NOW YOU SEE ME, NOW YOU DON’T: THE RISE OF SNAPCHAT

“I can see why it’s strategically valuable, but is it worth $3 billion? Not in any universe I’m aware of.”

-A prominent venture capitalist on Facebook’s attempted acquisition of Snapchat.

Introduction

Dazing absence-mindedness had overcome Evan Spiegel. It was November of 2013 and the co-founder and CEO of Snapchat overlooked that familiar sunset of the Pacific ocean from his father’s house in Southern California, which also happened to serve as Snapchat headquarters. “Three billion dollars,” he murmured as if in trance. The 25-year-old had just received a call from Facebook founder Mark Zuckerberg. The Social Media pioneer’s offer of $3 billion for his app seemed astronomic, almost surreal. True, Spiegel’s app generated 400 million Snaps per day. True that big companies had started to use the app as a platform for advertisement. But Snapchat hardly generated any revenue and had not announced any official plans on how to do so in the near future. While, so far, investors had been lenient on the lack of monetization, this probably would not be the case forever. As if hypnotized, Spiegel’s look slowly followed a perfectly v-shaped flock of Pelicans, which was flying one foot above the magenta-colored water and was now disappearing behind the cliffs – disappearing as were millions of Snaps every day, as well as

an offer Spiegel could not refuse. His mind was racing now: how would Bobby Murphy, CTO and co-founder, react to “Zucks” offer – knowing that both of them owned 25% equity in the company? How would they respond to the offer of the youngest billionaire on the planet? And, if they turned down his offer, how would they generate sufficient revenue with an app whose main feature was to let pictures disappear?

**History of Snapchat**

Snapchat’s saga can be traced back to the dorms of Stanford University’s Kappa Sig Fraternity in 2008. It was here that freshman and future Snapchat CEO, Evan Spiegel, met Reggie Brown and Bobby Murphy. The idea for what would later be called “ephemeral social media” originated from the harsh and sometimes embarrassingly comical, realities of college life. After a wild night of partying, Brown voiced his regret to Spiegel and Murphy, “I wish these pictures I sent this girl would disappear.” This regret sparked the creation of what would be Snapchat’s predecessor “Pictaboo.” The three undergraduates launched the company in the ensuing summer with Brown acting as CMO and Murphy as CTO. After a feud over ownership of the original idea and equity splits, Spiegel and Murphy released Brown from his duties and renamed the app “Snapchat.” The app allows you to share ephemeral images and videos with your followers. In other words, after the recipient opens the image or video, it disappears. By the end of the summer, the app managed to attract only a mere 127 users.

With the start of high school, Snapchat gained traction. All of a sudden, Evans and Murphy noticed a spike in activity from 9am to 3pm, which initiated the rapid rise of Snapchat’s most important customer segment: teenagers. In the following months Snapchat’s followership increased to 100,000 – primarily through word of mouth. With rapid growth came big capital. In April of 2012, Lightspeed Venture Capital invested $485,000 on a $4.85 million valuation. Assured of the app’s future success, Spiegel dropped out from Stanford to devote all of his time

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to Snapchat, working day and night from his father’s house in Southern California. He and Murphy continuously improved the app and added new features, such as Video-Snaps. In December 2012, the Snapchat user base had grown to 10 million, which generated 20 million Snaps per day.\(^4\) When Snapchat received publicity in these early days it was primarily portrayed as a “sexting” tool.\(^5\) In other words, students were using the app to send photos of a sexual nature to each other (the realities of young adult life).

In spite of this, Snapchat’s popularity continued to grow and, by early 2013, users were sending some 60 million Snaps per day.\(^6\) At the same time, Snapchat had been named 2012’s Fastest Rising Startup at the Crunchies.\(^7\) In February 2013, the new popularity helped Spiegel to raise $13.5 million in a Series A through Benchmark Capital with a valuation of $70 million.\(^8\)

**The Changing Nature of Social Media**

By 2012, social media usage was increasingly shifting towards mobile phones. Against this backdrop, industry giant Facebook purchased Instagram for $1 billion in what was widely interpreted as a defensive move to take control of the app due to its popularity among teens. Instagram enables its users to take pictures and videos, and share them either publicly or privately on the app, as well as through a variety of other social networking platforms, such as Facebook, Twitter, Tumblr, and Flickr.\(^9\) Other industry commentators asserted that Facebook was hedging bets that it would have trouble with a transition to mobile.\(^10\) Launched in 2004, Facebook had

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\(^5\) Id.

