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Positioned to Score:

**A Strategic Analysis of Match.com and the Online Dating Industry**

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## **EXECUTIVE SUMMARY**

The online dating industry is one of the few Internet content segments that has survived the late 1990s “boom to bust” phenomenon and is growing at an unprecedented rate while providing significant economic returns for its incumbents. Among these companies, none is better positioned to gain sustainable market dominance than Match.com (“Match” or the “Company”), a division of media conglomerate USA Interactive. The following analysis examines the online dating industry and Match’s current strategic position, potential threats and opportunities for competitive advantage. Despite the Company’s current position, the threat of disintermediation and encroachment by new competitors remains a constant risk for any online business. Match needs to protect its market share and financial performance by enhancing its differentiation advantage, leveraging potential corporate synergies and preempting positional disintermediation.

## **COMPANY DESCRIPTION**

Match is the leading subscription-based online dating service, with more than 6 million member profiles and over 650,000 paying subscribers. In addition to the Match.com website, the Company is the leading provider of outsourced online personal services. Match powers the paid online dating services of The Microsoft Network; The Excite Network's Relationship Channels; BET Interactive and is the premier provider of personals for Love@AOL, offering the Match.com service across AOL, AOL.com, CompuServe and Netscape.com. In 2002 Match’s parent company, TicketMaster-CitySearch, was acquired by USA Interactive, one of the world’s leading media conglomerates. While Match has to date operated independently, it has potential access to such leading media content properties as USA Networks, CitySearch.com, Expedia.com, and StyleClick (a B2C consulting, site design and operating business).

Match hosts server space for millions of personal profiles, which include basic biographic data; short written descriptions of interests and desired partner traits; photographs; and other lighthearted question fields meant to assist users in forming search criteria (i.e. I smoke: a) never, b) socially or c) Like a fiend). While the Company allows anyone to post an appropriate profile for free, only paying subscribers can send initiate contact through the Company’s “double-blind” anonymous email system. Additionally, Match subscribers are provided with regular lists of potential dating candidates, called Venus, generated by the Company’s search algorithm and based on the



biographical and single answer data fields. Venus uses an exclusive two-way matching technology which searches through millions of profiles to seek out matches and delivers the newest profiles directly to a user's inbox. The Company also holds off-line events in major cities and provides written guidance to subscribers on how to formulate an attractive profile, how to construct a good first email and how to conduct online courting effectively and appropriately. Match often offers trial periods where an interested user can contact a limited number of potential matches before having to pay a subscription fee ranging from \$24.95 per month to \$99.95 per year to gain full access to the system and its services.

Match's online dating service is one of very few international services with websites dedicated to 28 different countries in addition to having a density of profiles in nearly every major U.S. city. Despite the economic recession, a drastic national curtailment of advertising spending, and apparent resistance to subscription fees at many previously free content sites, Match has managed to grow revenues from \$9mm in 1999 to over \$140 million (pro forma for its recent acquisition of UDate.com) in the trailing twelve months, approximately 90 percent of which is subscription based. Additionally, the Company has consistently maintained superior operating margins to its competitors reaching \$16 million in EBITDA (representing a 33.5% margin) in 2001 and pro forma EBITDA of \$42 million in the trailing twelve months. While accounts of market size vary drastically, Match's revenue and subscriber numbers would indicate that it has been successful in capturing a dominant share of online dating subscribers in the past, having over a third of the estimate one million subscribers as of 2001. This dominant network size should leave it in an excellent position to capture a disproportionate share of the estimated subscriber growth to nearly five million by the end of 2003.

## **INDUSTRY OVERVIEW**

Match is considered part of the business to consumer segment of the \$50 billion online content segment. Aggregate spending for total online content market (including B2B and B2C sites) is rapidly increasing and expected to surpass \$100 billion in 2006. The increase in consumer access to computers, massive increase in bandwidth, and the Internet's marginalization of traditional barriers to entry has resulted in a flood of online content during the last ten years. In addition to competing with on and off-line dating services, Match must capture online subscriber dollars from sites providing content such as: news, information and analysis (WSJ.com); entertainment



