

The Business of Search: Racing beyond the Bottom Line
By Jim Hedger, StepForth News Editor, [StepForth Placement Inc.](#)

The Rubicon has been crossed. Even for traditionalists, there is no going back. The Internet has finally become the world's primary marketing tool, fundamentally altering corporate ad planning and spending. Momentum had been building around the online marketing sector for over three years but 2005 appears to be the year that mainstream marketers notice their universe has changed.

Over the previous three years, a very public race between Yahoo, Microsoft and Google caught the attention and imaginations of most people in the search marketing industry. Known as the Search Engine Wars, this competition has propelled innovation and invention in all aspects of search, especially in the realm of paid-search advertising. As in all races, there are going to be winners and, of course, there are going to be losers. Unlike most races however, this one does not have a fixed finish line and anyone can enter the race at any point, provided they can keep pace with the leaders. Recently, Ask Jeeves worked its way into the race and, as absurd as this might read, may actually be in a better position today than its far larger rival, Google. The same can be said of Yahoo and MSN. The race might be influenced by size and speed but in the long run, everyone knows that this is an endurance race.

Technically, the search engine landscape is sound and growing. Both Google and Yahoo recently updated their organic algorithms in the past month. Microsoft continues to tweak and improve MSN, which is expected to enter the lucrative paid-search advertising market before the end of this year. Rounding out the Big4, Ask Jeeves VP for European Products, Tony Macklin, weighed in at [vnunet.com](#) last week saying Ask's newly developed search technology will outperform Google, luring previously loyal users away.

The ideal purpose of search may be to assist Internet users in finding specific information in a chaotic ocean of documents but the business of search is entirely about paid advertising and product delivery. User loyalty is the foundation of success for the major search engines, each of which has developed, acquired or partnered with massive networks of digital advertising media. Aside from their associations with the Internet's basic navigation tools, paid search programs offer marketers a bonus their elders could only dream of; direct ad placement by user-interest or contextual delivery. Membership in these networks is not particularly exclusive with websites made by small business webmasters displaying the same paid-ads as huge corporate sites. In other words, an ad for a unique auto part supplier could be delivered to viewers who were specifically interested in that unique type of vehicle. Ads for Boston Red Sox memorabilia could be served to Beantown sports fans, without wasting valuable impressions on unimpressed Yankee fans from the New York region.

Once the feasibility of that concept became clear, advertising and investment dollars started pouring into the sector. Paid advertising produces the record-breaking revenues shown nearly every quarter by most firms in the search sector. The growth of various paid search ad delivery models gives financial analysts like Safa Rashtchy of Piper Jaffray the confidence to predict search engine revenues will surpass \$23 billion a year in the next five years.

In a huge bid of confidence, AOL has transferred much of its massive advertising budget to paid search advertising through Google AdWords and Yahoo Search Marketing. After preparing a \$50 million

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television campaign, AOL execs noticed the majority of traffic to their travel, music and other services came from organic and paid listings on other search engines.

Along with AOL's latest \$50 million, literally hundreds of billions of dollars has gone into developing and sustaining the search engine landscape. As we know it today, that landscape is huge and the horizons seem limitless but in the distance, dark clouds of market realities are starting to form. Three reports were issued last week detailing three different difficulties the paid search sector will face in near future.

Searchers prefer organic

The first was a research study from Penn State University presented at the ACM Conference on Electronic Commerce in Vancouver, "Examining Searcher Perceptions of and Interactions with Sponsored Results". ([summary](#)) ([full report](#)) The study followed the search experiences of 56 subjects aged 18 – 29. The subjects followed instructions leading them to perform hundreds of common queries across the major search engines.

While searching, the subjects communicated their impressions of their search experiences to the researchers. One test had subjects pretend they were going on vacation and needed to find a low-cost tennis racquet they could take with them. Another had them look for a dirt bike for sale in Pittsburgh.

After analysing their verbal impressions and click patterns, the researchers concluded that search engine users tend to trust and consequently click on organic results before paid ads more than 80% of the time. "Consumers have a bias against the links that businesses pay search engines to provide," said Jim Jansen, assistant professor in the Penn State School of Information Sciences and Technology (IST).

