

Virtual E-Business with ‘Second Life’

Chances and Challenges for today’s Enterprises

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Abstract: ‘Second Life’, the “[...] 3-D virtual world entirely built and owned by its residents [...]” [1] provides great opportunities of starting up new businesses in this virtual world – for both, already existing traditional enterprises and new founded companies. The investment costs are extremely low, due to the low prices for ownership of real estates and islands and for rents and leases of offices for instance. Finally, the production costs of ‘virtual material goods’ are very low as well, combined with the advantage of having unlimited stocks. Other chances are to build up subsidiaries in many cities and regions within ‘Second Life’ in a very short time, building up second trade mark strategies, testing new products and labels before pushing them onto traditional markets up to the possibility of doing business in completely new branches. A great advantage but also a threat for conventional enterprises are the brand and customer loyalties – that is, the residents in ‘Second Life’ will buy and use the same products and services as they do as individuals in real life and possibly vice versa since the virtual world is also a good chance to try out new clothing and outfits, new hairstyles, etc. Also potential real life barriers like warranty claims for material products are blown off in this virtual world.

On the other hand, this huge, great and almost unrestricted virtual electronic marketplace holds some challenges, threats and a lot of open-end questions about currency exchange, earnings and losses, taxes, law and order. One of the biggest challenges are – similar to the real world business – the product placement and the commercialization of products and services in ‘Second Life’, starting with the choice of an adequate location within this huge and unlimited virtual world, building up marketing and sales strategies, getting virtual customers and the transferability into real life and vice versa. Another challenge is to adapt the traditional goods and services process to make them suitable for virtual electronic business.

Keywords: Second Life, Virtual Electronic Business, V-Business, Virtual E-Business

1 INTRODUCTION

Who hasn’t ever dreamt of having a second life? Meanwhile this dream became (virtual) reality in ‘Second Life’. In public as well as in many populist discussions, magazines and blogs ‘Second Life’ is often called a game. It is true that it could also be a global game for the players, named residents, in this virtual world. But ‘Second Life’ is much more. Within the last years since its foundation in 2003 on June, 23rd it grew up spirally, consequential and more and more exponential to a seriously taken business with USD 2.6 million trading volume [2] at round about 10.7 million transactions [3] in November 2006. The trading volume in the reference period one year ago was only USD 0.3 million [2].

Today a wide variety of companies of all industries like Adidas, Amazon, American Apparel, BMW, EnBW, Mercedes-Benz, Sony BMG, Toyota and Vodafone have built up virtual branches, agencies and stores in ‘Second Life’. Also newswires, radio stations and publishing companies such as Reuters, BBC and Axel Springer Verlag are participating actively in this virtual world. The German boulevard magazine ‘Bild’, for instance, published the first edition of the online magazine ‘The Avastar’ on December 21st, 2006 [4]. Finally, individuals started their own virtual trade-off, rent and lease businesses or doing trading with acquired real estates and islands.

So, the question could be, why it is interesting for mankind to participate in a virtual world. On the one hand it is the possibility to exchange the real, over-directed life with a new one which can be created by the individual himself [5]. In this context this virtual world can offer a diversity of things which are impossible to buy, to have or to do in the real life for most people, like buying an expensive sports car at a fraction of the real costs, having an island for oneself or to hold down an exciting job as a disk jockey, model or fashion designer [6]. On the other hand the interpersonal social behavior has developed from door-to-door and place-to-place up to person-to-person relationships – a social network of individuals [7].

But ‘Second Life’ is, of course, no closed economical and financial circuit. On the one hand real money must be exchanged into ‘Linden Dollars’ – the virtual currency, traded at the virtual user-to-user commerce market, the ‘LindeX Currency Exchange’, and vice versa. Otherwise, real companies are selling (virtual) products and services in ‘Second Life’, providing services for the online communities and people are working as employees for virtual enterprises. An example is the IBM Corporation, which “[...] is ramping up its push into virtual worlds with an investment of roughly \$ 10 million over the next 12 months [...]” [8]. The EMDS AG, Stuttgart, Germany built up a new virtual convention center and a virtual booth for the CeBIT trade fair in 2007. Furthermore, Sun Microsystems, Inc. expressed the significance of ‘Second Life’ in a press release in October 2006: “Sun Microsystems will launch its presence in the virtual world Second Life next week, holding the first ‘in-world’ press conference by a Fortune 500 company at the opening of the company’s new virtual Sun Pavilion.” [9].