(digital music, video, pornography, sports, etc.); consumer research and directory services (Classmates.com, Ancestry.com); reference material (Britanica.com or Mapquest.com); personal finance and investing information and services (Thestreet.com or Changewave.com); analytical business research (Hoovers.com, Forrester.com or eMarketer.com); and niche business or consumer content (health, automotive, real estate, lifestyles, religion, etc.). Despite all this traffic, online dating services have risen over the last five years from a nascent concept to the third largest category in this market with an estimated \$72 million in aggregate spending during 2001. The segment trails only the business content (\$214 million) and Entertainment/lifestyles (\$112 million) categories and Match itself is the second largest online subscription service behind Yahoo! Furthermore, the average monthly subscription for most B2C sites is less than \$10.00, while Match and other online dating services receive on average \$17.00 per month, representing an average premium of over 70 percent (with many dating subscriptions costing between five and 500 percent more than other consumer content sites).

Dating and personal services have existed for several decades in the form of classifieds, video dating and the unfortunately painful tradition of blind dating. With development of Internet personal networks and services, which provide significant value added to the matchmaking process, the online industry has rapidly become the dominant vehicle for dating services, both spurring growth in the market as a whole and taking an increasingly larger portion of the pie. Online dating has increased exposure to and acceptance of dating services by a growing and diverse base of singles. A recent survey conducted with 14,833 of dating services subscribers revealed that there are nearly equal numbers of men and women online, the vast majority of which are looking for a genuine relationship (See Exhibits 1 and 2). Estimates show that the number of subscribers should increase from 15 million in 2001 to over 24 million in 2007.

The rapid growth and attractiveness of the online dating market has drawn an increasing number of new entrants and even spurred the symbiotic growth of online dating aggregator and review sites. Despite this activity, industry profitability and growth remains remarkably strong, with a moderate number of competitors including Match.com, Yahoo! Personals, Matchmaker.com, Friendfinder.com and Lavalife.com, dominating the U.S. market. The economic and structural factors driving this competitive landscape can best be illustrated through an analysis of Porter's Five Forces (See Exhibit 3):



**Rivalry:** The technological requirements and boundaryless nature of the Internet can potentially drive disastrous levels of competition, as demonstrated by the price wars of attrition found in many online retail segments. The Internet results in high fixed relative to marginal costs, a large number of competitors, and moderate – at best – levels of differentiation (due to the ease of mimicking quality designs and technology platforms). In addition the critical importance of having the largest base of users in network based products and services, can create a capture at all cost mentality towards potential customers resulting in damaging levels of price competition from new entrants. Despite these potentially hazardous structural indications, the segment has been marked by price cooperation that borders on collusion. The ease of price signaling on the Internet and levels of growth that permit new entrants to reach minimum efficient scale without disturbing the incumbents (to be discussed in more detail below) has dampened the competitive intensity of the segment – for now. (See Exhibit 6)

**Entry Barriers:** Online dating providers face conflicting forces with respect to barriers to entry. The absence of geographic and physical barriers, difficulty protecting differentiation advantages, and ability to outsource or rent most of the critical fixed assets required for operation, serve to erode traditional barriers to entry. Alternatively, the demand side increasing returns associated with any network business, provide incumbents with the ability to capture increasingly larger portions of new consumers potentially limiting a new entrants access to the market.

**Substitutes:** While singles can always attempt to meet through clubs, activities, bars and off-line services, these alternatives fail in a variety of different ways to meet the unique needs of singles and are increasingly perceived as less effective. While traditional dating lacks the stigma of online dating, a comparison of the capabilities of each option to meet single's needs and the premium paid for these services indicates that the threat of substitutes is minimal. (See Exhibit 1)

**Buyer Power:** The industry has a large and fragmented base of buyers, which have low price sensitivity. Trends show that the users are seeking meaningful relationships, and as such are willing to commit a surprising level of resources on increasing their access to attractive candidates. This has driven favorable margins, but it may be difficult for any one provider to appropriate these rents in the future, as buyers enjoy low switching costs due to the ease of navigating the Internet and the absence of meaningful sources of customer lock-in.



**Supplier Power:** An interesting aspect of the online dating industry is that due to the structure that allows free access to content, eventually buyers become suppliers. As the number of buyers increase, the database increases concomitantly driving its value and appeal. Additionally, the significant overcapacity of bandwidth and server access, which are required for maintaining the service and data storage, drastically reduces supplier power.