In sharp contrast, the study showed only 6% of searchers clicked on the paid or sponsored results first. "What our study shows is that even when the returned results are exactly the same, people still view what they thought of as the organic results as better. The quality of the sponsored links isn't the issue; it's the placement of the results", Jansen added.

Keyword bid-prices dropping

The second report came from Fathom Online's [Keyword Price Index](#) (KPI) showing the first decline in keyword bid prices since August 2004. The KPI tracks the bid costs of 500 generic keywords across the major paid search engines. In April, bid prices declined 31 cents on average, leading to a short sell frenzy of search stocks on Wall St. Google, which looked like it would peak \$300 a share has fallen to \$282.50 today. Yahoo took a minor hit of 88 cents per share but gained most of it back by today.

Declining keyword bid prices are likely natural phenomena as the market matures to correct itself after months of inflated bids. It might also have something to do with a slowing housing market as the biggest decline was seen in the mortgage and home finance sector.

Even with rational reasons behind the falling click costs, there is worry that investors will see this as a long-term trend that could threaten the values of their shares. Google investors seem particularly worried, especially when analysts and observers start speculating on the burst of a bubble.

Do all bubbles burst?

It has only been nine months since Google released its IPO at \$85/share. Two days ago the stock price peaked at just under \$300/share and is trading around \$282.50/share today. Its rivals, Yahoo, MSN and Ask are all trading in the \$25 – 36 range. With a decline in bid prices on paid-ads that are being ignored by search engine users, Google's financial stability appears based on a shifting foundation.

In a rather biting piece in today's [Guardian Unlimited](#), UK tech writer Nils Pratley asks, "Who in their right mind would buy shares in a company at a price equivalent to 25 times its annual sales?" Google, which is operating in an increasingly competitive environment, might have a very difficult time sustaining shareholder expectations while continuing to expand operations. Pratley looks at the value shareholders have vested in Google and wonders exactly where the floor will be found. He concludes his piece with a lecture Sun Microsystems CEO Scott McNealy gave investors two years after the dot-com crash.

"Anybody thinking of buying Google at 25 times should listen to Sun chief executive Scott McNealy's post-crash analysis of the stupidity of his own shareholders. In 2002, he said at an investor conference: "At 10 times revenues, to give you a 10-year payback, I have to pay you 100% of revenues for 10 straight years in dividends. That assumes I can get that by my shareholders. That assumes I have zero cost of goods sold, which is very hard for a computer company.

"That assumes zero expenses, which is really hard with 39,000 employees. That assumes I pay no taxes, which is very hard. And that assumes you pay no taxes on your dividends, which is kind of illegal. And that assumes with zero R&D for the next 10 years, I can maintain the current revenue run rate.

"Now, having done that, would any of you like to buy my stock at \$64? Do you realise how ridiculous those basic assumptions are? You don't need any transparency. You don't need any footnotes. What were you thinking?"

Indeed. Five years is an awfully long time on the Internet. It has been five long and very successful years since the dot-com crash of 2000 and the enthusiasm shown for Google stock is reminiscent of the bitter sweet love affair investors had with tech stocks in the late 1990s. The value of other tech stocks seems to conform to the perceived value of their respective firms. What are investors thinking when they are willing to place their educated bets at prices equivalent to 25X the value of the entire firm? Some believe they are simply seeing gold in Google while others think investors are concentrating on one mighty tree in a huge and growing forest.

Google has a terrible problem faced by many businesses. Even though they are the most popular search engine and have the largest paid advertising distribution network, approximately 95% of their revenues come from paid-search advertising. In contrast, paid-search accounted for less than half of Yahoo's annual income until revenues from its acquisition of Overture increased 235% in 2004. MSN is subsidized by Microsoft and is just entering the paid advertising field and newcomer, Ask Jeeves is hardly reliant on paid search advertising and just starting to roll out its own contextual distribution network based on its association with Barry Diller's Interactive Corporation and its recent absorption of the Excite network.

Finding other forms of income will be essential for Google if it hopes to continue moving forward and supporting such a high share value. Realizing that income might be more difficult for Google than for its rivals as they have much wider foundations to build on. The business of search is a battleground with multiple fronts. While Google is the current leader on the most profitable front, paid-search, it might not be able to retain that position indefinitely. Hopefully both Google and its investors are thinking eight quarters ahead instead of only focusing on tomorrow's bottom line.