WHATSAPP DEAL

Facebook's Future Lies in Investing in R&D

Sharad Raghavan

Facebook's decision to acquire WhatsApp has spawned a whole lot of criticism and some amount of praise as well. When seen in the context of the social network's ongoing strategic plan, its most recent acquisition deserves both criticism and praise in equal measure.

Most of the criticism Facebook is receiving is due to the whopping price of the deal: worth at least $16 billion, with $4 billion in cash and the rest in shares. Add the $3 billion worth of restricted stock units WhatsApp's founders and employees are getting and the deal size goes up to $19 billion. Now that's a huge sum of money, more than Facebook has ever paid for any company before.

So, the question arises: why does Facebook think WhatsApp is worth so much? WhatsApp barely has a revenue model: it displays no ads and charges only $0.99 as subscription fee. The key lies in a deeper look into the social network's ongoing strategic shift. The most important point here is that Facebook's transformation into a predominantly mobile company seems to be finally paying off. That it is comfortable paying $19 billion for a company that has no money-making potential shows that Facebook has now got a firm grip on its mobile advertising model.

It was investors' lack of confidence in this model that resulted in the social network's IPO failing in 2012. This deal, on top of Facebook's Q3 results, comes as quite a dramatic signal to investors that they should no longer worry about the company's future revenue streams.

WhatsApp also doesn't represent Facebook's first engagement in the messaging space: Facebook has been pretty desperate to make a messaging deal for quite some time now. Following the Instragram deal, the social network last year made an offer to buy the highly popular photo-sharing app Snapchat for what was then considered an astronomical sum of $3 billion. Though rejected, the deal highlighted Facebook's hunger for messaging acquisitions.

Acquiring WhatsApp, thus, makes sense for Facebook. Ever since Facebook decided to focus on mobile, the messaging app has been the closest threat to Facebook's hegemony over social communication.

Look at it this way: Facebook in January said that it had 945 million users who accessed its various apps on their phones. WhatsApp boasts 450 million users and is reportedly adding around one million new users every day. The messaging app also offers very similar features: group chats, photo sharing, status updates, shared links and audio files.

Most importantly, given that Facebook's user attrition is driven primarily by privacy-related concerns, WhatsApp messages are private between the sender and receiver. It was hardly surprising that Facebook's Q3 results saw its daily user numbers declining for the first time.

So, it makes sense for Facebook to buy WhatsApp. But was the deal worth $19 billion? To answer that, one must realise that gone are the days when Facebook was a young, dynamic start-up. One way to look at the acquisition is to view it as a sign of Facebook's maturity. The company has realised that it cannot simply rely on its core services and so is looking to diversify into related services. This policy was followed by Google as well, but Google also has the innovation to back its acquisitions up.

Which leads us to the flip side of the coin. This so-called maturity on Facebook's part could just be a complete lack of innovation. With various companies starting to snap at its heels, Facebook would rather buy them out than innovate itself away from the competition. Facebook will have to answer whether the WhatsApp deal was made by watching its behind or looking ahead.

Siding with the former argument, that Facebook is realising its maturity, is the easy way out for the social network: cash in hand, it can go on swallowing the competition. But the lack of innovative initiative is a more plausible and worrying explanation.

Throwing money at a problem works for a while, but sooner or later, Facebook will realise it would have been better served investing that cash in R&D instead.

The writer is an MBA student at the Great Lakes Institute of Management, Chennai. Views are personal