and needs—either on websites (Netflix, Amazon.com) or increasingly with customizable applications for mobile phones, PDAs, Netbooks, and new devices such as the Apple iPad.

These three elements enable the primary value of social apponomics: customer life-cycle management that builds loyalty (and uses electronic media to perpetually earn and reinforce that loyalty). A company that can mobilize these elements in an integrated way can build lifetime loyalty among consumers. Already, the best e-tailers outperform the best retailers in net promoter scores, a survey-based metric of customer loyalty (see Exhibit 1).

The winners in social apponomics will be those businesses that master three elements of this domain—social media, community-based marketing, and personalized and tailored applications.
To fully understand this opportunity, marketers need to look at the evolution of dominant trends in the online consumer space. As we see it, social apponomics is the third stage of e-commerce evolution (see Exhibit 2).

1990s–2001: The Race for Scale
The early days of the Internet, as in most new industries, were marked by competition for early dominance. In this case, that meant generating Web traffic. With vast amounts of cash available from fantasy-drunk investors, millions of dollars were spent on marketing, building infrastructure (virtual and real), and providing a wide range of free content and services to give people a reason to come online. For an unhealthy number of companies, the focus on revenue growth overwhelmed any plans for profitability; it was widely assumed that advertising revenue would fund growth, as it had for television.

During the shakeout in 2001, cash flow became a growing concern for investors and startup entrepreneurs, and the online world moved its focus to monetization. Some major Web-based companies have struggled to convert their brand and traffic into revenues ever since. They don’t always find great answers to the question about why they should be valued at tens of billions of dollars. We believe this will continue to be true for a handful of players even in 2010, after the Great Recession.

Exhibit 2
Evolution of Online Value Drivers Over Time
A few companies that emerged during this stage truly changed the world and continue to do so. Amazon.com was only launched in 1995, but today its revenues (US$25 billion) exceed those of Barnes & Noble by 379 percent and are at least 20 percent of the revenues generated by each of the global retail giants Tesco, Metro, and Carrefour (see Exhibit 3). Google, for its part, was only created in 1996, but by 2010, every major company in telecom, technology, or retail has had to figure out its “Google strategy”; its decision about whether to defend against, compete with, or partner with Google.

During this period, some bricks-and-mortar companies reinvented their business models or their entire industries—as Charles Schwab did in online brokerage. Other companies expanded into online channels complementary to their offline businesses. They learned that online traffic, branding, and reach were necessary but not sufficient conditions for success. In other words, was the race for scale and traffic the right priority to focus on to succeed online? Absolutely! Was it sustainable? Not if monetization didn’t follow.

**2010 and Beyond: Social Apponomics**

Today, we are at the next frontier of online evolution. In just a few years, social media giants have emerged to overshadow previous forms of electronic media. For example, Facebook was launched to the public in 2006; by 2010, it had more than 200 million users worldwide. Twitter, also created in 2006, was faster than major news media companies to report on events like Michael Jackson’s death, the 2009 elections in Iran, and natural disasters all over the world. So far, these companies have done amazing things; they have changed the way hundreds of millions of people communicate. But they largely haven’t yet mastered the challenge of monetization.

At the same time, their position as social media giants seems hard to combat directly. If you are a company seeking to engage customers, the question is not how to beat Facebook, but how to make use of Facebook as a lead generation engine, a sales channel, or a marketing and PR tool. The same is true for YouTube, or Apple’s iTunes or app store platform.

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**Exhibit 3**

*Amazon.com vs. Leading Retailers*

<table>
<thead>
<tr>
<th></th>
<th>1999</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Barnes &amp; Noble</strong></td>
<td>47%</td>
<td>5%</td>
</tr>
<tr>
<td><strong>Ahold</strong></td>
<td>5%</td>
<td></td>
</tr>
<tr>
<td><strong>Tesco</strong></td>
<td>5%</td>
<td>65%</td>
</tr>
<tr>
<td><strong>Metro</strong></td>
<td>26%</td>
<td>25%</td>
</tr>
<tr>
<td><strong>Carrefour</strong></td>
<td>20%</td>
<td>1%</td>
</tr>
<tr>
<td><strong>Walmart</strong></td>
<td></td>
<td>6%</td>
</tr>
</tbody>
</table>

Source: Bloomberg; Booz & Company analysis
In this new environment, the combination of social media and applications enables customer life-cycle management.

Customer lifetime value is a fairly well-known concept in many industries. Airlines, hotels, and retailers have developed sophisticated loyalty programs. But app stores are fundamentally changing the way these concepts work. Consumers are increasingly developing loyalty and stickiness to places like social media.

