On October 10, Google announced its purchase of YouTube in an all-stock transaction valued at $1.65 billion. The video-sharing site is a 20-month-old startup which despite its immense level of traffic has yet to register a profit. Are we looking at an investment akin to those of the Internet bubble, which burst so spectacularly in March of 2001? Although it is too soon for anyone to cast aside this possibility, and despite the fact that YouTube’s real value is still unknown, there are a few indicators that the move has a more solid foundation.

First off, Google is not venturing into the unknown, given its launch of Google Video at the start of the year. The online video search service allows users to view content such as movie trailers, videos and even segments of television programs. It also offers Net users the option to purchase television content, such as episodes from the popular series CSI. With Google Video, the king of search engines was looking to challenge its rival Apple, whose iTunes store also sells videos which users can then view in the famous iPod video player.

Nevertheless, YouTube has taken the world by storm in this area. The site was launched in 2005 by Chad Hurley and Steve Chen, along with Jawed Karim, who has since left the company. It allows users to upload homemade videos or clips—which in theory they have acquired legally—and view content posted by others. When posting a video, the user gives up the intellectual property rights, without receiving financial compensation in return.

In August, the site was serving 72 million videos daily, a figure which has since grown to 100 million. The current 65,000 daily postings of new material also bear witness to the success of this formula. Meanwhile traditional television broadcasters are showing YouTube content on their home-video programs. And broadcasters and music companies such as NBC, CBS, Universal Music Group, Sony BMG and Warner Music Group have struck deals with YouTube to include some of its content on their sites, to be shown free of charge to all users. In Spain, where YouTube leads the
leisure and entertainment category, the site received 4.2 million visitors in June, July and August of this year alone.

**Complementary Companies**

By combining Google Video, which holds 10% of the US market for video downloads, with YouTube, which has 45%, Google steps ahead of its direct Internet rivals Microsoft and Yahoo! The social network for young people MySpace, owned by News Corp., has about 20% of the market share, and both Yahoo! Video and Microsoft’s MSN Video hold around 6%.

In the new Web 2.0, where multimedia resources take center stage, know-how in managing video continues to gain importance and is showing signs of being among the key tools of the future. Forecasts such as those of eMarketer estimate that video-based advertising will reach $640 million this year and $1.5 billion by 2009. If Google manages to come away with a good portion of the market, the investment will no doubt be profitable.

While developments such as these favor this important new shift toward market concentration, question marks about opportunity of the transaction remain. One is that the availability of cash will make YouTube the object of future lawsuits, stemming from the potential infractions of intellectual property laws. It is not easy to prevent users from posting content on the site which is subject to third-party copyright. At the end of the day, though, the key risk is that despite the company being the leader in online video, advertising revenues have not made YouTube a profitable business—at least not for the moment.

However, this weakness could become a strength thanks to the complementary relationship between the two companies. To develop its business model, YouTube will need some time to experiment and Google can provide this, as well as the necessary infrastructure until the business becomes profitable.

In addition, while YouTube provides the content—generated by individual users or media companies—Google contributes the technology and experience necessary for indexing and performing searches for that content. The two companies coincide in yet another key area: the same conception of advertising, based on a clear separation between content and ads. Search results on Google are sectioned off by a well-defined border that separates them from the advertisers’ messages, which are related to the searched content. YouTube has also refused to yield to advertisers, who want their spots to be placed at the beginning and end of the videos, as they are accustomed to doing on other sites.

This complementary relationship between the two companies is the best chance for the two to justify the $1.65 billion paid for YouTube, a price which is probably a result of the unwillingness to sell or direct bidding from Yahoo! and Microsoft. Will Google ever recoup this huge investment? It will basically depend on what percentage of the market share ends up in the hands of general-interest video download sites, such as YouTube, and what portion will go to the specialized sites, such as CNN, Bloomberg or Disney’s go.com.