The most interesting on-going and upcoming things are the convergence and conflation of real world and virtual businesses on the one hand and the harmonization of principles and standards on the other hand. However, this will have a major impact on economical and social behavior, even on corporate identities and cultures. But this will be likewise a chance and a challenge for almost all of today’s and future enterprises. For the individuals, however, this brings along a number of opportunities and shows that the residents will remain the most important factor in ‘Second Life’ [10].

2 VIRTUAL ELECTRONIC BUSINESS

According to the definition of electronic business of Wirtz [11] virtual electronic business is the initiation and the partial respectively complete support, development and maintenance of performance exchange processes by using electronic networks and internet based electronic intermediaries within the internet economy, see also Figure 1. An intermediary such as ‘Second Life’ also promotes the disintermediation – the elimination of interstages like wholesale traders and retailers within the distribution chain.

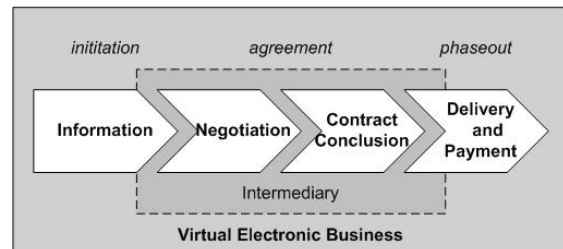


Figure 1 Performance Exchange Process [12]

Furthermore, in this context the intermediaries could also act as ‘information intermediaries’ or ‘infomediaries’ under the precondition that they are able to support the information exchange process between transaction partners.

If an enterprise intends to do virtual electronic business in ‘Second Life’ this can be done in three ways:

1. Doing any kind of advertising for real world products and services within ‘Second Life’ that the individuals behind the residents will buy the products and services in the real world like shoes, cars and mobile phone contracts. This is the common goal of probably all enterprises which are located in ‘Second Life’.
2. Trading with real world products and services by using ‘Second Life’ as an intermediary while promoting products and services – equivalent to point 1 – in ‘Second Life’ and linking to an online

shop outside 'Second Life' where the products can be bought or to a website where the individual behind the resident can offer services or get in contact with a consultant or sales representative.

3. Trading with virtual products and services within 'Second Life'. In this case 'Second Life' is much more than just an intermediary as the whole process exchange transaction is done completely in this virtual world by using the 'Second Life' currency – 'Linden Dollars'. In this case the only restrictions are the daily and monthly billing and trading limits, depending on the personal account [13].

In the first case only the initiation phase of a virtual electronic business transaction is concerned whereas in the following two cases the whole performance exchange process takes effect.

The advantage for well-known companies like Adidas, BMW or Vodafone is their publicity and reputation they firstly bring in into 'Second Life'. In this virtual world, however, they have the possibility even to increase their reputation via the so called 'Electronic Branding' which will then have a positive effect onto real world business.

3 CHANCES

3.1 Doing new business in 'Second Life'

First, there are great opportunities of starting up new businesses in this virtual world – for both, already existing traditional enterprises and new founded companies. Ideally, the virtual foundation can be done within a couple of minutes. There is no need for extensive registrations at registration courts, tax authorities and insurances for example. The investment costs are extremely low, due to the low prices for ownership of real estates and islands and for rents and leases of offices although the virtual world follows real world principles that is, rents are quite high in business quarters or shopping streets in comparison to those in rare populated areas. Otherwise there are no fixed running costs for electricity, heating or water.

The challenge hereby is the choice of the best location.

Another possibility, 'Second Life' offers, is to create new business models. Contrary to a new business or a branch in 'Second Life' enterprises can offer products and services from outside of their original industry. This is similar to the evolution in the telecommunication branch whose companies offered billing services for different service provider a couple of years ago.

A business model with an increasing growth – beyond the trading with lands and buildings – is the so called 'real-life education' in 'Second Life' to teach other people, to hold conferences or just to arrange world-wide virtual meetings or press conferences by using streaming media technologies [14].

For individuals 'Second Life' provides a variety of job opportunities – in the real world to work as a graphic designer, programmer, script author, landscaper or animator as well as in the virtual world, starting with employments as camper, greeter or shop attendant up to architect, journalist, casino operator or bodyguard [6].