\(^6\) Id.


become a key player in the area of desktop photos, but was far behind in the same domain on mobile phones. According to Ryan Tate at Wired, “photos are the fuel that social networks run on.” In late 2013, Snapchat and Facebook were processing about the same number of photos each day, even though Facebook had far more users. Further, messaging is a core function of mobile devices, and Snapchat’s users were growing in the mobile space by impressive numbers. Instagram had been a small team of less than 30 people, similar in size to the Snapchat team. Instagram’s revenues were purely theoretical at the time, just like Snapchat’s. In October 2013, at a time when Facebook was valued at over $100 billion, CFO David Ebersman acknowledged that teenagers were spending a decreasing amount of time on Facebook. This was part of the reason that the company saw its stock price fall by three percent from October 30 to October 31, to the tune of a $3 billion in valuation.

Fearing an erosion of its own user base, in December of 2012, Facebook launched Snapchat-clone “Poke” on the market. Though the app debuted as #1 on the Apple App Store charts in December 2012, it fell to #34 in less than a week. Instead of obliterating Snapchat, Poke helped Snapchat gain an unprecedented amount of popularity. In the week after Poke’s launch, Snapchat jumped from 27,000 to 153,000 mentions on Twitter. “It was like ‘Merry Christmas,’ Snapchat,” remembered Spiegel.

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14 Supra at 9.
15 Supra at 10.
16 Supra at 9.
17 Supra at 10.
Using Snapchat

In 2013, Snapchat unveiled “Stories,” its version of a personal timeline. Users could post Snapchat pictures or videos to their My Story (the feed that would be available to all their followers) and their “stories” would be available for 24 hours. This was unlike any social media feature to date and made it a game-changer for brands. Rather than sending Snaps to just a few followers, Snapchat users could now share Snaps with a mass audience. This update allowed brands to interact with their users in a highly personal, entertaining way. Big names, such as Taco Bell, wanted in on it and added Snapchat to their roster of social media accounts, making it a major player in the world of social media. The same year, and as a response to Instagram launching Instagram Direct, which allows users to send personal photos to one another, Snapchat added filters, timestamps, temperature, and speed overlays.

Consumer Behavior and Trend Analysis

“Somewhere along the way when we were building social media products we forgot the reason we like to communicate with our friends is because it is fun.”

This statement was made by Spiegel in an interview with the Associated Press. This notion of “fun” for “fun’s sake” is just one of the many purposes of social media, the other most popular use being “networking.” However, what remains ubiquitous in the world of social media is its demographic: teens and twenty-somethings are dominating the mobile app market. Facebook, Instagram, Twitter, Snapchat: in 2013, 88% of 18-29 year olds in the U.S. were using social media as opposed to 73% of 30-49 year olds.21

Jeff Bezos, CEO of Amazon, stated after purchasing the *Washington Post* that, “all businesses need to be young forever. If your customer base ages with you, you’re Woolworth’s.”\(^2\) Snapchat encapsulated how teenagers and young adults communicate with one another: “when we talk to each other, passing in the halls or just living out our lives, those moments disappear.”\(^3\) Before Snapchat came along, “the norm of the internet was to create platforms in which everything is saved – everything [was] stored and documented.”\(^4\) According to Gary Vaynerchuck, who agrees with Bezos, youth (in this case, teenagers), is where social networks find their audience and it grows fast. Vaynerchuck contended that there are two things that are undeniable when it comes to teens: “It is not cool to hang out at the same club as your mom. And two, you want to lock your room.”\(^5\) Snapchat answered both of these problems: parents were beginning to join Facebook and teens could protect their privacy by sending temporary pictures to their friends. By August 2014, 40% of 18 year olds in the U.S. were using Snapchat on a daily basis.\(^6\) In addition, a 2013 report by Pew showed that teens were growing increasingly frustrated by the presence of adults on Facebook.\(^7\)

The ephemeral nature of Snapchat grabbed these users. Thanks to the app, they could share weird, inappropriate, banal, funny, personal photos and videos to their friends without feeling uncomfortable about being judged or without the fear of it being there forever. Researcher Nathan Jurgenson summed up this preference for “ephemerality” in a July 2013 blog post: “It’s easy to underestimate the significance of injecting more ephemerality into social media. But to make social media more temporary fundamentally alters our relationships to online visibility, to data privacy, content ownership, the 'right to forget.' It alters the functioning of social stigma, shame, and identity itself.”

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24 Id.
25 Id.
26 Id.
What do photos tell you? “Like Selfies, photos are less precious and more about communicating moments and the process of life,” said Pamela Rutledge, director of the Media Psychology Research Center: “Images are a richer media than text and transmit much, much more information, such as emotions and environmental as well as triggers our own mental images and associations.”

