1.4. The Web: Advertising: **Overview**

The industry hasn't yet connected advertising content with deep user value. In spite of this, and the economic slowdown, analysts predict that huge amounts of money will be spent on online advertising in the coming years.

An interesting thing happened at the washingtonpost.com focus groups of early 2001. All of the focus group members were Internet users with experience levels ranging from novice to expert. Each group was dedicated to answering questions about specific types of content on the Web. Two groups discussed entertainment, two discussed news, one group talked about buying cars online and another discussed online real estate information. Even with all of those different kinds of conversations and with all of the different levels of experience, focus group members described advertising in almost identical terms. Although none used this exact wording, the common description was this:

"If it's not relevant to me, it's advertising. If it's relevant to me, then it's content."

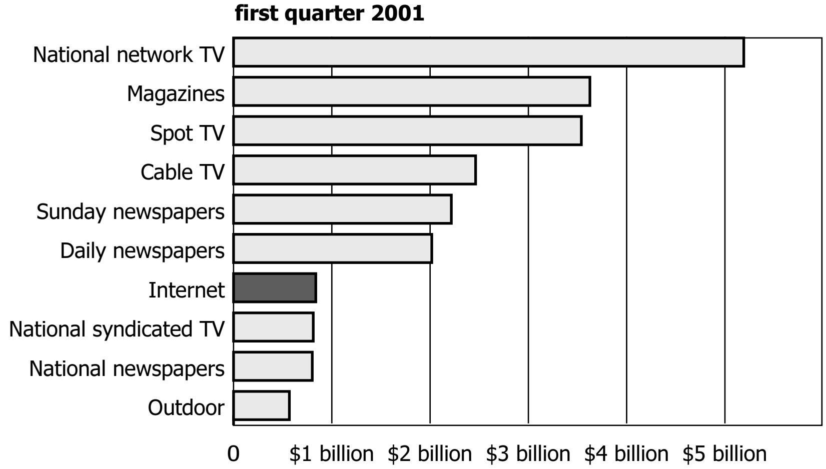
This was especially fascinating in the two classified advertising-related groups. Group members talked about how highly they valued the classified advertising listing information, with no recognition that people had paid The Washington Post Co. to publish the information. (The group members obviously understood that classified advertising is paid for. The point is that because the listing information was the core of the data they were seeking, they treated it the same way the news focus groups treated a news article.)

The focus groups didn't say anything positive about the information they called "advertising." Their use of the blanket term covered tiles, banners, sponsorships, and in a couple of groups, additional information supplementary to the classified listings that they felt weren't relevant enough. Web professionals are dismayed by the plummeting click-through rates for advertising vehicles, but it's a wonder our advertisers get any traffic from their advertising based on the response of our focus groups.

"Web advertising should be valued in terms of the value of the business it creates from the new users it attracts to your site," Web usability icon Jakob Nielsen wrote in 1997. "This value is usually very small, which is why Web advertising works poorly." Under the headline "Why Advertising Doesn't Work on the Web," Nielsen also pontificated:

> "It is amazing how little most Web ads work at attracting clicks: they should recognize that they are one end of a hypertext link and that they have to create expectations as to the value of going to the other end of the link.
>
> "The other end of the ad's hypertext link is the pay-off page. Most often, these pages are highly disappointing and cause the user to back out immediately. This is why even click-

U.S. advertising spending in selected media, first quarter 2001



Change from first quarter 2000 to first quarter 2001

National network TV	▼ (-2%)
Magazines	△ (+0.4%)
Spot TV	▼ (-15%)
Cable TV	△ (+7%)
Sunday newspapers	▼ (-11%)
Daily newspapers	▼ (-7%)
Internet	△ (+33%)
National syndicated TV	△ (+6%)
National newspapers	▼ (-17%)
Outdoor	△ (+6%)

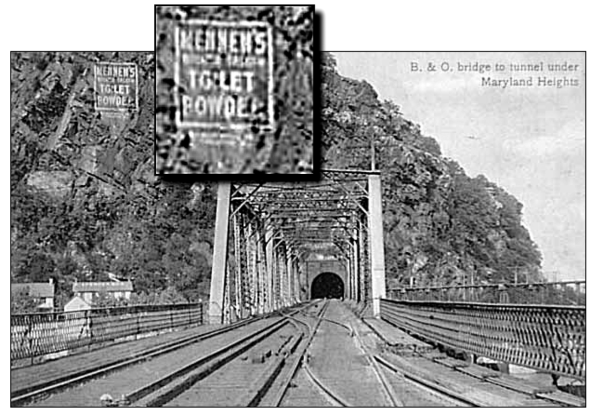
Source: Competitive Media Reporting, June 2001 through is a poor measure of the value of Web ads since it measures the alluring quality of your creative and not the ad's ability to deliver business.