### **COMPETITIVE ANALYSIS**

While most B2C content providers have watched their revenues shrink and losses widen during the past three years, Match has continued to post record subscriber growth and earnings. Match's continued success in this environment has been a function of the Company's position as a leader within an economically attractive, non-cyclical segment of the online content industry and ability to exploit its early entry and brand name to capture a dominant share of the value generated through societal trends towards online dating services. Recognizing the destabilizing nature of the internet, Match rapidly leveraged the positive aspect of the Internet to create a superior value proposition to off-line dating services, while aggressively building brand awareness and network size to mitigate many of the risks associated with low barriers to entry. The specific strengths and weaknesses with respect to the Company's model are discussed below:

#### ***Positional Analysis***

The economic structure of online dating industry has enabled providers to capture a dominant portion of the rents associated with delivering a viable networking mechanism for interested singles. Match has efficiently leveraged these favorable industry fundamentals by pursuing a broadly appealing marketing campaign and aggressive geographic expansion strategy. The Company systematically focused on generating a critical mass of consumers in opinion leading markets such as New York and Los Angeles by combining targeted online advertising, off-line events and regional media campaigns directed not only at introducing its service, but also at reducing the stigma associated with dating services in general. This approach gave the Company the perceived ubiquity amongst consumers required to expand nationally and capture a dominant portion of new users. While Match faces pressure due to the ease of entry associated with the Internet, the network externalities generated from its large installed base of active subscribers and profiles represents a source of significant customer value. Information businesses, particularly those focused on developing integrative networks, face high demand side



increasing returns resulting from the geometric increases in value from each additional user, as defined by Metcalf's law. New consumers can easily recognize the benefits associated with joining the largest "dating" pool enabling Match to draw a disproportionate share of subscribers and exploit the virtuous circle associated with consumer "tipping".

While the online dating segment has demonstrated low levels of competitive rivalry, the Company must assess how much of this behavior can be attributed to enduring structural benefits and how much is a function of the geometric growth of the industry as a whole. The apparent state of relative cooperation as demonstrated by the nearly identical prices across the industry is a direct function industry expansion at such a rate as to allow an increasing number of competitors to reach minimum efficient scale without taking share from industry leaders. eMarketer estimated that there would be five million paying subscribers to online dating services by the end of 2003. An analysis of Match and UDate indicates that companies can cover the operating expenses required to deliver a viable, albeit basic network with fewer than 20,000 subscribers and reach positive operating cash flows with less than 80,000 average subscribers. (see Exhibits 4 and 5) This would indicate that with the six largest providers accounting for less than two million paying subscribers, there remains room for between 30 and 150 viable competitors in the U.S. alone.

Eventually, however, the industry's low barriers to entry and marginal costs will leave competitors with excess capacity and increasing levels of competition. Furthermore, despite the large demand side increasing returns, the heterogeneity of the dating populous, societal focus on homogamy (i.e. attraction towards mates of similar race, religion, education level and socioeconomic status) and minimal customer switching costs suggest that niche players may be able to offer differentiated value proposition, reducing the likelihood of tipping towards a single dominant standard or provider in the long-term. Finally, Match and other providers indirectly depend on major Internet portals and search sites as a critical component of their distribution system. As this component of the value chain consolidates under increasingly bigger brand names such as Yahoo! and Google, the companies may be able to appropriate a greater portion of the economic rents from online dating service networks.



### *Internal Strengths and Weaknesses*

Match's aggressive and novel marketing approach has created a loyal customer base and a sense of familiarity and acceptance within the online dating community. Additionally, the Company concentrated its development efforts on creating an easily navigable and attractive end user interface, which required relatively low capital investment and made it easy for new users to rapidly and painlessly learn how to use all of the sites functions. The low investment costs and declining average cost structure (due to the low marginal cost and high value added of servicing new customers) associated with its strategy, has endowed the Company with meaningful economies of scale. As Match has increased its installed base of subscribers, it has increased its EBITDA margin by nearly 40% by leveraging relatively static overhead expenses and capital expenditures. Despite an investment of only \$2.5 million in capital expenditures in 2000, the company increased its EBITDA by \$10.2 million between 2000 and 2001, representing a 413% return on invested capital. Match enjoyed EBITDA margins and cash return on assets that were more than twice that of smaller, direct competitor UDate.com. In addition, UDate's servicing cost per average subscriber (defined as general and administrative expenses divided by average users – this detail was not available for Match) declined rapidly as its network increased, demonstrating the ability of larger competitors to more efficiently leverage semi-fixed overhead expenses. This cost advantage has provided Match with superior cash flows and the ability to reinvest in technology and marketing. The Company exploited these economies of scale in 2002 by investing heavily in a nationwide multi-media campaign while maintaining superior margins to its competitors, thus accelerating its positional advantage with respect to network size. (See Exhibit 4) it must be noted, however, that despite its significant size disadvantage, Udate.com significantly narrowed the gap between the two company's ROA and EBITDA Margins after reaching a critical mass of users. Additionally, customer acquisition costs at each company rose dramatically in 2002. This suggests that while economies of scale are critical below a certain size, Match may be rapidly approaching the point of diminishing marginal returns. (See Exhibit 5)