3.2 Worldwide business market and low production and distribution costs

In 'Second Life' companies with the intend of selling products have two enormous advantages in comparison to their real life businesses:

1. 'Second Life' is one unrestricted worldwide global business market.
2. With regard to selling virtual products the average production and distribution costs are extremely low.

The 'Second Life' global business market is, on the one hand, comparable with an online shop in the real world. The benefit is that products like cars, mobile phones, shoes or clothing can be virtually accessed, viewed in different perspectives and eventually tried on.

The selling of virtual products will mainly offer two benefits to a company – on the one hand the opportunity to bring a new product in a form of a virtual prototype in a very short time to market where it can be used by the residents. In case that this product is a complete success the company can start the real world

production process. On the other hand there are the low average production and distribution costs whereas the production costs will be the so called ‘first copy costs’ and the distribution costs will tend to zero under the precondition that the products can be sold automatically without manual support by a shop attendant, see also Figure 2.

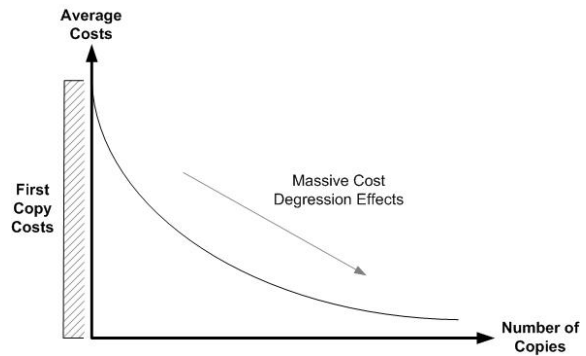


Figure 2 Decreasing average costs by increasing number of copies [15]

3.3 Marketing aspects

Doing virtual electronic business in ‘Second Life’ combines the amenities of both, one-to-one marketing and mass customization. This is enabled by:

- Individual customer relationships with a lot of knowledge about these individuals as most of them act as residents in the virtual world like they want to be in the real world.
- Products and services are easy to create, to build and to offer. The time-to-market tends to only a few days. Therefore, companies can react immediately on the changed needs of their customers.
- The cost advantages of a mass production are very high due to the massive cost degression effects (see also Figure 2) [16].

A point of principle, however is, if there are enough potential customers in the ‘Second Life’ network. In fact, as of end of February 2007 there are over four million registered total residents – but only at a sufficient amount of participants (which is not easy to define in this fragmented virtual world) the ‘critical mass problem’ will be vanquished and other network effects will take effect, such as:

- ‘Metcalfe’s Law’, the exponential coherence between the worth of a network performance and the amount of users.
- ‘Network externalities’, the consequences to other network participants due to the participation of one individual.

Another important aspect concerns the customer’s loyalty. The characteristics of the electronic business customer’s loyalty strategy are informatization, digitization, virtualization, convergence, prosumption, immediacy and globalization [17] – criteria, which are completely fulfilled in virtual electronic business to establish the so called ‘e-loyalty’.

4 CHALLENGES

4.1 Getting the location of choice

Since ‘Second Life’ is not limited to a restricted amount of land areas the choice of the best location is really a challenge. Basically, this depends on the type of business, if somebody is going to sell virtual products in a shop or offers services. But independent thereof attention is need. For setting up a shop, for example, this will be much easier in a busy shopping street, where, of course, the rents are quite high, than at a lonely spot with a wide range of untenanted shops to rent. It is also advisable to be in good neighborhood, even if these are competitors – so you can profit twice: being in the near of well-known companies and having the advantage of being noticed by the residents, maybe because their primal intention is to go to the competitor.

Since almost every week another main center is built up it is often only a question of time when the residents will move to another point of interest. To face this problem some companies have already built up several virtual settlements and local branches in different main centers.

The most popular example for a person who is trading with so called ‘sims’ (squares, named ‘regions’ with land or the possibility to build up land on them), lands and buildings is Ailin Graef, better known as Anshe Chung [18]. As of February 2007 this real estate tycoon is also the richest ‘Second Life’ resident [19] and owner of the Anshe Chung Studios in Wuhan, China with about 50 employees. They are creating virtual land and building up virtual real estates on the ‘Dreamland Continent’ [18]. As on February 22nd, 2007 no ‘sims’ or so called ‘prims’ – three-dimensional geometric objects which can be a simple square as well as a complex object like a piece of land – are available for sale [20].

