

With NBC Pact, YouTube Site Tries to Build a Lasting Business

Internet Video Service Sketches a Path to Profitability

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Over the past decade, large media and tech companies have tried to build mass-market services offering video over the Internet. Someone has finally succeeded big: a startup with 35 employees and an office over a pizza restaurant.

Through YouTube Inc.'s Web service, consumers view short videos more than 70 million times a day, ranging from clips of unicycling jugglers and aspiring musicians to vintage Bugs Bunny cartoons and World Cup soccer highlights recorded from TV. Users post more than 60,000 videos daily, with a limit of 10 minutes for most clips.

The big question for YouTube now: Can it turn this loose bazaar of videos into an enduring business?

It will take a step in that direction today when it gets a big endorsement from General Electric Co.'s NBC Universal. NBC plans to announce that it will make available on YouTube promotional video clips for some of its popular shows, such as "The Office," "Saturday Night Live" and "The Tonight Show with Jay Leno." NBC plans to market its new fall lineup using clips on YouTube, and is holding a contest for consumers to submit their own promotional videos for "The Office." It will also buy ads on the site and promote YouTube with mentions on television. That's a significant step for NBC, which earlier had demanded that YouTube take down clips of its programming. (Time Warner Inc.'s Warner Bros. has made a deal to distribute movies and TV shows via Guba.com.)

YouTube is a classic Silicon Valley garage-to-glory tale. Two friends, Chad Hurley and Steve Chen, started a company in a garage to tackle an issue they were grappling with personally: how to share home videos online. They maxed out Mr. Chen's credit card on business expenses before a financier bankrolled them. They built a huge consumer following under the noses of richer, better-known companies with vastly larger payrolls. The young company burst forth as the dominant player.

But for every Apple Computer Inc. or Google Inc., Silicon Valley's history is filled with dozens of hot startups that gained 15 minutes of fame but couldn't sustain their brief success. YouTube's executives, including some alumni of Internet flameouts, are now furiously planning strategy and making deals to sustain their upward arc.

YouTube's 29-year-old chief executive, Mr. Hurley, and its 27-year-old chief technology officer, Mr. Chen, see two big challenges. The first is to figure out how to make money. The second is to address concerns of copyright holders that many of their TV and movie clips, music videos and songs are available through YouTube without

permission.

Messrs. Hurley and Chen, who worked together at eBay Inc.'s PayPal electronic-payment unit, are trying to tackle both issues with a major stroke. They're quietly building an online-ad system with Google-scale ambitions, which they intend to use to entice producers to post their best videos on YouTube. When the system rolls out later this year, YouTube will share revenue from ads that appear alongside some videos with the producers of those videos. Messrs. Hurley and Chen hope that Hollywood will come to see YouTube much as it now views network TV: a legitimate means of distributing content with revenue and promotional payoff.

With stepped-up ad sales, YouTube could become a bigger target for lawsuits. While much of its content consists of home-shot videos, critics say the most-viewed items often involve some type of copyright infringement. On a recent day, top-viewed videos included clips from "Today" and "The Daily Show," a shaky "Radiohead" concert video and World Cup soccer highlights recorded from TV.

YouTube says it removes clips when content owners request it, under a procedure outlined in the Digital Millennium Copyright Act of 1998. In some cases, copyright owners such as TV producers put the clips on its site themselves in order to generate buzz or to test ideas.

NBC has been among the media companies most actively requesting YouTube to take down videos that users have uploaded without permission. With today's agreement, NBC seeks to promote its shows to YouTube's audience while getting assurances that material it doesn't want on the site will be removed. "YouTube has done their work on protecting copyright and we have assurances from them they will continue to do so," says NBC Universal Television Group Chief Marketing Officer John Miller. "They are a bright light, they have a lot of traffic," he adds.

Based in San Mateo, Calif., YouTube got its start in February 2005, after a dinner party attended by Mr. Hurley, who studied design in college and sports shoulder-length hair, and Mr. Chen, a Taiwan-born engineer with small hoops in each ear. They took videos of the party, but grew frustrated when they tried to share the footage with friends. They set out to build an online service that would let them do just that. At the time, Mr. Chen was still working at PayPal. Mr. Hurley, who had designed PayPal's current logo during his 1999 job interview there, was doing consulting work.

They set up shop in Mr. Hurley's Menlo Park garage. In May 2005, they released a test version of the site on the Web with no marketing. Early videos available prominently featured Mr. Chen's cat, PJ.

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Building a Following

The site quickly built up a following. It stood out from the growing corps of online video services, including an offering from Google, for its simplicity. YouTube serves up videos from its Web site directly or from other sites where people insert them, generally not requiring users to download any special software. To accomplish this technical feat, YouTube drew on open-source software and wrote its own code. The service can handle about 110 video formats and 64 audio formats used by digital photo and video cameras and cellphones.

It also let consumers display its videos on other sites, such as blogs or personal pages on News Corp.'s popular MySpace social networking service. Users could easily upload the video and email links to YouTube videos to each other. The influential techie site Slashdot's mention of YouTube helped boost traffic.

After seeing Mr. Chen at a party last summer, former PayPal Chief Financial Officer Roelof Botha put some clips from his honeymoon in Italy on the site. Now a partner at venture-capital firm Sequoia Capital—known for backing Apple, Cisco, Google and Yahoo, among others—Mr. Botha invited the YouTube co-founders to his office in mid-August. Mr. Botha says that their project shares a key attribute with some of those tech legends: “building something for a personal need that winds up being universally useful.”