> "[The Web] is a user-driven experience, where the user is actively engaged in determining where to go next. The user is usually on the Web for a purpose and is not likely to be distracted from the goal by an advertisement … The Web is not simply a 'customer-oriented' medium; it's a customer-dominated medium."

eMarketer's August 2001 report "Online Advertising describes a larger challenge for online advertising:

> "The ultimate problem with banners … lies in the overload of media. The number of Web advertisements continues to grow faster than the time spent on the Internet, so Web surfers are being subjected to more and more ads.
>
> "By 2005, the average Web user will see 950 ad views per day. And that's nothing compared with the 4,000+ they'll see when you count television, radio, print and other traditional media."

Some also suggest that there are more elemental forces affecting the success of Web advertising. Microsoft eBook researcher Bill Hill describes users' reactions to animated advertising as a product of evolution. He suggests that early human beings whose fight-or-flight mechanisms kicked in when sudden, unexpected movement occurred within arm's reach lived long enough to procreate. Those that didn't react were killed and didn't procreate. So according to Hill, ingrained in all modern Web users is the idea that animated ads are trying to kill them.

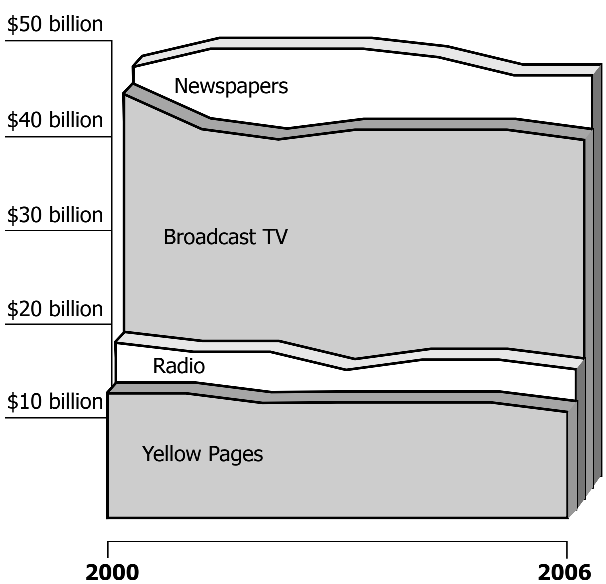


Historic Photo Collection, Harpers Ferry NHP

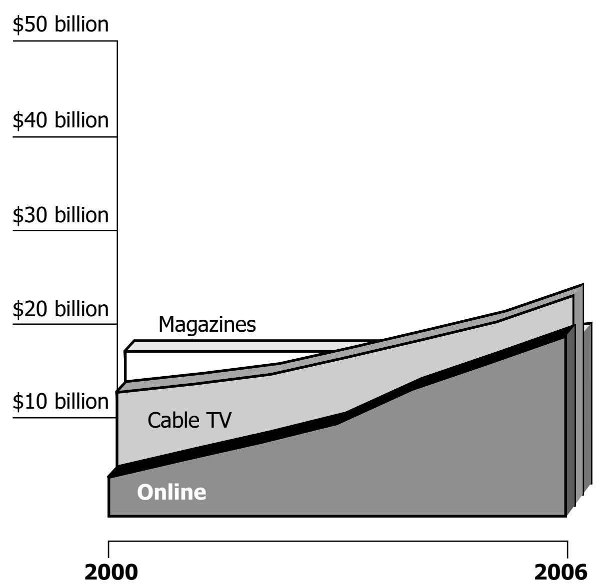
Down, but not out

There's an advertisement for Mennen's Borate Talcum Toilet Powder painted on the side of a cliff across the river from Harper's Ferry, West Virginia. You can imagine the conversation of residents the day the work was completed at the beginning of the 20th century. They likely complained that it was intrusive, that it was obnoxious, and that they never really looked at the thing anyway. There may have been arguments around town about whether the purpose of the ad was to remember the name of the product, or to induce people to buy the product.