4.2 Taxes, law and order

The most challenging issues for enterprises as well as for private persons are taxes in relation to ‘Second Life’. First, there are the three different types of doing virtual electronic business:

1. Advertising in ‘Second Life’ and executing real world transactions.
2. Trading with real world products and services by using ‘Second Life’ as an intermediary.
3. Trading with virtual products and services only within ‘Second Life’.

Regarding the first two cases, these transactions are subjected to tax laws as any other real world transactions.

The interesting point is the third case. Since the only financial interface between the real world and ‘Second Life’ is the virtual user-to-user commerce market, the ‘LindeX Currency Exchange’, individuals and companies will exchange real money into ‘Linden Dollars’ – the virtual currency – and vice versa. The balance of a period between exchanging real money into ‘Linden Dollars’ and back again are earnings or losses. These have to be reported to the real world tax authorities and if required in the balance sheet and the annual financial statement of a company. The rules differ, depending on the place of residence of the enterprise or the individual in the real world [21].

Contrary to the public opinion, earnings and losses are neither exchange profits nor losses by exchange, because the ‘Linden Dollars’ are not traded at any official foreign exchange trade.

Concerning law and order, “[...] There are no laws, no courts and no lawyers in Second Life. There are only the Linden authorities [...]” [22]. Although this obviously seems that ‘Second Life’ is a territory beyond jurisdiction it is not. At least any action, including the performance exchange processes, is effective in internet law.

4.3 Changes to the goods and services process

Participating in the ‘Second Life’ virtual electronic business trade means some changes to the goods and services processes mainly for industrial enterprises and manufacturers. In the real world these firms have to manufacture each product they want to sell. In ‘Second Life’ this is also possible, though the products are virtual. Normally, this only makes sense for make-to-order productions like exclusive clothing. Most of the products are sold as virtual digital copies of the original – the so called ‘prims’. This is comparable to the serial production in the industry. Although this is a great advantage with regard to the product development and a break even analysis (see Figure 3), the manufacturer has to meet the challenge that he has to create the first copy of the product – the digitized product. And to take a look at a automotive manufacturer, for instance, this creation process is completely different from what he is doing

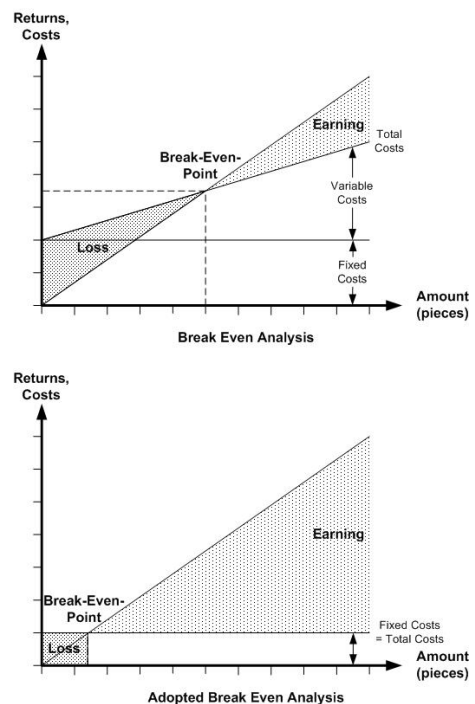


Figure 3 Break Even Analysis in comparison [23]

normally in the real world. Therefore, graphic designers, script authors, programmers and animators are needed instead of engineers, draftsmen and workers – also to build up lands, buildings, interiors and so on.

5 CONCLUSIONS

‘Second Life’ offers a variety of chances, mainly for building up new businesses, to enhance existing business models or to join (virtual) companies as a (virtual) employee. It can also provide an associated added value for both, enterprises and individuals. The benefit for today’s and future enterprises could be gorgeous and ‘Second Life’ will become a more and more important economic factor. But there are also some challenges which have to be taken seriously to survive and to participate long-term with success as long as ‘Second Life’ will exist.

A big threat however is that long-established and well-known companies will lose reputation if they are participating half-hearted in ‘Second Life’. A real world-wide consequence could be that their reputation will be damaged, their brand equity will decline and, in a worst case scenario, their products and services will not be bought any longer by real life individuals.

For these reasons ‘Second Life’ is already really much more than just a game!

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