Exhibit 4
Six elements for Creating Online Customer Lifetime Value

- Applications
- Personalized Support and Advice
- Personalized Offers and Campaigns
- Customer Experience
- Trust
- Ease of Use

Source: Booz & Company
media websites or e-tailers. These sites succeed at creating a lock-in with emotional, social, and technical resonance; they create personal relationships between companies and users as well as connections among users themselves. And they rely on user-generated content in the form of ratings, reviews, troubleshooting support, and tips. This content is an ever more important factor in purchase decisions, and a core element of a website’s customer experience.

Analysis of best-in-class online customer experience shows that successful players address value drivers through six distinct elements. The next generation of successful online business models will combine the elements of a traditional retail site—trust, ease of use, and personalized offers—with social apponomics features, such as personalized advice, community, and the functionality of customized applications (see Exhibit 4).

Applications are software tools that enhance otherwise static content by allowing users to manipulate their own data or accomplish related tasks. Personalized support and advice can be generated by the experts on a site but more often (and less expensively) comes from customers themselves. Personalized offers and campaigns, supported by sophisticated data mining and customer relationship management (CRM) analytics, ensure that customers receive advertisements or messages apt to be of interest to them and thus are more likely to click through to a sale; this is one of the greatest sources of revenue. Ease of use is a table stakes capability: Sites are now judged by how rapid, self-explanatory, and elegant they are.

Trust is a feature that is engendered by being trustworthy: by living up to promises, offering great return policies, avoiding scams or bad-faith encounters, and policing and eliminating exploitive behavior (including from other customers). The most important factor in building trust is transparency: Sites such as Craigslist, the New York Times, and Amazon.com are diligent about explaining policies they have instituted (such as when and why they remove offensive comments). The final feature is community: the creation and cultivation of interactive domains where people can come to post their ideas and thoughts, and hear back from others, with a sense that their messages (whether in text, image, or video form) will be recognized by a group of people with whom they feel a sense of belonging or shared interest.
Various companies have established proficiency in these individual elements. But the most successful players have combined several of them to create best-in-class online businesses. Examples:

**Netflix: Trust through Transparency**

Netflix, founded in 1997, is the world’s largest online movie rental service—with more than 10 million subscribers, revenues of about $1.3 billion, and around 2,000 employees. Its online model has turned the movie rental industry on its head (ask Blockbuster).

Netflix’s personalized advice comes through recommendations from customers. At the same time, it builds trust through transparency—for example, by showing the logic underlying the recommendations it displays (“because you enjoyed [a related movie]”) or by showing ratings of the “members’ average” versus “our best guess for you.”

Customers find Netflix easy to use. They can instantly watch online a growing number of Netflix movies, manage their queues through their smart phones, and change plans at any time. Netflix also provides a sense of community: Customers are able to find other users similar to them, check out one another’s reviews, and see how similar they are. They can also create their own recommendation lists (various “top 10” lists) and read others’ lists (similar to Listmania on Amazon.com).

Netflix has started to integrate partners in a marketplace: Other online media (Rotten Tomatoes, NYTimes

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Movies, etc.) have movies that can be added directly to Netflix accounts. The marketplace also includes electronics manufacturers that stream movies directly to devices.

**Amazon.com: Best-in-Class E-tail**

Amazon.com is the clear global e-tail leader. The key to its success lies in its system of capabilities that create the target customer experience elements identified as most relevant. A personalized customer experience is created through Amazon’s CRM system that enables data-driven personalization and cross-selling, as well as through highly customized bundles driven by real-time sales data. Portal features include a large community that provides robust, trusted customer reviews, and marketplaces that integrate third-party sellers. Amazon’s wish list features, Prime membership, and one-click checkout offer maximum ease of use, while mobile access is provided through iPhone and BlackBerry apps, as well as through the company’s own Kindle handheld electronic reader. The value of a functioning lifetime customer experience can be shown through Amazon’s Prime service. According to Gene Munster of Piper Jaffray, an estimated 2 million users have signed up for Amazon Prime, the number grew 24 percent in the past year, and the average gross merchandise value of Prime users grew from $400 per year to about $900 in their first year of using the service, driven by greater order sizes and order frequencies.

Amazon has been particularly active in developing new capabilities both internally and externally, often acquiring emerging competitors before they became too competitive with its own offerings (see Exhibit 5).