Media with declining U.S. advertising spending



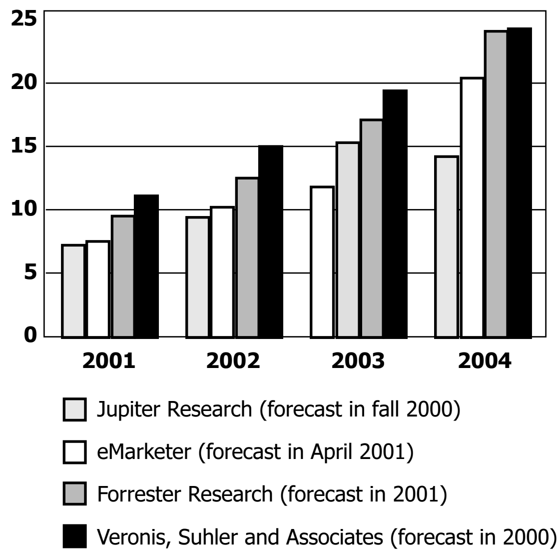
Media with increasing U.S. advertising spending



Source: Myers Group, 2001

So the complaints heard about Web advertising are nothing new. For better or worse, Web advertising is just part of the overall advertising industry.

U.S. online advertising spending forecasts,
in billions



When the U.S. economy took a turn for the worse in 2000, it started a series of events that would seriously affect the advertising industry. U.S. companies started to miss earnings forecasts, stock market values plummeted, venture capital dried up, and advertising budgets everywhere were reassessed and reallocated. And online companies laid-off staff and shuttered their operations.

But in a column in The Wall Street Journal earlier this year, washingtonpost.Newsweek Interactive CEO Chris Schroeder made the case for online advertising's inevitable survival:

> "The Internet has so dramatically changed the way we live and work that, even with the pendulum swings, it's here to stay. Daily user or Luddite, the Internet affects one's life. Its reach and growth, combined with quality news content, can lead to real dollars for media companies.
>
> "... It is unprecedented in media history for this kind of reach, usage and retention not to become a prime advertising vehicle. Not only does the Internet's audience offer unique branding opportunities (what other medium is constantly in front of people at work?), but its interactive capabilities create targeting opportunities that bring both quantity and quality of audience.
>
> "...Even if the Internet represents only a fraction of total media buys, it will still be a multibillion-dollar industry."

EMarketer outlines four factors that will affect online advertising's recovery:

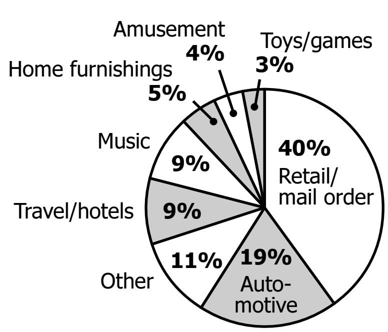
1. The extent and sustained length of the current economic downturn.
2. The emergence of better solutions to issues involving measurement, standards, and return on investment.
3. The embrace of Web advertising by large traditional marketing companies.
4. The evolution of technology providing advertisers with new and enhanced online advertising opportunities

One could add a fifth factor: The development of new content strategies by advertisers, working with content companies, to evolve online revenue opportunities.

There are signs that even in the current economic slump, online advertising is starting to mature in some areas. Over the past year or so, the seasonal fluctuations of online advertising have resembled those of print, radio, and television. This suggests (according to eMarketer) that the Web is being included in normal budgetary processes along with traditional media rather than being funded from small, experimental budgets.

U.S. Internet advertising spending rose 33% from $629 million in the first quarter of 2000 to $837 million in the first quarter of 2001. Advertising spending on daily and Sunday newspapers, network radio, and national network television all declined in the same time period, according to Competitive Media Reporting. The Myers Group forecasts that annual online advertising spending in the U.S. will grow from $4.3 billion in 2000 to almost $20 billion in 2006. Spending will decrease for advertising spending on newspapers, broadcast television, radio, and Yellow Pages during the same time period.