The Company's position as the dominant online dating service has enabled it to generate critical expertise and proprietary assets in ancillary services, as well. The Company's efficiency and scale have positioned it to be the logical provider for outsourced development and maintenance other portal's dating functions. By delivering a



scaled down version of its service with a remarkably similar end user interface to leading portals such as MSN, AOL and BET.com, Match can capture a portion of the revenues generated by these sites and familiarize an increasingly greater number of potential users with its interface. When these customers become more serious and desire a larger and more functional network, they are likely to gravitate towards Match.com. The Company has also developed an unparalleled database of information on over six million demographically desirable consumers. While to date it has utilized this database to attract advertisers to its site and occasionally to conduct surveys regarding online dating for publications, the information contained in its profiles and the millions of searches run each year represent a significant untapped, proprietary asset.

In contrast, Match's singular focus on reaching the broadest audience has resulted in certain functional and strategic weaknesses. First, the development focus on ease of use and visual attractiveness came at the cost of leading-edge technology. Numerous online dating review sites claim that Match's search algorithm and database fields are inefficient and ineffective at generating value added suggestions with respect to logical candidates. Additionally, the Company has not invested in developing a body of content or separate sites for the increasing number of niche consumers who do not need one million profiles throughout the world, but unique and targeted guidance on accessing other singles with the same race, religion, sexual or other preference. Accordingly, as the online dating community becomes more sophisticated, the Company is at risk of consumers placing greater value on the technological superiority and focus of a network rather than on sheer size.

Finally, Match's breakneck growth pace and commitment to remaining focused on the online dating segment may have served as a hindrance to forming efficient structures, routines and cultures which encourage synergistic developments between the Company and its parent's other media properties. The Company operates as an independent silo, coordinating with other USA properties only to share advertising space (which could just as easily be done through contracting alone). While Match has a broad focus within its particular segment, it remains a relatively narrow and specific online content service provider with access to only a limited portion of the population. By not exploiting its relationship with other online providers it has failed to capitalize on potential economies of scope (i.e. spreading of brand building, marketing and technical development costs across an number of online content or other services). This could represent a fatal flaw as companies like Yahoo!, with access to over



93 million users and 1.5mm paid subscribers become increasingly more interested in capturing the excess profits that the online dating industry has enjoyed.

The Company's critical sources of future competitive threat include: 1) disintermediation by large diversified gatekeepers, such as Yahoo! or Google and 2) the erosion of network benefits and scale economies due to increasingly more effective niche players. These niche players will target specific demographics based on religion, ethnicity, and other factors, and have the potential to gain market share and momentum where Match may not have any. In the following recommendations, we address how Match can combat these threats and indeed achieve a sustainable advantage and position as the online dating leader.

### **RECOMMENDATIONS:**

We have segmented our strategic recommendations into three categories: Enhance Differentiation Advantages, Leverage Corporate Synergies, and Preempt Positional Disintermediation. Below, we explain the details of our recommendations, providing support as to how they will increase revenue per subscriber, expand Match's user base, and erect sustainable barriers to entry.

#### ***Enhance Differentiation Advantages***

The company must improve its technological platform and resulting consumer value proposition. The two primary subjects of such technological improvement would be the site's search algorithm and database field relevance. UDate, Match's recent acquisition, has search algorithms and database field designs that are superior to Match's, and thus Match needs to exploit this advantage to further its differentiation. This tactic will expand the company's user base, as more people experience and realize the value of the superior product.