One important 2009 acquisition was Zappos, an e-tailer that began with footwear and subsequently broadened its portfolio to other products. Zappos’s key to success is the strong loyalty and emotional lock-in that is created through a personalized customer experience around trust and transparency that is built on social media and outstanding customer service. For example, almost 500 Zappos employees—including the CEO—are active on Twitter, ensuring that there is an ongoing conversation with customers.

In addition, Zappos uses existing communities such as YouTube to facilitate word-of-mouth marketing, and it has created an active community by making use of blogs.

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More than 10 blogs are available on the Zappos site, including one on which its senior executives post. In short, the company has learned how to develop its “virtual humanity.” This capability is expected to gradually accrue to Amazon.com in general, as the Zappos acquisition takes hold.

Intuit: Engaging with Applications
Intuit develops financial and tax preparation software (such as Quicken, TurboTax, and QuickBooks) and related services for small businesses, accountants, and individuals. The company was founded in 1983 and today generates about $3.1 billion in revenues with 8,200 employees.

Intuit has built trust by having customers test products in development phases. “Experiments” on Intuitlabs.com provide customers with early versions of new products and services for free. This deployment of “the wisdom of crowds” gives large amounts of real-time feedback directly to developers, to enable rapid improvement and make sure they solve real problems. Intuit has also fostered an active and growing community by recognizing contributors. The community Leaderboard recognizes the top 10 contributors of all time and of the current month. The company has partnered with Meetup.com to reach out to local small business and entrepreneur groups. The Intuit website also features specialized community centers, tailored to groups such as accountants, women, and educators. Its TaxAlmanac is a free, stand-alone online tax research wiki resource run by Intuit and written by tax professionals across the United States.

Customers can also find featured partners and applications and post classified ads for contractors, training, or business on the Intuit marketplace.

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In addition to these companies, a large number of often still young and relatively small companies are experimenting with new business models around social media and innovative marketplace concepts. Examples:

- **Elance** is a crowdsourcing site for technology projects. It provides community ratings and certifies talent.

- **Mint.com** consolidates personal banking data from multiple sources into a single interface. The service is free, but it serves as a market for financial services; for example, lower-interest credit cards are marketed to customers who fit the profile.

- Salesforce.com provides subscription-based, hosted CRM services, outsourcing the configuration of corporation-specific applications to trusted partners. It provides mobile applications and community-oriented sites on the Web (for example, one on our source innovation). It has also integrated its lead generation with Facebook.

- Spiceworks ("It’s everything IT") develops free network management, PC inventory, and help desk software for small and medium-sized businesses, and in the process, it has built a community of 900,000 business entrepreneurs. Based on this access to a great customer group, it is developing a distinctive CRM software market.

- Woot.com is “an online store and community that focuses on selling cool stuff [mainly electronic gear] cheap.” It publishes statistics about user interests and creates a sense of community and shared interests. The site experiments with exploding offers, daily contests, blogs, forums, and chat lines that get pulled into sales pages.

The benefits of these online business models are evident:

- Higher conversion rates into sales, reflecting the impact of better-targeted offers, peer recommendations, and crowd-voting influence

- Higher repeat purchase rates and larger basket sizes, reflecting the prevalence of relevant connections with customers based on sophisticated database marketing and analysis or on lock-ins created by applications such as iTunes

- Lower customer acquisition costs, based on the benefit of having loyal net promoters

- Lower customer care costs, as communities take over troubleshooting or as general product advice is shared among users
We are still at the frontier of this approach. Many of the most creative, valuable solutions are yet to be fully developed. Some may come from your own company. Companies that succeed in monetizing online access will be those that develop customers for life online—through a combination of social media, community-based marketing, tailored applications, and, most of all, an understanding of how people’s loyalties and attitudes evolve in this age of emerging communications.

Seven lessons drawn from our extensive work with and research on leading e-commerce business models can help your company get ready for the age of social apponomics:

1. Winners will not compete with social giants like Facebook or Twitter; they will ally with existing social media and monetize their own related efforts.

2. Online solutions need to be location-specific—targeted to particular customer groups—while being device-agnostic.

3. People transcend customer segments; consumers have identities, preferences, product histories, and social data that generate broader “cloud profiles” beyond the borders of any one site.

4. Pricing can be a dynamic conversation. Use information about individuals’ pricing preferences to close sales.

5. Make use of the power of crowds in your Web apps or other innovations.

6. Learn to “virtually humanize” your company: Expose your employees and decentralize your messaging. Avoid giving the impression of being a “command and control” company.

7. Develop forms of online credentialing of the value of your goods and services: Your own corporate certification is good, employee voices are better, and user credentialing is best.

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