U.S. online advertising spending, by major consumer category
Third quarter, 2000



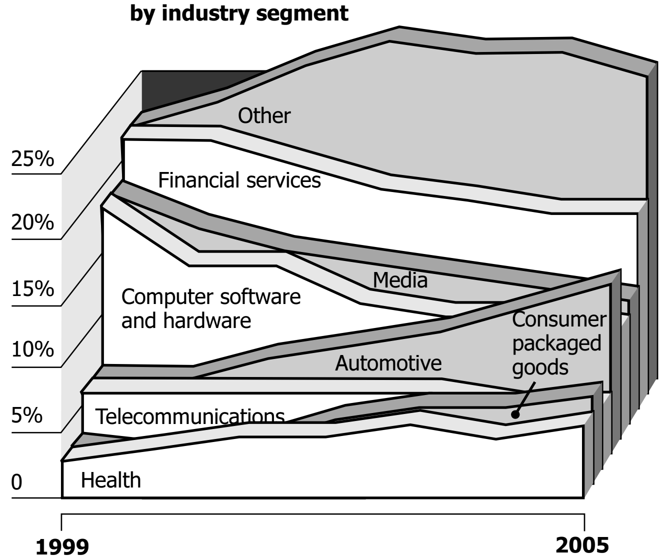
Source: Interactive Advertising Bureau, 2000

Online advertising in the U.S. is evolving in other ways as well. More than half of online advertising spending went to the purchase of banners in the last quarter of 1999. A year later, that number had dropped to 40%, according to the Interactive Advertising Bureau

(IAB).

Also, Forrester Research forecasts that online ad revenues from performance-based marketing will equal revenues from impression-based marketing by 2006.

Percentage of U.S. online advertising spending by industry segment



Note: Based on spending excluding classified listings
Source: Jupiter Research, 2000

The advertisers – who are those guys?

Many of the advertisers online are new to the medium. The number of new advertisers coming online throughout 2000 consistently increased from month to month, despite the crumbling economy. According to AdRelevance, a bit less than a thousand first-time advertisers came online in January. By the middle of the year, almost 1,500 first-timers bought online advertising each month, and by December, the number had doubled to almost 3,000.

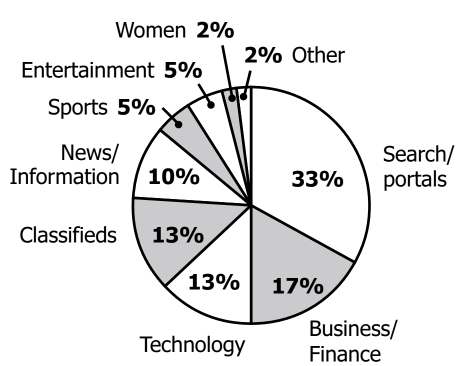
Jupiter Research predicts that the sectors with two of the largest percentages of online U.S. spending today (financial service and media) will still be the leaders in 2005, but each will garner six percentage points less of the spending. Computer hardware and software, another of today's leaders, will be supplanted by the automotive sector by 2004.

EMarketer predicts that U.S. online advertisers, who spent $30 per Internet user in 1998, will be spending $143 per Internet user by 2004. (They actually expect a drop-off in the near term from $81 in 2000, $74 for 2001, but expect a rebound in the subsequent years.)

Who's getting the cash?

According to the IAB, the top 10 Web sites increased their share of U.S. Internet advertising revenues from 64% in the first quarter of 1998 to 71% by the fourth quarter of 2000. The share for the top 25 sites went from 75% to 85%, and the top 50 sites moved from 79% to a whopping 95% by the fourth quarter of 2000. EMarketer expects the concentration of ad dollars to flatten out starting in 2002 as the Web advertising market matures and increasing numbers of strong vertical sites come to the market after an economic recovery.