Match also needs to increase the frequency and geographic presence of its offline events, such as happy hour mixers, group date nights, Match.com-sponsored plays and shows, and other types of social gatherings. Such events are revenue generating business activities (by securing sponsorship) and powerful marketing vehicles. The increase in perceived ubiquity of Match as a result of such events enhances the potential for tipping the industry towards utilizing Match as the singular standard, thus reinforcing barriers to entry and securing new users as the Match name becomes synonymous with dating-related social activities nationwide.



Finally, Match should exploit the valuable information housed in its database and readily accessible through observation and survey of its rapidly growing network. The company is in a unique position to become an authority with respect to its industry and societal trends in general. In a discretionary and legal manner, Match can provide extremely robust data regarding dating demographics, ethnic makeup, financial data, and a host of other significant figures. The company has already been quoted in several publications on the topic of dating industry data, and it should further explore the opportunities therein. This tactic would serve to: 1) increase the value of the network as Match could use the data to provide meaningful guidance to its customers; 2) draw in new users to the increased perception of Match as the standard in online dating (due to its expert status); and 3) increase revenue through the sale of processed information to publications or marketing research firms.

***Leverage Corporate Synergies.***

With respect to its corporate strategy, Match must take full advantage of the resources in USA Interactive, beyond the occasional advertising bartering that has defined its current strategic relationship. Specifically the Company must establish cross-functional teams and mechanisms for communication to share best practices, generate creative content and exploit relevant technological advances. For example, the company could work with USA to create a reality-based dating show (similar to “Elimidate” or “Blind Date”). Such an endeavor would provide Match with increased brand awareness, USA with pop-culture relevant programming, and would create additional advertising revenue streams for both entities.

In addition, the company should leverage its connections to CitySearch, Ticketmaster, and USA Interactive’s other online properties. With CitySearch, Match should enter into a technological and marketing agreement, whereby CitySearch could provide Match users with real-time suggestions for restaurants, date activities, and social gatherings. Users would receive greater value from these enhanced information sources, and the resulting superior product would expand Match’s user base. Such an information-sharing approach can also be applied to promotions with Ticketmaster and Expedia.com. These synergies are indeed relevant, accessible, and potentially very powerful.



### *Preempt Disintermediation*

Finally, Match must preempt competitors from gaining access to economically viable positions if it wants to dominate the online dating industry. One specific way to achieve this goal is to focus on niche markets. As the general culture grows in heterogeneity but ironically moves towards homogamy, Match must exploit its economies of scale by targeting religious, ethnic, age-based, sexual orientation-based, socio-economic, and several other demographically spliced segments. Specific differentiation will allow Match to garner momentum and presence in markets (e.g. the South Asian and Korean matrimonial ad market) that previously were unavailable to online dating sites. Match can approach these markets by employing its own brand or by private labeling its service to existing leaders (e.g.: the India West publication for South Asian matrimonial ads). Along these lines, Match.com can even impose different pricing strategies, with premium pricing to those who want more specific or focused dating markets. By offering its existing partner companies access to additional, more niche oriented sites for a small premium for example (effectively bundling the products), it could populate a new site rapidly and generate incremental revenues from its existing subscriber base. This could drive an expanded user base, increase revenue per subscriber, and defend barriers to entry as Match gains preemptive strongholds in these niche markets.

Secondly, to stave off the entry attempts of powerful gatekeepers like Yahoo! and Google, Match must constantly strive to improve and upgrade its products and services. By utilizing the recommendations mentioned above, as well as efforts such as frequent user programs and tie-ins with other popular sites, Match will be able to increase switching costs and sustain considerable customer lock-in, mitigating the competitive moves made by players like Yahoo! that have huge traffic and subscriber bases. The idea here is to be the best, biggest, and most relevant online dating company.

Lastly, Match.com should explore merger and joint venture options. Matchmaker.com, for example, could be an excellent merger target, as its online dating subscriber base added to Match's would create a potentially insurmountable gap in network size. Additionally, Matchmaker's partnership with Lycos would ensure Match preferential access to a critical consumer gateway. Moreover, the Company can explore making MSN a more strategic joint venture, rather than just a private label partner. With MSN, Match has a traffic base that would allow it to compete with Yahoo! should Yahoo! decide to attack the online dating industry more aggressively.