By September, users were viewing YouTube videos more than a million times a day. Plotting strategy with Mr. Botha in October, the YouTube founders still believed their main business opportunity involved individuals sharing home videos. The next month, they announced Sequoia had injected \$3.5 million to help finance the company.

But it started becoming clear to YouTube that users were sharing more than just their own videos, and viewership stretched far beyond circles of friends. By the time of the site's official public release on Dec. 15, consumers were viewing YouTube videos more than three million times daily. Millions of users had watched clips starring Brazilian soccer star Ronaldinho posted by sneaker giant Nike Inc. A few days later, someone posted to YouTube a skit from NBC's “Saturday Night Live” dubbed “Lazy Sunday,” featuring two grown men rapping about cupcakes, red licorice candy and “The Chronicles of Narnia” film.

After it turned up among user favorites on the site, Mr. Hurley on Dec. 28 emailed a contact at NBC. He asked whether NBC had provided the clip itself, and volunteered to remove it from YouTube if the video had been shared without NBC's permission. The NBC staffer replied that he didn't know the answer, but would look into it, Mr. Hurley says.

Consumers viewed “Lazy Sunday” six million times before NBC on Feb. 3 contacted YouTube to request that it be removed, along with hundreds of other clips including Jay Leno monologues and video from the Winter Olympics.

Run-In With MySpace

YouTube's rising popularity led to run-ins with others. In December, MySpace blocked users from playing YouTube videos on their MySpace pages. Consumer outcry followed and MySpace activated the YouTube feature again. A News Corp. executive later said MySpace was concerned that the YouTube videos contained porn, and only reactivated them once YouTube had given it assurances about porn filtering. (YouTube says it removes any pornography after users point it out.) Shortly after the incident, MySpace released its own video service to compete with YouTube.

As YouTube users began complaining that the system was slowing, the company spent more on technology. In January, it began displaying limited advertising to help offset its rising costs for computer equipment and telecom lines. Mr. Chen predicts YouTube will open one new data center with computers to run its service each month this year.

Thanks partly to its use on MySpace and the Saturday Night Live clip, YouTube quickly became a cultural phenomenon. Amateur video enthusiasts created their own video tributes to “Lazy Sunday” that they titled “Lazy Monday” and “Lazy Muncie.” Videos of young people, including two Chinese students, hamming it up in front of Webcams while lip synching to popular songs were viewed millions of times.

Along the way, the entertainment world began exploring how it might benefit from YouTube's audience. The Weinstein Co., a movie company run by producers Bob and Harvey Weinstein, in April premiered the first eight minutes of the film “Lucky Number Slevin” on YouTube. Viacom Inc.'s Paramount Vantage movie unit last Friday posted exclusively on YouTube an 83-second animated clip poking fun at Al Gore to promote its “An Inconvenient Truth” film. By midday yesterday, it had been viewed nearly 600,000 times. “As a marketer you almost can't find a better place than YouTube to promote your movie,” says Andrew Lin, vice president for interactive marketing at Paramount Vantage. Viacom owns YouTube rival ifilm.

Still, there were bumps. C-SPAN asked YouTube to take down popular clips of an appearance by television personality Stephen Colbert at the White House Correspondents' Association dinner in April. C-SPAN distributed the clips free through Google's video service.

Some top tech and entertainment executives have lambasted the company—while others have showed grudging

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admiration. Microsoft Corp. Chairman Bill Gates in May told attendees of The Wall Street Journal's "D" technology conference that, given the copyright issues and the lack of a clear path to profitability, his company would be "in a lot of trouble" if it did what YouTube has. But he also acknowledged spending time on the site. "I saw a bunch of old Harlem Globetrotters movies up there the other night, it's great," he said.

Google and other YouTube competitors also stepped up their games. Google simplified its video-upload interface to match what YouTube had been offering. Yahoo this month upgraded its video service to allow consumers to submit videos directly to it, competing more squarely with YouTube.

Rumors have circulated in recent months that some major media companies have expressed interest in buying YouTube. In response Mr. Hurley says the company is not for sale. He says an initial public offering in the future is a possibility.

The YouTube co-founders decline to provide many specific details of the ad system they expect to gradually begin rolling out next month. But they say they're not fond of commercials that play before a user can watch a video, known in the industry as "prerolls." YouTube recently hired Yahoo sales executive Tony Nethercutt to build its sales team.

Submission by Cellphone

Consumers can now submit videos from their mobile phones, and Messrs. Chen and Hurley say they one day should be able to view YouTube clips on phones and other devices. They say they'll potentially expand beyond video to audio and other content.

For now, YouTube remains by far the most-visited video site on the Web. It attracted more than 20 million U.S. users in May, compared with 11.1 million for Microsoft's MSN Video and around seven million for both MySpace's video site and Google Video, according to research firm NetRatings Inc. YouTube says behavior indicates that users are most interested in viewing clips three minutes or shorter.

"We're at the fork in the road where Google was at maybe four or five years ago before they rolled out" their current ad model, says Mr. Chen.

A big question is whether more advertising and promotions will drive away some users who like the site's edgy feeling. Consumers spoke up earlier this year when YouTube's home page began to highlight in yellow links to videos from official content partners, questioning the preferential treatment. In response, YouTube quickly removed the yellow highlighting from the page.