Percentage of U.S. online advertising spending, by Web site type
Fourth quarter, 2000



Source: Interactive Advertising Bureau, 2001

The great disparity between online ad dollars and page views may have reached its zenith last year. In "The Content Site Turnaround" (December 2000), Forrester predicted that more and more advertisers would come to the Web, but the sharp increases in total page views from 1996 to 2000 would slow down. Their argument was that the supply of page views wouldn't grow as fast anymore because the majority of consumers that will come online, have come online. They also suggested that the page views per user are unlikely to increase, with any gains from broadband access tempered by competition from other media using the same bandwidth.

Forrester described the upshot of a shrinking disparity between online ad dollars and page views:

"By 2005, content sites will reap $26 billion in ad revenues – and the shortage of page views will stem advertisers' ability to demand performance-based deals … And average CPM [the cost of delivering an ad to 1,000 consumers] will rise from $8 today to $20 by 2005."

The sharp decline in the economy will affect Forrester's timeframe, but otherwise their analysis is sound.

Unlocking the potential of online advertising

The short history of CPMs online

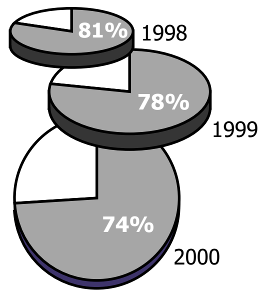
From eMarketer's online advertising report, August 2001

"Does anyone still remember the early days of Internet advertising? When traditional print publications first started putting up Web sites, they would offer banner advertising as a value-add that was given to advertisers free along with a regular media schedule. If you were lucky, they threw in lunch as well.

"Not surprisingly, media representatives back then tried to make the bold new world of Internet advertising more palatable by cloaking it in traditional advertising terminology. While they couldn't offer the time honored spread four-color bleed insertion, they could talk about reach, frequency and of course CPM, or cost-per-thousand.

"When the Internet blossomed into a viable advertising medium, Web sites were understandably excited about the prospects. Advertisers were caught up in the Web frenzy like everyone else and agreed to pay CPM rates for online advertising that were substantially above what offline media was charging. Online advertising is capable of targeting a highly targeted slice of the consumer market and thereby increases the advertiser's chances of making a sale.

Available, but unsold U.S. online advertising inventory



Source: eMarketer, 2001

"Unfortunately, things didn't quite work out that way. As the number of Web sites grew exponentially, the available advertising space grew accordingly. Advertisers were inundated with advertising opportunities and had precious little data on which to choose a site. Hoping to bring some order to the marketplace, packaged goods behemoth Proctor & Gamble came up with a novel idea. They would pay a flat $5 CPM, take it or leave it. That was in early 1999 and in those heady pre-crash days, Web sites smugly declined the P&G solution.

"Now here we are some three years after the P&G offer and, while CPM rates haven't officially fallen to $5, the downward pressure has been relentless. The IPO market has crashed and VC money is scarce, advertisers are taking a much harder look at their online expenditures. Why should a company pay upwards of $60 CPM just for the privilege of reaching an audience that may never buy their products?

"In the future, it seems inevitable that CPM will diminish as a benchmark for online advertising pricing. There are simply too many variables and other pricing options for CPM to prevail."

EMarketer has identified seven barriers to U.S. online advertising:

1. Not all target audiences are wired, at least to the same degree.
2. The online audience is highly fragmented.
3. Branding is questionable on the Web.
4. Bandwidth problems limit creative options.
5. Internet users tend to be goal-directed, so anything that gets in their way, including ads, is perceived as an intrusion.
6. Advertisers have not cracked the problem of integrating online and offline advertising.
7. Personalization technology raises issues about privacy and the use of personal information.

Online advertising's long-term success could be dependent on how well each of these barriers is overcome. In the short term, there are some incremental solutions that are worth examining. "Rich media" is a term used to describe advertising that goes beyond simple, animated GIFs. Rich media ads can have the ability for users to actually begin processes (like logging in, signing up, or searching) from a banner or tile. Studies have shown that a majority of users come online to complete specific tasks so a rich media ad would seem to appeal to a greater number of users. But the ability to take action is meaningless if the user feels the action isn't relevant to them.

