Intrinsic Value Thesis for Digital Media:

Foundations of the Creator Economy

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The Problem: Digital media does not fit into the conventional financial model of fundamental valuation.

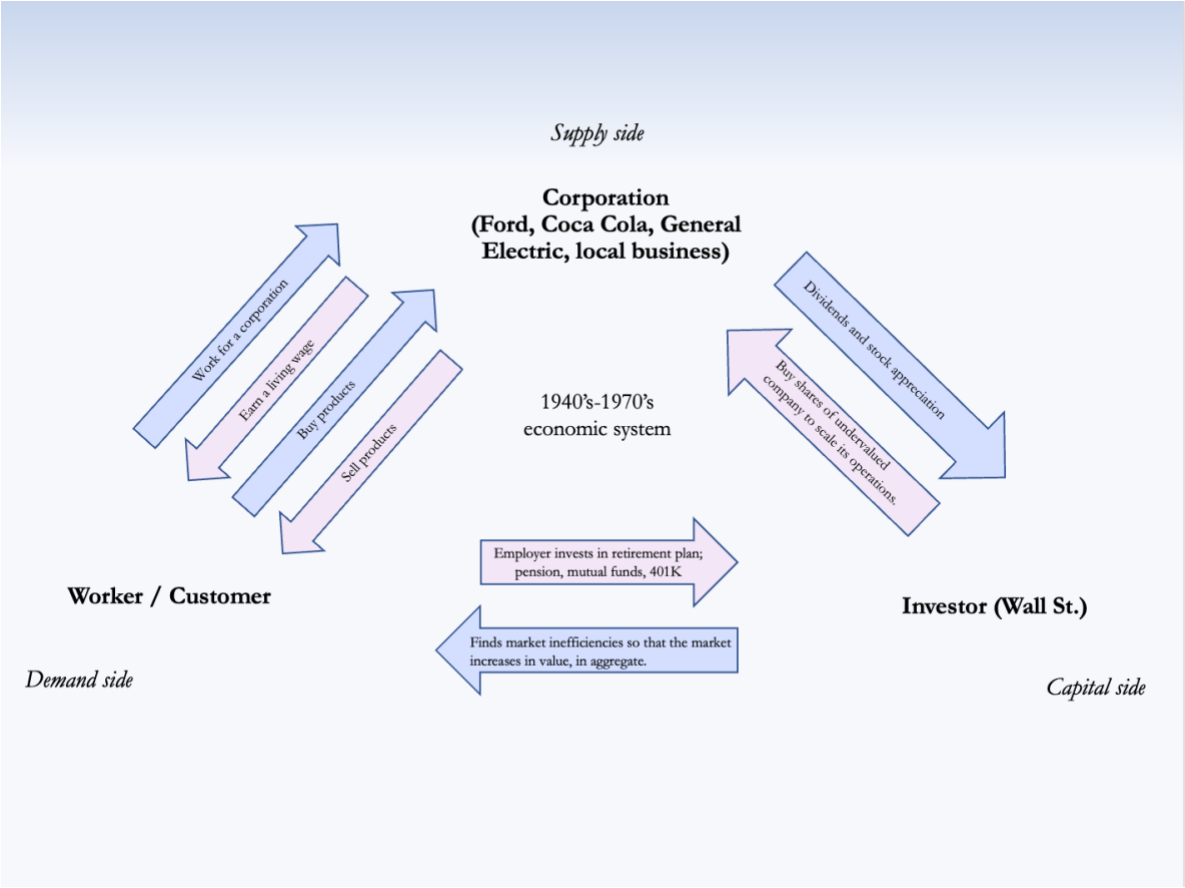
The dot com era companies had flawed business model assumptions, lacking fundamental value. But even the successful digital media companies show deep market failures: monopoly concentration, censorship problems, privacy issues, fragmentation and polarization of society, mental and physical health issues. The lack of fundamental valuation for digital media causes severe problems for the market and for society. This presents an opportunity for economic and social gain.

Let us look at the conventional finance fundamental valuation model. The Benjamin Graham-Warren Buffet model of **fundamental valuation**, is essentially:

Low **price** / high **cashflows** = good fundamental value investment
where,
asset price = aggregation of publicly available information (efficient market hypothesis)
cashflows = revenues / operating expenses (or demand / cost of supply**)**

A fundamental value investor looks at the stock price, looks at the financials of the company he is investing in, and does research on how well the business functions. He then invests if there is a low price relative to future cashflows. This concept of fundamental value was a basic principle of American investment for many years.

