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Microsoft Buys Stake in Facebook

By BRAD STONE OCT. 25, 2007

SAN FRANCISCO, Oct. 24 — Microsoft has won a high-profile technology industry battle with Google and Yahoo to invest in the social networking upstart Facebook.

The two companies said on Wednesday that Microsoft would pay $240 million for a 1.6 percent stake in Facebook. The investment values Facebook, which is three and a half years old and will bring in about $150 million in revenue this year, at $15 billion.

The deal throws the value of the holdings of Facebook investors into the stratosphere. Mark Zuckerberg, the 23-year-old Facebook founder who followed the path of Bill Gates by dropping out of Harvard to build a company, owns a 20 percent share that may now be worth as much as $3 billion. Accel Partners, the venture capital firm that invested $12.7 million in May 2005, now holds stock that could be worth $1.65 billion.

The investment also ends two months of jockeying among three major Internet players for the right to invest in and forge close ties with Facebook.

Microsoft and Facebook executives said they had met in several cities over the last month and moved toward consummating the deal by sending cellphone text messages to each other while Steven A. Ballmer, chief executive of Microsoft, was speaking last week at the Web 2.0 technology conference in San Francisco.

The final negotiations were completed Wednesday morning in Facebook's offices in Palo Alto.

As part of the deal, Microsoft will sell the graphical banner ads appearing on Facebook outside of the United States, splitting the revenue. Microsoft has an existing deal with Facebook to run banner ads on the site in the United States through 2011.

The astronomical value placed on Facebook is evidence that Microsoft executives believed they could not afford to lose out on the deal. Google appears to be building a dominant position in the race to serve advertisements online. Fearing it might lose control over the next generation of computer users, Microsoft has been trying to keep up with and in some cases block Google's moves, even if that effort is costly.

"We are now stepping outside what is typically a business decision," said Rob Enderle, the founder of the strategy concern Enderle Group. "This was almost personal. I wouldn't want to be the executive that's on the losing side at either firm."

In a conference call with journalists and analysts, Kevin Johnson, president of the platforms and services division at Microsoft, described the deal as a "major advertising syndication win for Microsoft."

"The equity stake that we are taking in Facebook is a strong statement of confidence in this partnership," Mr. Johnson said. "It's a statement of confidence in the fact that our advertising platform is going to get stronger and will help monetize Facebook."

On the same call, Mr. Van Natta responded to a question about reports that both Yahoo and Google were bidding to invest in Facebook by saying, "We were very fortunate to have a lot of folks interested in a partnership with us around advertising."

Mr. Van Natta said the investment would allow the company to more than double its work force to 700 employees by the end of next year. He also said it would help Facebook expand internationally and buy the technology to help keep up with its rapid growth. Facebook says it has 50 million active members and is adding 200,000 new ones each day.

MySpace, the site owned by the News Corporation that is Facebook’s main rival in social networking, has more than twice as many members but is growing more slowly.

The two companies left several questions unanswered. Facebook hinted that it had other investors alongside Microsoft, but declined to say who they were or how much money they had injected into the company. It was also unclear whether Facebook would involve Microsoft as it continued to develop its own advertising network to serve ads on portions of its site. Facebook has plans to introduce an advertising system at an event in New York City next month.

Speaking with reporters after a conference for analysts at Google headquarters, Eric E. Schmidt, Google’s chief executive, declined to comment about losing out to Microsoft, but suggested that Google would be open to collaborating with Facebook. Google already makes money on Facebook indirectly, by selling ads inside third-party applications that run on the site.

A person briefed on the discussions said Google had dropped out not because of the financial terms, but because the proposed deal did not give it enough say in the development of their joint advertising efforts.

Facebook’s $15 billion value also represents a belief that the company is creating an important new operating system that, unlike Microsoft’s Windows, exists on the Web instead of on personal computers. In May it began inviting other companies and outside developers to create tools for the site and share in the advertising revenues.

The move unleashed a flurry of activity around the social network. More than 5,000 applications, like games and music-sharing tools, have since been created for the site, a step that has in turn accelerated Facebook’s membership growth.

“Once a social operating system takes over a country, it’s like it becomes the native language of that country,” said Lee Lorenzen, a venture capitalist who has invested in companies making Facebook applications. Mr. Lorenzen noted that Google's Orkut dominates Brazil, Friendster dominates the Philippines and Facebook is becoming the dominant forum in the United States, Canada and Western Europe.

Facebook boosters say social networking represents the future of online activity. Advertisers are attracted to these sites because they offer an opportunity to aim ads at particular users who are likely to be interested in their product or service.

Mr. Lorenzen and other investors are often dismissive of MySpace. "MySpace is not based on authentic identities," he said. "Facebook is based on who you really are and who your friends really are. That is who marketers really want to reach, not the 'fantasy you' that lives on MySpace and uses a photo of a model."

The News Corporation bought the parent company of MySpace in 2005 for $580 million. That amount seems small now, an indication of how fast the value of Web companies has risen in the current climate of optimism.

Miguel Helft contributed reporting.

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