Relevance is the driving force behind ad targeting. The theory is that if we know more about the user (where they live, what information they've seen online) we can be more successful in the delivery of relevant advertising. This will certainly prove to be true in some cases. In 2000, washingtonpost.com began work on the mywashingtonpost product; a product designed to allow users to make decisions about the content that gets delivered to their own mywashingtonpost page. The construction of this new tool sparked conversation about the difference between customization (the ability for a user to pick information to be delivered within a dictated format) and personalization (the ability for a user to use a site's content however it makes sense to that particular user as well as the ability for that site to deliver information based on that user's personal data). While the ideal version of mywashingtonpost is a personalized product, the launch version was in fact a customized product. Ad targeting is to relevant advertising content as customization is to personalization. Delivering an ad based on a user's ZIP code, for example, may not add enough value to the user to noticeably increase the effectiveness of that ad.

Another short-term solution the industry is experimenting with is the introduction of larger ad sizes, including "skyscrapers" (120 x 600) and "big boxes" (300 x 500). Some suggest that any bump in the effectiveness of the ads is going to be temporary. "Each successful new technique sows the seeds of its own failure," eMarketer reports, "Once advertisers become aware of a high-response technique, they pile on it. And consumers get numbed to effects."

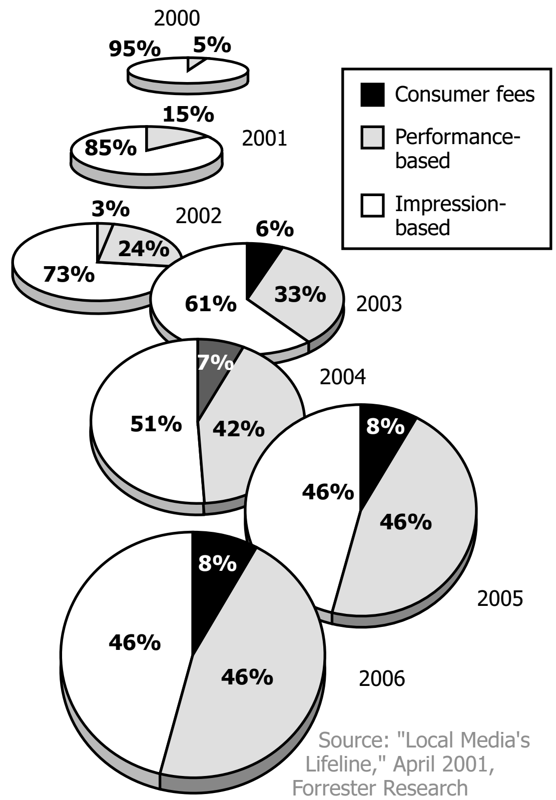
Skyscrapers, big boxes, and sponsorships are just different variations of the same old banner solution. The banner solution acts like flypaper for distracting arguments about topics other than size. Conversations about the effectiveness of online branding campaigns, for example, draw energy away from real efforts to develop successful long-term online advertising solutions.

"This industry will begin to flourish," eMarketer's online advertising report states, "once it adopts more effective ad units that are in less abundant supply." This simple concept is further fleshed out in Forrester's "Content Site Turnaround" which concludes:

> "Delivering more and more ads around content will muddle the user experience and dilute advertising results. Instead, sites should use rich knowledge of users to deliver contextual experiences that better serve users and advertisers. Creating audience profiles that integrate historical and real-time user data … will drive better results."

Whether they realize it or not, advertisers have the exact same challenge as content companies. Unlike other media experiences, users completely control their own Web experiences. All activities on the Web come down, eventually, to a single user

U.S. local online ad revenues



Source: "Local Media's Lifeline," April 2001, Forrester Research

and the content and functionality that they choose to explore. Because of this, the challenge for advertisers and content companies is to provide value to users. If its user value proposition isn't obvious, a feature will fail. If its user value proposition is obvious, but a feature is delivered to users who don't feel it's relevant to them, the feature will fail.

Successful Web sites will be the ones who connect very specific users to valuable, relevant advertiser content. To accomplish this, the Web sites will need to develop tools to identify those specific users. Forrester also suggests that the relationship between salesperson and client will need to be overhauled. "[Content sites should] replace ad sales reps with account managers who can develop consulting relationships with marketers," Forrester suggests in "The Content Site Turnaround. Most importantly, online sales strategy and infrastructure will need to evolve from their current CPM- and click-through-based models to strategy and infrastructure based on selling users to advertisers.