Idealized value production economy, a system of mutual benefits:

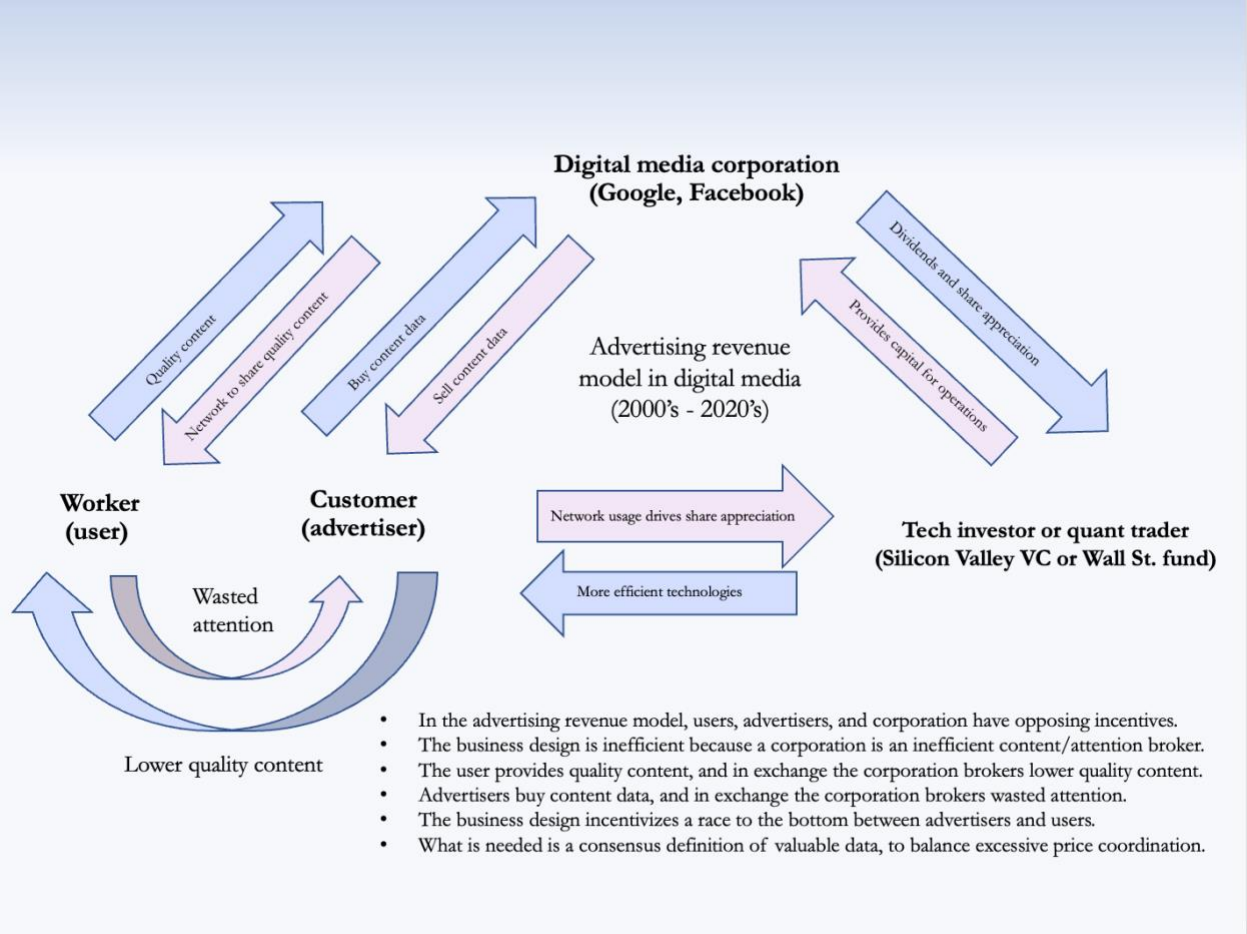


Why doesn't digital media fit into the fundamental valuation model? The **product** that digital media produces is **data**. Data is not limited in supply, only **valuable data** is limited in supply. Yet there is no consensus definition of what valuable data is or how it is limited. Therefore, the implicit economic consensus is that valuable data is defined by market price. However, price is only a *small subset* of valuable data and doesn't determine how valuable data itself is limited. Therefore, **price cannot coordinate the production of valuable data in digital media,** as it coordinates the production of limited supply goods in the conventional economy. The fundamental value model requires that price be an accurate signal of production.