In addition, Rutledge believes that there is an exclusive component to Snapchat that teens and young adults relate to: the social media platform is akin to an exclusive community group and temporary images define who is in your Snap “crowd.” In addition to exclusivity, the barrier set for the type of image or video is lowered. On Instagram and Facebook, users are inundated with a “feed” type platform, which ultimately, does not give them much choice on who to pay attention to. In addition, Instagram and Facebook leave a physical mark on the user’s “internet report-card.” Anybody that has access to the user’s profile can go back and look at what they’ve chosen to share. On Snapchat, the trace is ephemeral: in twenty-four hours it is gone. “Who wouldn’t want their messages to be a little more fun, flirty, or sending them to their friends?” More importantly, who doesn’t want to a safety net against where your posts and messages could end up? The magic of Snapchat’s disappearing photos is exactly the kind of tangible privacy that users value more than the long, inconspicuous jargon found in “privacy settings” on Facebook. It is believed that when consumers feel truly protected by a level of privacy they can feel and see, they will spend more time being themselves and sharing their true ideas and real preferences.

Highly Valued but Under-monetized

Despite the advantages of ephemerality in social media, by late 2013, Snapchat had yet to be monetized. In fact, any email that was marketing related – that is, proposals to use the platform to market products to specific users – went to an unmonitored inbox. In May 2013, Snapchat sought

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30 Id.


32 Id.
to change course and pursue monetization strategies such as in-app purchases and native advertising. Indeed, Snapchat hired Phillippe Browning, a former Vice President of advertising and operations for CBS Mobile, as the Vice President of Monetization.\textsuperscript{33} Native advertising, a form of paid media where the ad experience follows the natural form and function of the user experience in which it is placed, constituted a potential option.\textsuperscript{34} However, according to Larry Freed, CEO of analytics firm ForeSee, ads are major source of discontent for users.\textsuperscript{35}

By mid-2013, users were sending 200 million Snaps per day. Along with the platform’s incredible growth came the conclusion of its Series B funding round. Snapchat had raised $80 million and had been valued at $800 million. In other words, in the eyes of investors, Snapchat was viewed as an $860 million company with only two years of operations under its belt and no revenue to speak of.\textsuperscript{36} Bill Gurley, a Series B investor and Venture Capitalist at Benchmark, justified the $800 million valuation by making two points.\textsuperscript{37} First, he asserted that those social networks that generated a significant user base very quickly had a higher probability that they would be valued at a larger price at a later stage in the company’s development. Second, Snapchat was popular. Younger people were drifting away from Facebook and to Snapchat because they wanted a place to communicate that provided privacy.\textsuperscript{38} But even though big companies such as Taco Bell had discovered Snapchat as an ad-platform and the user base increased to 400 million by the fall of 2013, the founders had yet to monetize the app and turn a profit.

\textsuperscript{33} Supra at 23.


\textsuperscript{36} Supra at 23.

\textsuperscript{37} Supra at 18.

Privacy Issues

At the same time, a discussion regarding how private Snapchat was in reality, erupted. In mid-2013, a Facebook page revealed pictures taken on Snapchat. While Facebook closed down this leaked page, the issue raised doubts that Snapchat was not as private as it is thought to be.\(^3\)(Blake, Jonathan. “Snapchat Leaked Photos Page Closed Over Bullying Claims.” May 29, 2013. BBC Newsbeat. Accessed March 20, 2016. http://www.bbc.co.uk/newsbeat/article/22704846/snapchat-leaked-photos-page-closed-over-bullying-claims.) Parallel to this, the online community debated hotly whether that the “deleted” photos on an Android phone were merely hidden on the device, and could be retrieved with the right forensic software.\(^4\)(\textit{Ibid}.). Snapchat’s ethos of ephemerality and privacy would be put into question in such cases.

Challenges Ahead

Spiegel, who started out in a dorm room and now found himself in his father’s home, was heading a company valued at a price that could afford him a multiple McMansions. Yet, this young drop-out of one of the country’s leading institutions, was facing the decision whether he wanted to join the country’s leading tech & social media institution, or if he preferred to stay a maverick. If Spiegel were to accept Facebook’s offer, what would become of Snapchat? Would it join the ranks of Instagram and WhatsApp, the other social media platforms acquired by Facebook? This question, in itself, posed a significant challenge for the company. Yet, other challenges were occupying the CEO’s mind. Despite the sky-high valuations, the company was still facing a lack of revenue and potential privacy issues. What if the cool kids did not want to play with the app anymore and Snapchat turned into yet another fad?

As the sun set on the Pacific, Spiegel considered what else would be setting into the darkness were he to refuse Facebook’s generous offer: Financial nirvana in the form of $750 million dollars for himself and for co-founder Bobby Murphy? Jet-setting around the world like Kevin Systrom, founder of Instagram did, after Facebook’s acquisition? Or refuse the offer and take on
the enormous financial and individual challenge of turning Snapchat into a revenue-generating business? The choice was his.
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Source: [AppAnnie.com](http://AppAnnie.com)