Why can't price coordinate production of valuable data in digital media? Many of the largest digital media companies, like Google and Facebook, use an advertising revenue model. Both users and advertisers are on the demand side, but with opposing incentives around the product (valuable data). Advertisers care more about **price / ROI** of data, not as much about content. Users care more about **content or quality** of data, not as much about price. Price has a consensus economic definition, but content does not; valuable data must include both, or else half of the demand is

excluded. Therefore, **in a digital economy, the economic definition of price requires a consensus economic definition of valuable data.**

Digital media economy with advertising revenue model; a ***race to the bottom****:*



What is the economic definition of valuable data? With digital assets, the economic definition of valuable data becomes more clear. There is less distinction between user, advertiser, and company. Thus, the motives of those who produce valuable data versus its opposite, is more clear. Thus, it is more clear that *content* determines the *price* of digital assets, rather than price determining content. And this applies in the economy more generally. The quality of a good determines its price, the price ought not determine its quality. Valuable data is therefore defined more by content than by price. Then how is valuable data produced, if not by price coordination? Valuable data is produced by **internal coordination** in small collaborative groups. Internal coordination produces valuable data fundamentals such as engineering, incentives, and design. These are the fundamentals that also determine price in digital media more generally. Therefore, the economic definition of **valuable data is: a limited good produced by *internal coordination* in small group communications.**

This economic definition is derived from Ronald Coase's "The Nature of the Firm" (1937). Coase shows that internal coordination is **mutually opposed** to price coordination:

> In view of the fact that while economists treat the price mechanism as a co-ordinating instrument, they also admit the co-ordinating function of the "entrepreneur," it is surely important to enquire why co-ordination is the work of the price mechanism in one case and of the entrepreneur in another. The purpose of this paper is to bridge what

There is a cost to coordination by price mechanism:

> We may sum up this section of the argument by saying that the operation of a market costs something and by forming an organisation and allowing some authority (an "entrepreneur") to direct the resources, certain marketing costs are saved. The entrepreneur has to carry out his function at less cost, taking into account the fact that he may get factors of production at a lower price than the market transactions which he supersedes, because it is always possible to revert to the open market if he fails to do this.

The cost of using the price mechanism is less **internal coordination** (within the firm):

> a firm will tend to expand until the costs of organising an extra transaction within the firm become equal to the costs of carrying out the same transaction by means of an exchange on the open market or the costs of organising in another firm.

and,

> or smaller. A firm becomes larger as additional transactions (which could be exchange transactions co-ordinated through the price mechanism) are organised by the entrepreneur and becomes smaller as he abandons the organisation of such transactions. The question which arises is whether it is possible to study the forces which determine the size of the firm. Why does the entrepreneur not organise one

There is an equilibrium dynamic between price coordination and internal coordination:

smoothly. The question always is, will it pay to bring an extra exchange transaction under the organising authority? At the margin, the costs of organising within the firm will be equal either to the costs of organising in another firm or to the costs involved in leaving the transaction to be "organised" by the price mechanism. Business men will be constantly experimenting, controlling more or less, and in this way, equilibrium will be maintained. This gives the position of equilibrium for static analysis.

Coase's "Nature of the Firm" has a new significance in the context of distributed networks and digital assets. The firm is now small groups of digital collaboration. With Coase in mind, let us return to the original fundamental valuation model:

Low **price** / high **cashflows** = good fundamental value investment
where,
asset price = aggregation of publicly available information (efficient market hypothesis)
cashflows = revenues / operating expenses (demand / supply**)**

Now, we can take the next step:
aggregation of publicly available information = internal coordination / price coordination

Conclusion:

Revenues and operating expenses (or demand and supply) in conventional finance are analogous to *internal coordination* and *price coordination* in digital media. The digital economy produces valuable data through *internal coordination* primarily, and *price coordination* secondarily. What the conventional economy produces- cars, tables, etc.- is now largely influenced by the valuable data that the digital economy produces. Valuable data is also a limited supply good, but in an altogether different sense than a material good. Valuable data is *limited* because internal coordination is extremely difficult.

Why is internal coordination difficult?
How is internal coordination to be measured or evaluated?
How is internal coordination to be applied for economic gain?

These questions are answered in Part II.

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